SECURITIES AND EXCHANGE COMMISSION

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

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(49 Documents)

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73294 / October 3, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3589 / October 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16186

In the Matter of **PETER A. JENSON, Chartered Accountant** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 4C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Peter A. Jenson, Chartered Accountant ("Respondent" or "Jenson") pursuant to Section 4C[1] of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

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1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(iii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found...to have willfully

violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Respondent admits the facts set forth in Annex A attached hereto, acknowledges that his conduct violated federal securities laws, admits the Commission's jurisdiction over him and the subject matter of these proceedings, and consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 4C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, 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[3] that:

A. RESPONDENT

Peter A. Jenson, age 48, was a Managing Director and the Chief Operating Officer of Harbinger Capital Partners LLC ("Harbinger") from April 2009 through July 2011. Jenson is an Australian citizen and resides in Winnetka, Illinois. Jenson was at one time licensed as a certified public accountant in Maryland, but his license expired in 2007. Jenson has active designation as a Chartered Accountant. Jenson previously was a Member of the Financial Services Institute of Australia and previously held a Series 27 license.

B. FACTS

1. On August 13, 2013, Philip A. Falcone ("Falcone") and Harbinger entered into a Final Consent Judgment to resolve the claims asserted against them in the civil action 12-CV-5028 (PAC) (the "Action") pending in the United States District Court for the Southern District of New York. As part of the Consent Judgment, Falcone and Harbinger admitted, among other things, that on October 14, 2009, without seeking or obtaining investor consent, in connection with the purchase, offer or sale of a security, Falcone improperly borrowed $113.2 million from the Harbinger Capital Partners Special Situations Fund, L.P. ("SSF") to pay his state and federal taxes.

2. Jenson, Harbinger's Chief Operating Officer, among other things, executed the loan agreement and other transaction documents on behalf of the SSF in connection with the loan.

3. The loan agreement provided that "[t]he Lender's counsel shall have provided advice to the Lender to the effect that the making of the Loan … would not be inconsistent with the

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3 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.

Borrower's fiduciary obligation to the Lender." Jenson, however, did not ensure that SSF as lender had separate counsel, and did not ensure that the loan was consistent with the Borrower's fiduciary obligation to the Lender.

4. Jenson also failed to ensure that Falcone paid an "above market" interest rate on the loan, failed to timely disclose the loan to investors, and failed to take actions to cause the SSF to accelerate Falcone's payment on the loan once investors in the SSF were permitted to begin redeeming their investments.

5. Jenson, with knowledge of Falcone's and Harbinger's violations in connection with the loan, substantially assisted these violations.

6. On October 1, 2014, the U.S. District Court for the Southern District of New York entered a final consent judgment against Jenson enjoining him from acting or being an associated person of any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization, as those terms are defined in Section 3 of the Exchange Act and Section 202 of the Investment Advisers Act of 1940 ("Advisers Act"). Jenson was further ordered to pay a civil penalty in the amount of $200,000 to the Commission.

IV.

In view of the foregoing, the Commission finds that Jenson willfully aided and abetted violations of Section 206 of the Advisers Act and further the Commission deems it appropriate pursuant to Rule 102(e)(1)(iii) of the Commission's Rules of Practice to impose the sanctions agreed to in Jenson's Offer.

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

A. Jenson is denied the privilege of appearing or practicing before the Commission as an accountant.

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

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

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

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

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

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

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

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

By the Commission.

Brent J. Fields
Secretary

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

ANNEX A

Peter A. Jenson ("Jenson") admits to the facts set forth below and acknowledges that his conduct violated the federal securities laws:

1. On August 13, 2013, Philip A. Falcone ("Falcone") and Harbinger Capital Partners LLC ("Harbinger") entered into a Final Consent Judgment to resolve the claims asserted against them in the civil action 12-CV-5028 (PAC) (the "Action") pending in the United States District Court for the Southern District of New York. As part of the Consent Judgment, Falcone and Harbinger admitted, among other things, that on October 14, 2009, without seeking or obtaining investor consent, in connection with the purchase, offer or sale of a security, Falcone improperly borrowed $113.2 million from the Harbinger Capital Partners Special Situations Fund, L.P. ("SSF") to pay his state and federal taxes.

2. Jenson, Harbinger's Chief Operating Officer, among other things, executed the loan agreement and other transaction documents on behalf of the SSF in connection with the loan.

3. The loan agreement provided that "[t]he Lender's counsel shall have provided advice to the Lender to the effect that the making of the Loan ... would not be inconsistent with the Borrower's fiduciary obligation to the Lender." Jenson, however, did not ensure that SSF as lender had separate counsel, and did not ensure that the loan was consistent with the Borrower's fiduciary obligation to the Lender.

4. Jenson also failed to ensure that Falcone paid an "above market" interest rate on the loan, failed to timely disclose the loan to investors, and failed to take actions to cause the SSF to accelerate Falcone's payment on the loan once investors in the SSF were permitted to begin redeeming their investments.

5. Jenson, with knowledge of Falcone's and Harbinger's violations in connection with the loan, substantially assisted these violations.

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73297 / October 3, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3943 / October 3, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31275 / October 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16187

In the Matter of **PAUL T. MANNION, JR. and ANDREW S. RECKLES** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 15(b) 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, 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"), 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 Paul T. Mannion, Jr. and Andrew S. Reckles ("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, Respondents admit the Commission's jurisdiction over them and the subject matter of these proceedings, and consent to the entry of this ("Order"), as set forth below.

III.

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

1. At the time of the relevant conduct, Mannion and Reckles were registered representatives associated with HPC Capital Management Corp., a SEC-registered broker-dealer, and were the sole owners of and portfolio managers at PEF Advisors, LLC and PEF Advisors Ltd, the investment advisers to Palisades Master Fund, LP (the "Fund"), an unregistered pooled investment vehicle. Mannion, 52, resides in Duluth, Georgia. Reckles, 44, resides in Milton, Georgia.

2. In August 2005 Mannion and Reckles each took valuable warrants belonging to the Fund, exercised those warrants, and had the shares that were issued deposited into their personal brokerage accounts. In June 2006, Mannion and Reckles informed the Fund's investors that they had "transfer[red]" to themselves these warrants that belonged to the Fund, and they compensated the Fund for the warrants by reducing their personal ownership interest in the Fund by an amount equivalent to a total of $325,000, representing the amount of the proceeds they had received when they sold the shares.

3. On October 19, 2010, the Commission initiated a civil action entitled Securities and Exchange Commission v. Paul T. Mannion, Jr., et al., Civil Action Number 1:10-cv-03374-WSD, in the United States District Court for the Northern District of Georgia ("District Court"). The Commission's complaint alleged, among other things, that Mannion and Reckles' taking of Fund warrants violated Section 206(2) of the Advisers Act, which makes it unlawful for any investment adviser, through jurisdictional means, directly or indirectly to engage in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

4. On March 25, 2013, the District Court entered summary judgment against Mannion and Reckles finding that their taking of the Fund's valuable warrants violated Section 206(2) of the Advisers Act.

5. As a result of the conduct described above, Mannion and Reckles willfully[1] violated Section 206(2) of the Advisers Act, which prohibits fraudulent conduct by an investment adviser.

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[1] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC,* 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC,* 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC,* 348 F.2d 798, 803 (D.C. Cir. 1965)).

IV.

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

Accordingly, pursuant to Section 15(b) of the Exchange Act, 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 Mannion cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.

B. Respondent Reckles cease and desist from committing or causing any violations and any future violations of Section 206(2) of the Advisers Act.

C. Respondent Mannion be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, or transfer agent;
>
> prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and
>
> barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock;

with the right to apply for reentry after two (2) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

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

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

D. Respondent Reckles be, and hereby is:

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

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

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

with the right to apply for reentry after two (2) 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.

E. Respondent Mannion shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $75,000 to the Securities and Exchange Commission. 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 Paul T. Mannion, Jr. 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 Julie M. Riewe, Co-Chief of the Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

F. Respondent Reckles shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $75,000 to the Securities and Exchange Commission. 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 Andrew S. Reckles 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 Julie M. Riewe, Co-Chief of the Asset Management Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

V.

It is further Ordered that, for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73307 / October 6, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16189

In the Matter of

M. "Shi" Shailendra,

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 M. "Shi" Shailendra ("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, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. From 2008 through 2014, Respondent, among other things, was the Manager of Interstate North 5 Acres, LLC f/k/a Shi Investments Six, LLC ("Shi Six), a Georgia limited liability company. During this time, Shailendra acted as an unregistered broker by soliciting potential investors, touting his ability to find distressed real estate for Shi Six that would be profitable for investors, opining on the expected returns investors would receive, recommending Shi Six as an investment, and repeatedly selling Shi Six membership interests. M. "Shi" Shailendra, age 69, is a resident of Jonesboro, Georgia.

2. On September 23, 2014, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. M. "Shi" Shailendra, Civil Action Number 1:14-cv-2465-TCB, in the United States District Court for the Northern District of Georgia.

3. The Commission's complaint alleged that, in connection with the sale of limited liability company membership interests, Respondent acted as an unregistered broker, falsely represented to investors that he had personally invested and would have his own money at risk in Shi Six, misused and misappropriated investor funds, and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors.

IV.

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

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

Brent J. Fields
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 ACT OF 1933
Release No. 9662 / October 9, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73324 / October 9, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16192

In the Matter of E*TRADE SECURITIES, LLC, and G1 EXECUTION SERVICES, LLC Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against G1 Execution Services, LLC and E*TRADE Securities, LLC (together, "Respondents" or "E*Trade").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

A. Summary

These proceedings arise from Respondents' facilitation of thousands of unregistered sales of penny stocks by three institutional customers. During various periods between March 2007 and April 2011, these customers routinely deposited to their E*Trade accounts large quantities of newly issued penny stocks that they had acquired from little known, non-reporting issuers, through private transactions. The customers claimed that these penny stocks were "freely tradable." Shortly after the three customers deposited these securities, the customers placed orders for Respondents to sell these securities to the public ("resales") without any registration statements being in effect. Circumstances such as these constitute red flags of possible unlawful distributions of securities in violation of Section 5 of the Securities Act.

Section 5 of the Securities Act generally requires registration of securities offerings, or an available exemption from registration, including for resales such as these. Although brokers frequently rely on an exemption under Section 4(a)(4) of the Act, known as the brokers' transaction exemption, this exemption was not available to Respondents for these resales. For this exemption to be available, Respondents were required, before selling securities on their customers' behalf, to engage in a reasonable inquiry into the facts surrounding the customers' proposed sales to determine if the customers were engaging in an unlawful distribution of securities. The amount of inquiry a broker must conduct as part of this reasonable inquiry varies with the facts and circumstances of each transaction. Here, Respondents were presented with numerous red flags, over a long period of time, indicating that the customers could be engaging in repeated, unlawful distributions of securities. In light of these red flags, Respondents were required to conduct a searching inquiry in order to claim the brokers' transaction exemption. As part of a searching inquiry, and among other things, Respondents had a responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act, and for each resale transaction they needed to be reasonably certain that an exemption was available.

Respondents initially made limited inquiries regarding the customers' resale transactions, and later they expanded those inquiries by adding additional steps to their review process. Respondents, however, failed to take adequate steps to be reasonably certain that the proposed sales were exempt from the registration requirements of the Securities Act. For example, Respondents initially did not ascertain the specific

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

exemptions on which the customers were relying. Later, beginning in March 2010, when Respondents enhanced their review process (by, among other things, identifying the customers' claimed exemptions and obtaining legal opinions), they did not conduct the required searching inquiry so that they could be reasonably certain that the claimed exemptions or any other exemptions were available. Accordingly, Respondents did not perform a reasonable inquiry and thus were not entitled to rely upon the brokers' transaction exemption.

By virtue of their conduct, Respondents willfully violated Sections 5(a) and 5(c) of the Securities Act.[2]

B. Respondents

1. **G1 Execution Services, LLC ("G1 Execution"), formerly known as E*TRADE Capital Markets, LLC**, is a broker-dealer located in Chicago and is registered with the Commission pursuant to Section 15(b) of the Exchange Act. G1 Execution offers execution services and is a market maker. It was a wholly owned subsidiary of E*TRADE Financial Corporation during the period at issue in this Order but was sold to a third party in February 2014.

2. **E*TRADE Securities, LLC ("E*Trade Securities")**, is a broker-dealer located in New York and is registered with the Commission pursuant to Section 15(b) of the Exchange Act. E*Trade Securities is an indirect, wholly owned subsidiary of E*TRADE Financial Corporation.

C. Facts

Respondents Facilitated Unregistered Sales of Penny Stocks

3. In March 2007, one of the three institutional customers, Customer A, opened a brokerage account at E*Trade. Another of the three institutional customers, Customer B, whose sole principal previously worked at Customer A, opened a brokerage account at E*Trade in December 2007. The last of the three institutional customers, Customer C, opened a brokerage account at E*Trade in March 2010. E*Trade terminated the brokerage accounts for all three customers in April 2011.

4. During various periods between March 2007 and April 2011 (the "Relevant Period"), Customers A, B and C routinely acquired large quantities of newly issued penny

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[2] A "willful" violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

stocks from little known, non-reporting issuers in private offerings.[3] The three customers each represented to E*Trade that these penny stocks were acquired in Private Investment in Public Equity ("PIPEs") transactions. These penny stocks traded in the over-the-counter market and were quoted on quotation mediums operated by OTC Markets Group (formerly known as the Pink Sheets). No registration statements were filed with the Commission in connection with any of the private offerings through which these customers acquired their shares.

5. At various times during the relevant period, Customers A, B and C deposited the penny stocks they acquired through private offerings in their E*Trade accounts shortly after those transactions closed. Their deposits of these securities were either in the form of physical certificates (which did not bear restrictive legends) or electronic transfers from transfer agents known as deposit/withdrawal at custodian ("DWAC") transfers. During the respective periods when each of the customers traded through E*Trade,[4] they made these deposits almost daily, and the deposits ranged in size from tens of thousands to approximately a billion shares of penny stocks. All three customers often made numerous deposits of penny stocks from the same issuer over several weeks or months.

6. Shortly after Customers A, B and C submitted the penny stocks to E*Trade for deposit, they resold them. During the respective periods when the customers traded through E*Trade, Respondents executed these resales almost daily. After the resales, Customers A, B and C wired the sales proceeds out of their accounts. No registration statements were filed with the Commission in connection with any of these resales.

7. On behalf of Customers A, B and C, Respondents facilitated the sale of shares of penny stock issued by approximately 247 different companies. For these transactions, the three customers realized gross sales proceeds in the millions of dollars, and Respondents earned substantial commissions.

Respondents' Inquiries Regarding the Three Customers' Resale Transactions

8. Between March 2007 and March 2010, Respondents did not ask Customers A and B to identify the specific exemptions from registration on which they were relying. Respondents did not ask the customers to submit documentation, such as attorney opinion letters, that may have helped substantiate the availability of an exemption. Respondents

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[3] See, 15 U.S.C. § 78c(a)(51); 17 C.F.R. § 240.3a51-1 (defining the term "penny stock"). Through their E*Trade accounts, the customers mostly traded stocks that traded for less than a penny per share.

[4] Customer A traded from March 2007 to April 2008, and from March 2009 to April 2011. Customer B traded from December 2007 to April 2010, and thereafter traded on a few occasions through April 2011. Customer C traded from March 2010 to April 2011.

also did not become aware of any other exemptions potentially available to Customers A and B.

9. Between March 2007 and March 2010, Respondents made the following general inquiries regarding the trading activities of Customers A and B: (1) prior to accepting Customers A and B, Respondents inquired as to the nature of their intended trading activities; (2) Respondents obtained written representations from Customer A, and later from the issuers, that the securities Customer A sold were "freely tradable" (but these representations were not supported by any facts); (3) Respondents received written representations from Customer A that it would comply with laws and regulations applicable to its trading activities; (4) on multiple occasions, Respondents visited the offices of Customer A and B in New York in an effort to gain comfort that they were responsible customers; (5) beginning in late March 2009, Respondents reviewed pending deposits by Customers A and B to assess whether Respondents would assume any financial risk associated with their resales; and (6) around November 2009, Respondents reviewed the trading history for securities that Customers A and B had already resold, to assess whether those securities had been subject to market manipulation.

10. From approximately late March 2010 through April 2011, Respondents expanded their review of pending security deposits by Customers A and C under a process they referred to as the Enhanced Due Diligence review. Under this review, Respondents made additional inquiries and collected certain documentation for the purpose of addressing potential unregistered sales of securities and anti-money laundering issues.

11. Under the Enhanced Due Diligence review, Customers A and C submitted to Respondents, with each of their pending security deposits, written representations from themselves and the issuer of the securities that the securities to be deposited were "freely tradable." Respondents reviewed these representations. With each pending security deposit, Customers A and C also submitted to Respondents an attorney opinion letter. Those letters claimed to identify an applicable exemption from the registration requirements of the Securities Act and claimed to explain why that exemption was available for the securities to be deposited. These attorney opinion letters indicated that the legal conclusions were based primarily on representations made by the reseller and issuer and that the attorneys did not independently verify the facts forming the basis for their opinions.

12. Under the Enhanced Due Diligence process, Respondents regularly reviewed these attorney opinion letters to identify the registration exemption on which Customers A and C were relying and to verify that the securities described in the letters matched the related deposits. Respondents also researched the attorneys who had authored the opinions to identify any potentially negative information about them, including confirming that the attorneys were not on a list of banned attorneys maintained on pinksheets.com (now known as otcmarkets.com).[5]

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[5] Respondents conducted other inquiries under the Enhanced Due Diligence review. Prior to accepting each penny stock deposit from the customers, and for each

Respondents Did Not Engage in a Reasonable Inquiry

13. Sections 5(a) and 5(c) of the Securities Act prohibit the offer and sale of securities through interstate commerce or the mails, unless a registration statement is filed with the Commission and is in effect, or the offer and sale are subject to an exemption. 15 U.S.C. § 77e(a) and (c).

14. Section 4(a)(4) of the Securities Act exempts from the registration requirements of Section 5 "brokers' transactions executed upon customers' orders on any exchange or in the over-the-counter market but not the solicitation of such orders." 15 U.S.C. § 77d(a)(4). Section 4(a)(4) of the Securities Act is unavailable, for example, when a broker-dealer "knows or has reasonable grounds to believe that the selling customer's part of the transaction is not exempt from Section 5 of the Securities Act." In the Matter of John A. Carley, Exchange Act Rel. No. 57,246, 2008 WL 268598, *8 (Jan. 31, 2008) (Commission opinion). To rely on this exemption, the broker must, among other things, engage in a "reasonable inquiry" into the facts surrounding the proposed unregistered sale, and after such inquiry it must not be "aware of circumstances indicating that the person for whose account the securities are sold is an underwriter with respect to the securities or that the transaction is part of a distribution of the securities of the issuer." 15 U.S.C. § 77d(a)(4); 17 CFR § 230.144(g)(4). Section 2(a)(11) of the Securities Act defines an underwriter as "any person who has purchased from an issuer, with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking." 15 U.S.C. § 77b(a)(11).

15. Whether a broker has conducted a "reasonable inquiry" depends on the facts and circumstances surrounding the transaction:

> A dealer who is offered a modest amount of a widely traded security by a responsible customer, whose lack of relationship to the issuer is well known to him, may ordinarily proceed with considerable confidence. On the other hand, when a dealer is offered a substantial block of a little-known security, either by persons who appear reluctant to disclose exactly where the securities came from, or where the surrounding circumstances raise a question as to whether or not the ostensible sellers may be merely intermediaries for controlling persons or statutory underwriters, then searching inquiry is called for. Distribution by Broker-Dealers of

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such stock, Respondents reviewed, among other things: the security's rating on pinksheets.com, six month trading charts showing price and volume and the SEC's website to determine if there were any actions against the issuer or those affiliated with it. Respondents also obtained confirmation of shares outstanding from the transfer agent and conducted internet searches to learn information about the issuer, its affiliates or a potential stock promotion.

Unregistered Securities, Securities Act Release No. 4445 (Feb. 2, 1962) (Commission interpretative release).

16. From the time that Customers A, B and C each began trading penny stocks through their E*Trade accounts, Respondents were presented with the following recurring red flags, which together should have raised a question as to whether these customers were engaged in an unlawful distribution by, for example, acting as statutory underwriters: (1) the three customers acquired substantial amounts of newly issued penny stocks; (2) directly from little known, non-reporting issuers; (3) through private, unregistered transactions; (4) then immediately resold those shares; and (5) wired out the sales proceeds.

17. Given the specific red flags associated with Customers A, B and C's deposited securities and resale transactions, Respondents were required to engage in a searching inquiry to properly rely on the Section 4(a)(4) brokers' transaction exemption. As part of a searching inquiry, Respondents had a responsibility to be aware of the requirements necessary to establish an exemption from the registration requirements of the Securities Act, and for each resale transaction they needed to be reasonably certain that such an exemption was available. In the Matter of World Trade Financial Corp., et. al., Exchange Act Release No. 66114 (Jan. 6, 2012) (Commission opinion), petition denied, 739 F.3d 1243 (9th Cir. 2014); In the Matter of Stone Summers & Co., et.al., 45 S.E.C. 105, 108 (1972) (Commission opinion).

18. For resale transactions that Customers A and B executed between March 2007 and March 2010, however, Respondents did not reasonably ascertain that an exemption from registration was available. During this period, Respondents did not ask Customers A and B to identify the specific exemptions from registration on which they were relying, and they also did not become aware of any other exemptions potentially available to the customers. Thus, Respondents could not be reasonably certain that any exemptions were available. Moreover, Respondents were presented with circumstances indicating that Customers A and B were engaging in unlawful distributions of securities including, for example, that Customers A and B were acting as underwriters. As a consequence, for resale transactions that Respondents facilitated for Customers A and B between March 2007 and March 2010, Respondents did not engage in a reasonable inquiry, and thus were not entitled to the brokers' transaction exemption under Section 4(a)(4) of the Securities Act.

19. For resale transactions that Respondents facilitated for Customers A and C between late March 2010 and April 2011, Respondents also did not engage in a reasonable inquiry, and were likewise not entitled to the brokers' transaction exemption under Section 4(a)(4) of the Securities Act. During this period, the inquiries Respondents made under the Enhanced Due Diligence review enabled Respondents to identify the claimed exemptions upon which Customers A and C were relying. Those inquiries, however, were not sufficient for Respondents to meet their obligation, given the continued presence of red flags, to be reasonably certain that those exemptions were available. In addition, during this period, Respondents did not become aware of any other exemptions that were potentially available to Customers A and C for their resale transactions.

20. For Respondents to qualify for the brokers' transaction exemption set forth in Section 4(a)(4), in circumstances such as those found here, where a searching inquiry was required because numerous, recurring red flags suggested that the customers were engaging in unregistered distributions of securities, it was necessary for Respondents to be reasonably certain that the customer's claimed exemption – or another exemption – was available for each resale transaction. Here, Respondents relied on the following inquiries to conclude that the exemptions claimed by Customers A and C were available: conclusory representations made by Customers A and C that the claimed exemptions were available, the attorney opinion letters that the customers submitted and certain independent inquiries that Respondents performed under the Enhanced Due Diligence review.

21. The independent inquiries that Respondents performed under the Enhanced Due Diligence review, however, were not sufficient for Respondents to be reasonably certain that the exemptions claimed by Customers A and C were available to them for one of two reasons. Those inquiries either revealed facts that called into question whether the claimed exemptions were available, or they did not address sufficiently facts that were necessary to support the claims of Customers A and C that those exemptions were available to them.

22. In addition, in the circumstances here, Respondents could not rely on the conclusory representations of Customers A and C, or the particular attorney opinion letters that those customers submitted, to be reasonably certain that the exemptions claimed by Customers A and C were available to them. When a broker is faced with recurring red flags suggesting that its customer is engaging in unregistered distributions of securities, it cannot satisfy its reasonable inquiry obligations by relying on the mere representations of its customer, the issuer, or counsel for the same, without reasonably investigating the potential for opposing facts. See, World Trade Financial Corp. v. SEC, 739 F.3d 1243, 1249 (9th Cir. 2014) (rejecting the argument that under the circumstances the duty of reasonable inquiry was met by reliance on third parties in conformity with industry practice and stating "brokers rely on third–parties at their own peril, and will not avoid liability through that reliance when the duty of reasonable inquiry rests with the brokers"); Wonsover v. SEC, 205 F.3d 408, 415-16 (D.C. Cir. 2000) (rejecting broker's argument that under the circumstances he justifiably relied on the clearance of sales by his firm's restricted stock department, the transfer agent, and counsel); see also, Distribution by Broker-Dealers of Unregistered Securities, Securities Act Release No. 4445 (Feb. 2, 1962) ("It is not sufficient for [a dealer] merely to accept self-serving statements of his sellers and their counsel without reasonably exploring the possibility of contrary facts." (internal quotation omitted)).

23. As discussed above, Respondents' customers engaged in a pattern of depositing large quantities of thinly traded securities that they acquired directly from little known non-reporting issuers through private transactions, and then immediately resold the securities and withdrew the proceeds. In these circumstances, a broker may reasonably rely on an attorney opinion concluding that an exemption from registration is available only where: (1) that opinion letter describes "the relevant facts in sufficient detail to provide an

explicit basis for the legal conclusions stated," Sales of Unregistered Securities by Broker-Dealers, Exchange Act Release No. 9239 (July 7, 1971);[6] and (2) the broker's reasonable independent investigation does not uncover contrary facts.

24. Here, in light of a pattern of recurring red flags over several years that strongly suggested that the customers were engaged in illegal, unregistered distributions of securities, the particular attorney opinion letters that Customers A and C submitted did not provide Respondents with a reasonable basis upon which to conclude that the claimed exemptions were available for several reasons. First, Respondents were aware of facts that should have called into question whether the representations that the customers and the issuers made to the attorneys who issued the opinions were accurate. For example, in some cases, the attorney opinion letters indicated that Customers A and C had investment intent. Respondents, however, knew that these two customers had a pattern of repeated deposits of newly issued shares followed immediately by requests to sell those same shares, which is inconsistent with investment intent. Second, nearly all of the letters were based primarily on conclusory representations by the issuers and Customers A or C. Third, some of the letters described facts to support the tacking of holding periods that should have put Respondents on notice that such tacking was not permitted, and thus the claimed exemption was not available. Finally, nearly half of the letters did not describe all of the elements of the exemptions they identified and they did not describe facts showing that those elements were met.

25. Because the attorney opinion letters that Customers A and C submitted to the Respondents did not provide a sufficient basis for Respondents to be reasonably certain that the claimed exemptions were available in light of other facts of which Respondents were aware, and because the further inquiries that Respondents made were not sufficient for them to be reasonably certain that those or any other exemptions were available, Respondents could not conclude that they were not aware of facts showing that Customers A and C were engaging in improper distributions of securities. As a consequence, Respondents could not claim the brokers' transaction exemption under Section 4(a)(4) with respect to their facilitation of Customers A's and C's resales of securities that were not registered under the Securities Act.

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[6] Exchange Act Release No. 9239 is a statement issued by the Director of the Division of Trading and Markets. On several occasions, Commission opinions have cited to different aspects of the guidance discussed in this release regarding a broker's duty to investigate the potential that a customer might be unlawfully distributing securities. See, e.g., In the Matter of Ronald S. Bloomfield et.al., Exchange Act Release No. 71632 (Feb. 27, 2014) (Commission opinion); In the Matter of World Trade Financial Corp., et. al., Exchange Act Release No. 66114 (Jan. 6, 2012) (Commission opinion), petition denied, 739 F.3d 1243 (9th Cir. 2014), In the Matter of Midas Securities LLC et.al., Exchange Act Release No. 66200 (Jan. 20, 2012) (Commission opinion).

D. Violations

26. As a result of the conduct described above, Respondents willfully violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the direct or indirect sale and offer for sale of securities through the mails or interstate commerce unless a registration statement has been filed or is in effect.

IV.

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

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

A. Respondents cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act.

B. Respondents are censured.

C. Respondents shall, within 30 days of the entry of this Order, pay, jointly and severally, disgorgement of $1,402,850 and prejudgment interest of $182,166 to the Securities and Exchange Commission for transfer to the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

D. Respondents shall, within 30 days of the entry of this Order, pay, jointly and severally, a civil money penalty in the amount of $1,000,000 to the Securities and Exchange Commission for transfer to the United States Treasury in accordance with Exchange Act Section 21F(g)(3). If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

E. The foregoing payments 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 G1 Execution Services, LLC and E*TRADE Securities, LLC as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Steven L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73343; File No. SR-OCC-2014-805)

October 14, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice Concerning Enhancements to the Risk Management Framework Applied to the Clearance of Confirmed Trades Executed in Extended and Overnight Trading Sessions

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010[1] ("Payment, Clearing and Settlement Supervision Act") and Rule 19b-4(n)(1)(i)[2] of the Securities Exchange Act of 1934 notice is hereby given that on September 17, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the advance notice as described in Items I and II below, which Items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. <u>Clearing Agency's Statement of the Terms of Substance of the Advance Notice</u>

This advance notice is filed by OCC in connection with a proposed change to OCC's operations that is designed to enhance the risk management framework applied to the clearance of confirmed trades executed in extended and overnight trading sessions (hereinafter, "overnight trading sessions") offered by exchanges for which OCC provides clearance and settlement services.

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1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.

III. (A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Description of Change

This advance notice is being filed in connection with a proposed change to OCC's operations to enhance the risk management framework applied to the clearance of confirmed trades executed in overnight trading sessions offered by exchanges for which OCC provides clearance and settlement services. OCC currently clears overnight trading activity for CBOE Futures Exchange, LLC ("CFE").[3] The total number of trades submitted to OCC from overnight trading sessions is nominal, typically less than 3,000 contracts per session. However, OCC has recently observed an industry trend whereby

3 ELX Futures LP ("ELX") previously submitted overnight trading activity to OCC, but currently does not submit trades from overnight trading sessions to OCC. OCC will re-evaluate ELX's risk controls in the event ELX re-institutes its overnight trading sessions.

exchanges are offering overnight trading sessions beyond traditional hours. Exchanges offering overnight trading sessions have indicated that such sessions benefit market participants by providing additional price transparency and hedging opportunities for products traded in such sessions, which, in turn, promotes market stability.[4]

OCC recently has re-evaluated the risks associated with providing clearing services for overnight trading sessions and, based on such review, is proposing to enhance its risk management framework for clearing overnight trading activity by incorporating a procedure to confirm that the relevant exchanges have implemented certain applicable pre-trade risk controls, complemented by kill-switch capabilities, and minimum exchange operational staffing requirements during overnight trading sessions.[5] OCC also is proposing to implement enhanced monitoring and credit risk controls as well as imposing minimum operational staffing requirements on clearing members that participate in such sessions. These changes (described in greater detail below) are designed to reduce and mitigate the risks associated with clearing trades executed in overnight trading sessions.

OCC's standards for determining whether to provide clearing services for overnight trading sessions offered by an exchange and enhanced risk management framework are designed to work in conjunction with the risk controls of the exchanges that allow overnight trading sessions. OCC will confirm an exchange's risk controls as

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4 *See* CFE-2014-010 at http://cfe.cboe.com/publish/CFErulefilings/SR-CFE-2014-010.pdf.

5 The Chicago Board Options Exchange, Incorporated ("CBOE") has approached OCC to provide clearance services for a proposed overnight trading session from 2:00 a.m. to 8:15 a.m. (Central Time) Monday through Friday ("Extended Trading Hours"). CBOE initially plans to list VIX and SPX options during Extended Trading Hours.

well as its staffing levels as they relate to overnight trading sessions to determine if OCC may reasonably rely on such risk controls to reduce risk presented to OCC by the exchange's overnight trading sessions. Such exchange risk controls may consist of: 1) price reasonability checks, 2) controls to prevent orders from being executed beyond a certain percentage (determined by the exchange) from the initial execution price, 3) activity based protections such as a maximum quantity per order and the ability to cancel all quotes when a threshold of contracts are traded in an individual option during a brief window, and 4) kill switch capabilities, which may be initiated by the exchange and can cancel all open quotes or all orders of a particular participant. OCC believes that confirming the existence of applicable pre-trade risk controls as well as overnight staffing at the relevant exchanges is essential to mitigating risks presented to OCC from overnight trading sessions.[6] Providing clearing services to exchanges offering such sessions is consistent with OCC's mission to provide market participants with clearing and risk management solutions that respond to changes in the marketplace. Cleared contract volume also may increase as a result of providing such services.

Enhanced Risk and Operational Controls at OCC

In order to mitigate the risks associated with the clearance of transactions executed during overnight trading sessions, and to promote robust risk management,

6 Comparable controls are applied to futures and future option trades executed in overnight trading sessions currently cleared by OCC, although such controls have been implemented by clearing futures commission merchants ("clearing FCMs") pursuant to Commodity Futures Trading Commission ("CFTC") Regulation 1.73, which also requires such clearing FCMs to monitor for adherence to such controls during regular and overnight trading sessions. OCC believes that it may reasonably rely on such regulation to reduce risk presented to OCC during futures markets overnight trading sessions. *See* 17 CFR 1.73. OCC also confirmed CFE maintains kill switch capabilities.

OCC proposes to implement enhancements to its risk management framework specific to overnight trading sessions. The enhanced risk management framework will include post-trade credit controls that have been designed to identify and mitigate credit risk associated with clearing trades executed during overnight trading sessions as well as requiring clearing members that participate in overnight trading sessions to have operational staff available to OCC during overnight trading sessions.

1. Overnight Monitoring and Credit Controls

OCC plans to implement overnight monitoring and credit controls in order to better monitor clearing members' credit risk during overnight trading sessions. Such monitoring of credit risk is similar to existing OCC practices concerning futures cleared during overnight trading hours and includes automated processes within ENCORE to measure, by clearing member: (i) the aggregate mark-to-market amounts of a clearing member's positions, including positions created during overnight trading, based on current prices using OCC's Portfolio Revaluation system, (ii) the aggregate incremental margin produced by all positions resulting from transactions executed during overnight trading, and (iii) with respect to options cleared during overnight trading hours, the aggregate net trade premium positions resulting from trades executed during overnight trading (each of these measures being a "Credit Risk Number"). ENCORE will generate hourly credit reports, which will contain the Credit Risk Numbers expressed in terms of both dollars and, except for the mark-to-market position values, as a percentage of net capital for each clearing member trading during overnight trading sessions. The Credit Risk Numbers are the same information used by OCC staff to evaluate clearing member exposure during regular trading hours and, in addition to OCC's knowledge of its clearing members' businesses, are effective measures of the risk presented to OCC by each clearing member. OCC's Operations staff will review such reports as they are generated and, in the event that any of the Credit Risk Numbers for positions established by a clearing member during an overnight trading session exceeds established thresholds, staff will alert OCC's Financial Risk Management staff[7] of the exceedance in accordance with established procedures, as described below. Financial Risk Management staff will follow a standardized process concerning such exceedances, including escalation to OCC's management, if required by such process. Given the nominal volume of trades executed in overnight trading sessions that are presently submitted for clearance, no changes in current staffing levels that support overnight clearing activities is contemplated at this time. However, such staffing levels will be periodically assessed and adjusted, as appropriate.

With respect to OCC's escalation thresholds, if any Credit Risk Number of a clearing member is $10 million or more, or any Credit Risk Number equals 10% or more of the clearing member's net capital, OCC's Operations staff will be required to provide e-mail notification to Financial Risk Management. If any Credit Risk Number is $50 million or more, or equals 25% or more of the clearing member's net capital, Operations staff will be required to contact, by telephone: (i) Financial Risk Management staff, (ii) the applicable exchange for secondary review, and (iii) the clearing member's designated contacts. If any Credit Risk Number is $75 million or more, or equals 50% or more of the clearing member's net capital, Operations staff will be required to contact, by telephone, a designated Senior Vice President or the Chief Risk Officer. Such officer

[7] OCC's Member Services staff will also receive alerts in order to contact clearing members as may be necessary.

will review the situation and determine whether to issue an intra-day margin call, increase a clearing member's margin requirement in order to prevent the withdrawal of a specified amount of excess margin collateral, if any, the clearing member has on deposit with OCC, whether further escalation is warranted in order for OCC to take protective measures pursuant to OCC Rule 305, as described below or contact the exchange in order to invoke use of its kill switch. OCC chose the above described escalation thresholds based on its analysis of historical overnight trading activity across the futures industry. OCC believes that these thresholds strike an appropriate balance between effective risk monitoring and operational efficiency.

2. Operational/Staffing Requirements

In order to mitigate operational risks associated with clearing for overnight trading sessions, clearing members that participate in such trading sessions will be required to provide contact information to OCC for operational personnel available to be contacted by OCC during such sessions. Under OCC Rule 201, each clearing member is required to maintain facilities for conducting business with OCC, and a representative of the clearing member authorized in the name of the clearing member to take all action necessary for conducting business with OCC is required to be available at the facility during such hours as may be specified from time-to-time by OCC. Similarly, OCC Rules 214(c) and (d) require clearing members to ensure that they have the appropriate number of qualified personnel and to maintain the ability to process anticipated volumes and values of transactions. OCC will use this existing authority to require clearing members trading during overnight trading sessions to maintain operational staff that may be contacted by OCC during such sessions. Each morning, shortly after the end of the overnight trading sessions, ENCORE will generate a report identifying clearing members that participated during that day's overnight trading sessions that have not provided OCC with overnight operational contacts. Clearing members who participated during overnight trading sessions that did not provide operational contacts to OCC, or whose operational contacts for overnight trading sessions were unavailable had OCC attempted to contact such individuals, will be subject to a minor rule violation fine.[8] OCC believes that, by having clearing member operational contacts available during overnight trading hours, operational issues that may arise during such trading hours can quickly be resolved thereby lowering the operational risk presented to OCC by clearing trades executed in overnight trading sessions.

Existing Risk Controls as They Relate to Overnight Trading Hours

In addition to implementing enhanced risk management practices specific to clearing trades executed in overnight trading sessions, OCC will apply, and in certain instances modify, existing (or planned) risk management controls to mitigate risks presented by clearance activities, including OCC's ability to issue an intra-day margin call, OCC's performance of a post-trade price reasonableness check and exercising OCC's authority to take protective action pursuant to OCC Rule 305. These controls, as they relate to clearing trades executed in such sessions, are discussed below.

1. Intra-day Margin Call Authority

In order to address credit risk associated with trading during overnight trading sessions, OCC staff will monitor and analyze the impact that positions established during such sessions have on a clearing member's overall exposure. Should the need arise, and

8 *See* OCC Rule 1201(b).

pursuant to OCC Rule 609, OCC may require the deposit of additional margin ("intra-day margin") by any clearing member that increases its incremental risk as a result of trading activity during overnight trading sessions. Accordingly, a clearing member's positions established during such sessions will be incorporated into OCC's intra-day margin process. Should a clearing member's exposure significantly increase while settlement banks are not open to process an intra-day margin call, OCC has the authority under OCC Rule 601 to increase a clearing member's margin requirement which would restrict its ability to withdraw excess margin collateral. The implementation of these measures is discussed more fully below.

In the event that a clearing member's exposure during overnight trading sessions causes a clearing member to exceed OCC's intra-day margin call threshold for overnight night trading sessions, OCC will require the clearing member to deposit intra-day margin equal to the increased incremental risk presented by the clearing member. Specifically, if a clearing member has a total risk charge[9] exceeding 25% (a reduction of the usual figure of 50%), as computed overnight by OCC's STANS system, and a loss of greater than $25,000 from an overnight trading session(s), as computed by Portfolio Revaluation, OCC will initiate an intra-day margin call. OCC will know at approximately 8:30 a.m. if it will need to initiate an intra-day margin call on a clearing member based on breaches of these thresholds. This "start of business" margin call is in addition to daily margin OCC collects from clearing members pursuant to OCC Rule 605, any intra-day margin call that

9 Total risk charge is a number derived from STANS outputs and is the sum of expected shortfall, stress test charges and any add-on charges computed by STANS. STANS is OCC's proprietary margin methodology.

OCC may initiate as a result of regular trading sessions or special margin call that OCC may initiate.

In addition to, or instead of, requiring additional intra-day margin, OCC Rule 601[10] and OCC's clearing member margin call policy work together to authorize Financial Risk Management staff to increase a clearing member's margin requirement which may be in an amount equal to an intra-day margin call.[11] (Any increased margin requirement will remain in effect until the next business day.) This action will immediately prevent clearing members from withdrawing any excess margin collateral (in the amount of the increased margin requirement) the clearing member has deposited with OCC. With respect to clearing trades executed in overnight trading sessions, and in the event OCC requires additional margin from a clearing member, Financial Risk Management staff may use increased margin requirements as a means of collateralizing the increase in incremental risk a clearing member incurred during such sessions without having to wait for banks to open to process an intra-day margin call.[12] Such action may be taken by OCC instead of or in addition to issuing an intra-day margin call depending on the amount of excess margin a clearing member has on deposit with OCC and the amount of the incremental risk presented by such clearing member. The expansion of OCC's intra-day margin call process as described in the preceding paragraph, including

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[10] In addition, OCC Rule 601 provides OCC with the authority to fix the margin requirement for any account or any class of cleared contracts at such amount as it deems necessary or appropriate under the circumstances to protect the respective interests of clearing members, OCC and the public.

[11] Clearing members frequently deposit margin at OCC in excess of requirements.

[12] Clearing members would be able to substitute the locked-up collateral during normal time frames (i.e., 6 a.m. to 5 p.m. (Central Time) for equity securities).

OCC's ability to manually increase clearing members' margin requirements, will mitigate the risk that OCC is under-collateralized as a result of overnight trading hours.

2. Post-Trade Price Reasonableness

In a separate pending rule filing, OCC has proposed to add an interpretation and policy concerning its administration of Article VI, Section 7(c) of its By-Laws and to implement price reasonableness checks in connection with the reporting of confirmed trades in standardized options and futures options to OCC by an exchange under Article VI, Section 7.[13] The new Interpretation and Policy to Article VI, Section 7(c) will allow OCC to review the reasonableness of prices for options transactions reported as confirmed trades and ask reporting exchanges to consider whether new or revised trade information is required to properly clear the transaction.[14] To promote OCC's ability to protect itself and clearing members from the negative effects of clearing trades in options that may contain erroneous premium information, OCC will apply a premium price threshold to accepted trades that will trigger further scrutiny of certain trades that exceed the threshold. This premium price threshold will apply to trades occurring during overnight trading sessions, upon regulatory approval, and thus will increase OCC's ability to monitor and mitigate risk arising from clearing trades executed during such trading sessions.

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13 Exchange Act Release No. 32718 (July 30, 2014), 79 FR 45527(August 5, 2014) (SR-OCC-2014-16). This filing, as amended, is pending regulatory approval.

14 *See* Article VI, Section 7(c); *see also* Exchange Act Release No. 46734 (October 28, 2002), 67 FR 67229 (November 4, 2002)(SR-OCC-2002-18) (approving amendments to OCC's By-Laws and Rules supporting the transition to near real-time reporting of matched trade information, including amendments to Article VI, Section 7 to allow instructions to OCC under certain conditions to disregard a matched trade).

3. Protective Action Pursuant to OCC Rule 305

Pursuant to OCC Rule 305, the Executive Chairman or the President of OCC, in certain situations, has the authority to impose limitations and restrictions on the transactions, positions and activities of a clearing member. This authority will be used, as needed, in the event a clearing member accumulates significant credit risk during overnight trading sessions, or a clearing member's activities during such trading sessions otherwise warrant OCC taking protective action.

Anticipated Effect on and Management of Risk

Clearing transactions executed in overnight trading sessions may increase risk presented to OCC due to the period of time between trade acceptance and settlement, the staffing levels at clearing members during such trading sessions and the deferment of executing intra-day margin calls until banking settlement services are operational. However, OCC will expand its risk management practices in order to mitigate these risks by implementing, and expanding, the various tools discussed above. For example, OCC will modify its existing risk management practices in order to closely monitor clearing members' credit risk from trades placed during overnight trading sessions as well as implement processes so that OCC takes appropriate action when such credit risk exceeds certain limits. OCC will also use its existing authority to require adequate clearing member staffing during such trading sessions, which will mitigate the operational risk associated with clearing members trading while they are not fully staffed. These risk management functions will work in tandem with risk controls, including the implementation of kill switch capabilities, adopted by the exchanges operating overnight trading sessions or by clearing FCMs, as applicable.

In addition to the above, OCC will adapt existing processes so that such processes can be used to mitigate risk associated with overnight trading sessions. Specifically, OCC will have the ability to issue margin calls, and prevent the withdrawal of excess margin on deposit at OCC, as a result of activity during such trading sessions as a means of reducing risk. OCC also will apply, pending regulatory approval, a post-trade price reasonability check to trades reported during overnight trading sessions, and therefore mitigate the risk of losses from erroneous trades. Finally, OCC will be able to take protective action pursuant to OCC Rule 305 as a result of clearing member activity during such sessions.

Consistency with the Payment, Clearing and Settlement Supervision Act

OCC believes that the proposed change is consistent with Section 805(b) of the Payment, Clearing and Settlement Supervision Act[15] because the proposed change will promote robust risk management.[16] OCC believes that the proposed enhancements to its risk management functions will provide OCC with the tools necessary to mitigate risks that may occur as a result of overnight trading sessions. As described above, OCC will implement new risk monitoring processes designed to identify increases in credit risk presented to OCC as a result of such sessions as well as implement changes designed to mitigate operational risk associated with overnight trading sessions. In addition, OCC will adapt certain existing practices to accommodate these overnight trading sessions including its margin call process and its authority to take protective action pursuant to OCC Rule 305. The new and modified practices are designed to identify and mitigate

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15 12 U.S.C. 5464(b).

16 12 U.S.C. 5464(b)(1).

risks that may be presented to OCC as a result of overnight trading sessions and thereby promote robust risk management.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The clearing agency shall not implement the proposed 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 the advance noticed is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not objected to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2014-805 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2014-805. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website

http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_805.pdf

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2014-805 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73345 / October 14, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16193

In the Matter of **WebXU, 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 WebXU, Inc. ("WebXU" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

1. WebXU (CIK No. 0001416729) is a Delaware corporation with its principal executive offices located in Santa Monica, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g).

2. WebXU 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, 2012. The common stock of WebXU was quoted on OTC Link operated by OTC Markets Group Inc. (formerly "Pink Sheets") ("OTC Link") under the ticker symbol WBXU.

3. The Commission issued a trading suspension in the securities of WebXU that began at 9:30 a.m. EDT on June 5, 2014, and terminated at 11:59 p.m. EDT on June 18, 2014.

A. DELINQUENT PERIODIC FILINGS

4. As discussed above, the Respondent is delinquent in its periodic filings with the Commission, having repeatedly failed to meet its obligation to file timely periodic reports.

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

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

III.

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

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

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

IV.

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

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

If 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's Rules of Practice.

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

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

By the Commission.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 73350 / October 15, 2014

Investment Advisers Act of 1940
Release No. 3947 / October 15, 2014

Administrative Proceeding
File No. 3-16195

In the Matter of **JUDY K. WOLF,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTIONS 203(f) AND 203(k) 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 and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(f) and 203(k) the Investment Advisers Act of 1940 ("Advisers Act") against Judy K. Wolf ("Wolf" or "Respondent").

II.

After an investigation, the Division of Enforcement (the "Division") alleges that:

A. SUMMARY

1. This action results from violations of the recordkeeping requirements of the Exchange Act and the record production requirements Advisers Act that Wolf willfully aided and abetted and caused while she was employed as a compliance officer at Wells Fargo Advisors, LLC ("Wells Fargo Advisors"), a dually registered broker-dealer and investment adviser. Wolf altered a document that was produced to Commission staff during an investigation that was seeking to determine, among other things, whether a Wells Fargo Advisors registered

representative committed insider trading and whether Wells Fargo Advisors failed to establish, maintain, and enforce written policies and procedures to prevent the misuse of material nonpublic information as required by Section 15(g) of the Exchange Act and Section 204A of the Advisers Act.

2. Wolf worked in a unit of the Wells Fargo Advisors' compliance department, the Retail Control Group, where she had direct responsibility for implementing certain of the firm's policies and procedures to prevent the misuse of material nonpublic information. Wolf was responsible for identifying potentially suspicious trading by the firm's personnel and its customers and clients and then analyzing whether trades may have been based on material nonpublic information. Wolf's trading reviews were referred to as "look back" reviews.

3. In this context, Wolf altered a document that summarized her review of a registered representative's trading that was produced to the Commission staff. Wolf first created the document in September 2010 at the time that she reviewed the registered representative's trading and closed her review with no findings. In December 2012, over two years after that review, after the Commission had filed an action against the registered representative for insider trading, and during the Commission's continuing investigation, Wolf altered the document. Wolf's alteration resulted in the document containing additional information about the extent of her review of the trading in September 2010. The alteration made it appear that Wolf performed a more thorough review than she actually did in September 2010.

4. In particular, Wolf added to the document a statement that rumors about an acquisition had been circulating for several weeks before the acquisition announcement. If Wolf had reviewed news articles during her review substantiating that statement, Wells Fargo Advisers' policies and procedures required Wolf to print and include them in her file. The file did not contain any news articles at all.

5. Wells Fargo Advisors produced the altered document in response to a Commission staff request for documents and made no mention it had been altered.

6. Wolf provided inconsistent information about the document when she was questioned during the Commission's investigation about her review of the trading. In her initial testimony, Wolf said she created the document in September 2010 when she performed the look back review. She also unequivocally denied altering the document after September 2010. In later investigative testimony, however, Wolf testified that she *had* altered the document after September 2010.

7. When questions arose surrounding the alteration of the document, Wells Fargo Advisors placed Wolf on administrative leave and eventually terminated her employment.

8. The recordkeeping requirements that Section 17(a) of the Exchange Act and Section 204(a) of the Advisers Act impose on broker-dealers and investment advisers are essential to the Commission's ability to enforce the federal securities laws and to protect investors. Wolf's alteration prolonged the Commission's ability to discharge its investigative

and law enforcement responsibilities. By producing the altered document without any mention that the document had been altered, Wells Fargo Advisors did not produce a true, complete and current copy of the document that existed at time of the staff's request, thereby violating the books and records requirements applicable to broker-dealers and investment advisers. By altering the document, Wolf willfully aided and abetted and caused Wells Fargo Advisors' violations of Section 17(a) of the Exchange Act and Rule 17a-4(j) thereunder and Rule 204(a) of the Advisers Act.

B. RESPONDENT

9. **Wolf,** a resident of St. Louis, Missouri, held the title of "compliance consultant" in the Retail Control Group of Wells Fargo Advisors or its predecessor entities from 2004 to June 13, 2013, when she was terminated by Wells Fargo Advisors. While associated with Wells Fargo Advisors, Wolf held Series 7, 24, 63, and 65 securities licenses. Wolf started working in the securities industry in 1990 when she first became licensed.

C. FACTUAL ALLEGATIONS

1. Wells Fargo Advisors' Obligations to Prevent the Misuse of Material Nonpublic Information

10. As a dually registered broker-dealer and investment adviser, Wells Fargo Advisors is required under Section 15(g) of the Exchange Act and Section 204A of the Advisers Act to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of its business, to prevent the misuse of material nonpublic information. Wells Fargo Advisors' business focuses on retail brokerage services. By providing retail services to customers and advisory clients who may be company insiders or have access to material nonpublic information, these customers and advisory clients, and the Wells Fargo Advisors registered representatives and advisory personnel who handle their accounts, can come into possession of such information. The risk that these customers and clients and Wells Fargo Advisors' personnel could come into possession of, and misuse, material nonpublic information was included by Wolf in Wells Fargo Advisors' policies and procedures for conducting look back reviews from at least early 2009 through April 2013.

2. Wolf's Responsibilities for Implementing the Policies and Procedures and Conducting Look Back Reviews

11. In early 2009, Wolf drafted Wells Fargo Advisors' policies and procedures governing how she was to conduct look back reviews. In doing so, Wolf was aware of the risk that Wells Fargo Advisors personnel could obtain material nonpublic information from the firm's customers and advisory clients and she understood that conducting effective look back reviews was an important part of Wells Fargo Advisors satisfying its regulatory obligations. Between 2009 through at least March 2013, Wolf was the sole compliance officer at Wells Fargo Advisors responsible for conducting look back reviews. During that period, Wolf conducted look back reviews and closed the vast majority of them with "no findings."

12. Wolf maintained a log enumerating the reviews she conducted and recorded the disposition of each review in the log. Wolf did not document routinely the reasons for closing look back reviews, but she relied on the log to identify the reviews she closed with "no findings." In certain instances, she input into the log additional information about the reasons for closing reviews and would note anything of particular interest she wanted to memorialize. Wolf and her manager relied on the log and Wolf shared excerpts from the log when her supervisor or others had questions about a particular look back review.

13. Wolf created a cover page for each look back review she performed by copying the contents from the relevant entry on her log and printing the entry to place in the hardcopy file. Wells Fargo Advisors' procedures required Wolf to print news stories for the file contemporaneously with conducting look back reviews. According to the procedures Wolf drafted, these files had a six year retention period.

a. Trading in Burger King Securities

i. The Underlying Securities Law Violations

14. Waldyr Da Silva Prado Neto ("Prado") was a registered representative and associated person of Wells Fargo Advisors in a branch office in Miami. In September 2012, the Commission charged Prado with trading the securities of Burger King on the basis of material, nonpublic information concerning the September 2, 2010 announcement that 3G Capital Partners Ltd. ("3G Capital"), a private equity firm, would acquire Burger King and take it private (the "Announcement").[1] The Commission alleged that Prado, who held Series 7 and 65 registrations and while an employee of Wells Fargo Advisors, misappropriated information about the acquisition from one of his brokerage customers who invested in the private equity fund 3G Capital used to acquire Burger King. The Commission alleged that Prado traded Burger King securities through his personal Wells Fargo Advisors brokerage account and that Prado tipped several of his other brokerage customers, including at least three tippees who traded Burger King securities through their Wells Fargo Advisors accounts. The Commission alleged that Prado and his tippees reaped profits of over $2 million in total from their Burger King trades, which included trading through Wells Fargo Advisors and another firm.

[1] *SEC v. Waldyr Da Silva Prado Neto*, Civil Action No. 12-CIV- 7094 (SDNY Sept. 20, 2012); Litigation Release No. 22486 (Sept. 21, 2012). Prado was permanently enjoined from committing future violations on January 7, 2014. Litigation Release No. 22905 (Jan. 14, 2014). Based on the court's entry of the permanent injunction, follow-on administrative proceedings were instituted against Prado. Exchange Act Release No. 71379 (Jan. 23, 2014). The Initial Decision barring Prado was issued on May 20, 2014. Initial Decision Release No. 600 (May 20, 2014). The Initial Decision became final on July 1, 2014. Exchange Act Release No. 72513 (July 1, 2014). Prado was also criminally charged with conspiracy to commit securities fraud, securities fraud, and fraud in connection with a tender offer in *USA v. Waldyr Prado, et al.*, SDNY Case No. 13MAG2201 (Sept. 13, 2013).

ii. *Wolf's Look Back Review of Trading in Burger King Securities*

15. Beginning on September 2, 2010, Wolf conducted a look back review of trading in Burger King securities at Wells Fargo Advisors before the Announcement by Prado and three of his customers. Wolf determined that:

a. Prado and his customers represented the top four positions in Burger King securities firm-wide;

b. Prado and his customers bought Burger King securities within 10 days before the Announcement, including on the same days;

c. The profits by Prado and his customers each exceeded the $5,000 threshold specified in the look back review procedures;

d. Both Prado and Burger King were located in Miami; and

e. Prado, his customers, and the company acquiring Burger King were all Brazilian.

16. Wolf determined at the time of her review that each of these factors was not a "red flag" that would require follow up with Prado and his branch manager. She did not contact the branch, did not take any further steps, did not escalate the matter to her manager, and closed the review with "no findings." Although the procedures in effect at the time required news articles to be printed for the file, Wolf's file did not contain printouts of any such articles. Contemporaneous with her review, Wolf noted on her log that Burger King was being acquired by 3G Capital for $24 per share and that the stock price opened 24% higher on September 2, 2010 than the previous day's closing price.

17. Because Wolf closed the Burger King trading review with no findings, her supervisors within the compliance department were unaware that she conducted the review of trading by Prado that may have been based on material nonpublic information he obtained from a client or customer of the firm. The supervisors first learned that she had reviewed the trading in September 2012, when the Commission charged Prado with insider trading. About a week after the Commission charged Prado, one of Wolf's supervisors asked if she reviewed the trading in September 2010. Wolf reported she performed a review. She also retrieved her look back files for Burger King from offsite storage and began to perform additional work on Burger King although no one asked her to. Over the next several months Wolf progressively provided additional justifications to her supervisors why she closed the review with no findings. The additional justifications were not reflected in the log or documented in the September 2010 file.

3. *Wolf Altered a Document Related to her Burger King Look Back Review that Was Produced to the Commission Staff*

18. In July 2012, during the investigation by the Commission, the staff requested, among other things, that Wells Fargo Advisors produce all "compliance files including but not

limited to reviews, inquiries, or complaints" relating to Prado that was not limited to any timeframe. Wells Fargo Advisors certified its production as complete in early September 2012, but the production did not contain any of Wolf's or the Retail Control Group's files.

19. The staff expanded its request in December 2012 for any compliance files not only related to Prado but for trading in Burger King securities. In January 2013, Wells Fargo Advisors produced documents relating to Wolf's look back review of trading in Burger King securities by Prado and his customers. The production included the Burger King file Wolf created in September 2010 that contained as a cover page the excerpt from the log that referenced the Burger King look back review. Wolf learned by at least January 2013 that Wells Fargo Advisors had produced her Burger King file to the Commission staff.

20. As produced by Wells Fargo Advisors in January 2013, Wolf's log stated: "09/02/10 opened 24% higher@ $23.35 vs. previous close of $18.86. Rumors of acquisition by a private equity group had been circulating for several weeks prior to the announcement. The stock price was up 15% on 9/1/12 [sic], the day prior to the announcement."

21. Wolf provided contradictory testimony before the Commission staff about the log. During her initial testimony, in March, 2013, Wolf testified that she created the Burger King log entry in September 2010 when she performed the look back review. Wolf denied altering the document after September 2010. When questioned by the staff about the discrepancy in the different years referenced in the log entry – "09/02/**10**" compared to "9/1/**12**" – Wolf testified that "9/1/12" was a typo that she made in September 2010. Wolf also claimed that one of the reasons she closed the review with no findings was new articles reported that rumors had been circulating for several weeks prior to the announcement. Although the policies and procedures required Wolf to print such news articles for the file, her file contained no such articles printed in September 2010.

22. Wells Fargo Advisors produced the altered document without any mention it had been altered. Following Wolf's testimony, however, Wells Fargo Advisors produced documents indicating that the Burger King log entry had, in fact, been altered on December 28, 2012. In particular, Wells Fargo Advisors produced prior iterations of the log that did not show the sentences that Wolf later added. Metadata for the version that included the additional lines of text showed that Wolf was the last person to alter the log before its production to the staff.

23. In March 2013 Wells Fargo Advisors placed Wolf on administrative leave and terminated her employment with the firm in June 2013. Wells Fargo Advisors filed a Form U5, which stated that Wolf was "terminated after questions raised during regulatory matter concerning the accuracy of information provided by the team member."

24. After the termination of her employment, the Commission staff took Wolf's testimony a second time, where she was confronted with the additional documents and metadata produced by Wells Fargo to the Commission. In the face of that additional evidence, Wolf finally admitted that she performed additional work on Burger King in 2012, although no one had asked her to. She also admitted she added the two sentences to the log entry after September

2010, but claimed she did not know when she added them. Finally, she admitted that her initial testimony before the Commission, where she had denied altering her records of look back review, was not true and correct.

D. VIOLATIONS

25. As a result of the conduct described above, Wolf willfully aided and abetted and caused Wells Fargo Advisors' violation of Section 17(a) of the Exchange Act and Rule 17a-4(j) thereunder, which require broker-dealers to "furnish promptly to a representative of the Commission legible, true, complete and current copies of [records required by Rule 17a-4] or . . . any other records of the member, broker, or dealer . . . that are requested by the representative of the Commission." Wolf's alteration of the document, which Wells Fargo Advisors then produced to Commission staff, was a cause of, and wilfully aided and abetted, Wells Fargo Advisors' violations of these provisions.[2]

26. As a result of the conduct described above, Wolf willfully aided and abetted and caused Wells Fargo Advisors' violation of Section 204(a) of the Advisers Act, which provides that all records of an investment adviser are subject to examination by the Commission. Wolf's alteration of the document, which Wells Fargo Advisors then produced to Commission staff without mentioning the alteration, was a cause of, and wilfully aided and abetted, Wells Fargo Advisors' violation of this provision.

III.

In view of the allegations made by the Division, 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 are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations; and

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act including, but not limited to, civil penalties pursuant to Section 21B 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 including, but not limited to, civil penalties pursuant to Section 203(i) of the Advisers Act; and

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[2] The Commission instituted a settled public administrative and cease-and-desist proceeding against Wells Fargo Advisors, pursuant to Sections 15(b) and 21C of the Exchange Act and 203(e) and 203(k) of the Advisers Act, in which Wells Fargo consented to the issuance of a cease-and-desist order: (1) admitting findings it willfully violated Sections 15(g), 17(a), and 17(b) of the Exchange Act and Rule 17a-4(j) thereunder and Sections 204A and 204(a) of the Advisers Act; (2) censuring it; (3) ordering it to comply with certain undertakings; and (4) ordering it to pay a $5 million civil money penalty. Exchange Act Release No. 73175 (Sept. 22, 2014).

D. 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 17(a) of the Exchange Act and Rule 17a-4(j) thereunder, and Section 204(a) of the Advisers Act, and whether Respondent should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act and Section 203(i) of the Advisers Act.

IV.

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

IT IS FURTHER ORDERED that 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher-
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73360 / October 15, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31287 / October 15, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16196

In the Matter of

Edward J. Hanrahan

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Edward J. Hanrahan ("Hanrahan" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Exchange 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[1] that:

Summary

These proceedings arise out of the fraudulent activities of Joseph A. Caramadre ("Caramadre"), who devised a scheme to defraud insurance companies. Caramadre purchased variable annuities for himself and actively solicited others to invest in variable annuities using terminally-ill individuals as annuitants. The annuities offered certain benefits upon the death of the annuitants. These benefits included a guaranteed return of all of the money that was invested, plus, under certain annuity contracts, interest and other bonuses and enhancements. Because Caramadre had reason to believe that the designated annuitant would die shortly after the purchase of the annuity, these annuities served as short-term investment vehicles that practically guaranteed an immediate return on the investment.

Caramadre was not registered as a broker, so he needed the assistance of a registered representative of a broker-dealer to purchase the variable annuities from insurance companies. Accordingly, he approached Hanrahan, a registered representative of a broker-dealer. As a registered representative, Hanrahan brokered the sale of variable annuities. Hanrahan received a commission for each transaction, which he, in turn, shared with Caramadre, knowing that Caramadre was not a registered person. Accordingly, Hanrahan willfully aided and abetted Caramadre's violation of Section 15(a) of the Exchange Act, which prohibits any broker or dealer from using the mails or any other means of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless that broker or dealer is registered with the Commission in accordance with Section 15(b) of the Exchange Act.

Respondent

1. **Edward J. Hanrahan**, age 44, is a resident of West Greenwich, Rhode Island. From in or about October 2006 through November 2010, Hanrahan was a registered representative of a registered broker-dealer. In or about 2006, Hanrahan became a 17.25% owner of Estate Planning Resources, Inc.

Other Relevant Persons and Entities

2. **Estate Planning Resources, Inc.** ("EPR") was incorporated in Rhode Island in 2006 and its principal place of business was in Cranston, Rhode Island. EPR was not registered with the Commission in any capacity.

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

3. **Joseph A. Caramadre**, age 54, is a resident of Cranston, Rhode Island. He was the President, Chief Executive Officer and majority owner of EPR. On November 17, 2011, Caramadre was charged in a 66-count federal grand jury indictment alleging that he conspired to steal and to use the identities of terminally-ill patients and elderly individuals to obtain more than 25 million dollars in illicit profits from insurance companies and bond issuers. Caramadre was charged with conspiracy, mail fraud, wire fraud, identity fraud, aggravated identity theft, money laundering and witness tampering. On November 19, 2012, Caramadre pleaded guilty to one count of wire fraud and one count of conspiracy and on December 16, 2013, he was sentenced to six years in prison. Further, on February 3, 2014, the court ordered Caramadre to pay restitution in the amount of $46,330,077.61, representing the entire loss that the insurance companies sustained since the beginning of the scheme.[2]

Background

4. From September 2007 through October 2008, Hanrahan, as a registered representative of a broker-dealer and minority owner of EPR, offered and sold variable annuities to individuals identified by Caramadre.

5. A variable annuity is an insurance contract that functions as a retirement-savings vehicle similar to a 401(k) plan. Variable annuities are long-term investments for retirement savings purposes and other long-range goals. The purchaser of the annuity deposits money. The money is then invested in stock or bond funds and grows tax-deferred. When opening the annuity, the purchaser identifies an individual as an "annuitant," *i.e.*, the person whose death would trigger a payout under the variable annuity contract.

6. Caramadre's investment scheme took advantage of a feature of a variable annuity known as the death benefit. Through the death benefit, insurers promised that the annuity would generate a return of at least the amount that was originally invested, less withdrawals, at the time of the annuitant's death. So, for example, if an investor paid $1 million for the annuity, and the market subsequently declined, the beneficiary still received $1 million when the annuitant died. Further, some insurance companies sold annuities with enhancements to this basic death benefit, including a built-in interest rate equal to 5-8% of the greater of the principal invested or the value of the underlying portfolio at the time of death, which increased the minimum money-back amount for these policies.

7. The investment scheme resulted in nearly guaranteed returns for purchasers of the variable annuities (the investors). If stock prices rose while the annuitant was still alive, the investor profited from the rise in the market. If stock prices fell, the investor received a full refund of his/her original investment at the time of the death of the annuitant, plus any interest offered as part of certain annuity contracts. Because Caramadre and others had reason to believe that the designated annuitant would die in the near future, the scheme allowed investors to invest their

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[2] The court found that Caramadre and his co-defendant, Raymour Radhakrishnan, were jointly and severally liable for $33,197,425.26 and Caramadre was solely liable for the remaining $13,132,652.35 because these losses were sustained before Radhakrishnan's involvement in the scheme.

money on a risk-free, short-term basis, and, depending on the terms of the annuity, guaranteed an immediate 5-8% return.

8. Hanrahan was responsible for brokering the sale of some of the variable annuities to investors who Caramadre identified because Caramadre himself was not an associated person of a registered broker-dealer. Between September 2007 and October 2008, Hanrahan submitted at least seven applications with the identifying information and signatures of the terminally-ill annuitants identified by Caramadre to his broker-dealer.

9. After the broker-dealer approved the sale of the variable annuity and the insurance company issued the variable annuity, the broker-dealer paid Hanrahan a share of the commission that it received on each variable annuity sale. Hanrahan, in turn, shared a portion of his commission with Caramadre. Specifically, Hanrahan received more than $483,187 in commissions, of which he shared 82.75% with Caramadre, leaving Hanrahan with at least $83,349.76. Thus, Caramadre actively solicited investors in exchange for compensation that was entirely dependent on the successful completion of the securities transactions. Hanrahan knew that Caramadre was not an associated person of a registered broker-dealer.

10. As a result of the conduct described above, Hanrahan willfully aided and abetted Caramadre's violation of Section 15(a) of the Exchange Act, which makes it unlawful for any broker or dealer to use the mails or any other means of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless that broker or dealer is registered with the Commission in accordance with Section 15(b) of the Exchange Act.

IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Hanrahan cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent Hanrahan be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;
>
> prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

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

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.

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 received at least $483,187 in commissions, of which he gave $399,837.24 (or 82.75%) to Caramadre, leaving Respondent with $83,349.76. Respondent shall pay disgorgement of $83,349.76 and prejudgment interest of $16,603.94, for a total payment of $99,953.76, but this amount is to be offset by $200,000 that Respondent has already paid, directly or indirectly, to settle related claims. Accordingly, no money is owed to the Commission at this time.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73361 / October 15, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3948 / October 15, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31288 / October 15, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16197

In the Matter of **Edward L. Maggiacomo, Jr.** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 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 Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Section 203(f) of the Investment Advisers Act of 1940 ("Investment Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Edward L. Maggiacomo, Jr. ("Maggiacomo" or "Respondent").

II.

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

Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 15(b) and 21C of the Exchange Act, Section 203(f) of the Investment 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[1] that:

Summary

These proceedings arise out of the fraudulent activities of Joseph A. Caramadre ("Caramadre"), who devised a scheme to defraud insurance companies. As part of the scheme, Caramadre purchased variable annuities for himself and actively solicited others to invest in variable annuities using terminally-ill individuals as annuitants. The annuities offered certain benefits upon the death of the annuitants. These benefits included a guaranteed return of all of the money that was invested, plus, under certain annuity contracts, interest and other bonuses and enhancements. Because Caramadre had reason to believe that the designated annuitant would die shortly after the purchase of the annuity, these annuities served as short-term investment vehicles that practically guaranteed an immediate return on the investment.

Caramadre was not registered as a broker, so he needed the assistance of a registered representative of a broker-dealer to purchase the variable annuities from insurance companies. Accordingly, he approached Maggiacomo, a registered representative of a broker-dealer. As a registered representative, Maggiacomo brokered the sale of variable annuities. Maggiacomo received a commission for each transaction, which he, in turn, shared with Caramadre knowing that Caramadre was not a registered person. Accordingly, Maggiacomo willfully aided and abetted Caramadre's violation of Section 15(a) of the Exchange Act, which prohibits any broker or dealer from using the mails or any other means of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless that broker or dealer is registered with the Commission in accordance with Section 15(b) of the Exchange Act.

Further, Maggiacomo made certain misrepresentations to his broker-dealer in connection with the sale of the variable annuities. Specifically, Maggiacomo submitted forms to his broker-dealer indicating that annuitants were not compensated, directly or indirectly, in connection with the variable annuity sales that he brokered. However, in certain instances, Maggiacomo met with

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

the terminally-ill individuals and/or their family members and gave them sums of money at or about the time he obtained their signatures and identifying information for the variable annuity applications. Moreover, in other instances, he knew that someone other than Maggiacomo was compensating certain annuitants. Accordingly, Maggiacomo's misrepresentations violate Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder.

Respondent

1. **Edward L. Maggiacomo, Jr.**, age 50, is a resident of Warwick, Rhode Island. Beginning in or about November 2005 until he was terminated on December 21, 2012, Maggiacomo was a registered representative of a registered broker-dealer and was associated with an investment adviser.

Other Relevant Persons and Entities

2. **Estate Planning Resources, Inc.** ("EPR") was incorporated in Rhode Island in 2006 and its principal place of business was in Cranston, Rhode Island. EPR was not registered with the Commission in any capacity.

3. **Joseph A. Caramadre**, age 54, is a resident of Cranston, Rhode Island. He was the President, Chief Executive Officer and majority owner of EPR. On November 17, 2011, Caramadre was charged in a 66-count federal grand jury indictment alleging that he conspired to steal and to use the identities of terminally-ill patients and elderly individuals to obtain more than 25 million dollars in illicit profits from insurance companies and bond issuers. Caramadre was charged with conspiracy, mail fraud, wire fraud, identity fraud, aggravated identity theft, money laundering and witness tampering. On November 19, 2012, Caramadre pleaded guilty to one count of wire fraud and one count of conspiracy and on December 16, 2013, he was sentenced to six years in prison. Further, on February 3, 2014, the court ordered Caramadre to pay restitution in the amount of $46,330,077.61, representing the entire loss that the insurance companies sustained since the beginning of the scheme.[2]

Background

4. From June 2007 through June 2008, Maggiacomo, as a registered representative of a broker-dealer, offered and sold variable annuities, in connection with an investment scheme devised by Caramadre and implemented through Caramadre's company, EPR.

5. A variable annuity is an insurance contract that functions as a retirement-savings vehicle similar to a 401(k) plan. Variable annuities are long-term investments for retirement savings purposes and other long-range goals. The purchaser of the annuity deposits money. The money is then invested in stock or bond funds and grows tax-deferred. When

[2] The court found that Caramadre and his co-defendant, Raymour Radhakrishnan, were jointly and severally liable for $33,197,425.26 and Caramadre was solely liable for the remaining $13,132,652.35 because these losses were sustained before Radhakrishnan's involvement in the scheme.

opening the annuity, the purchaser identifies an individual as an "annuitant," *i.e.*, the person whose death would trigger a payout under the variable annuity contract.

6. Caramadre's investment scheme took advantage of a feature of a variable annuity known as the death benefit. Through the death benefit, insurers promised that the annuity would generate a return of at least the amount that was originally invested, less withdrawals, at the time of the annuitant's death. So, for example, if an investor paid $1 million for the annuity, and the market subsequently declined, the beneficiary still received $1 million when the annuitant died. Further, some insurance companies sold annuities with enhancements to this basic death benefit, including a built-in interest rate equal to 5-8% of the greater of the principal invested or the value of the underlying portfolio at the time of death, which increased the minimum money-back amount for these policies.

7. The investment scheme resulted in nearly guaranteed returns for purchasers of the variable annuities (the investors). If stock prices rose while the annuitant was still alive, the investor profited from the rise in the market. If stock prices fell, the investor received a full refund of his/her original investment at the time of the death of the annuitant, plus any interest offered as part of certain annuity contracts. Because Caramadre and others had reason to believe that the designated annuitant would die in the near future, the scheme allowed investors to invest their money on a risk-free, short term basis, and, depending on the terms of the annuity, guaranteed an immediate 5-8% return.

8. Maggiacomo was responsible for brokering the sale of some of the variable annuities to investors who Caramadre identified because Caramadre himself was not an associated person of a registered broker-dealer. Between June 2007 and June 2008, Maggiacomo submitted at least fourteen applications with the identifying information and signatures of the terminally-ill annuitants identified by Caramadre to his broker-dealer.

9. To obtain the necessary information for the variable annuity applications, Caramadre and others offered terminally-ill individuals sums of money (usually between $2,000 and $5,000). Indeed, Maggiacomo spoke directly with some of the terminally-ill individuals and/or their family members and, in certain instances, provided them with sums of money.

10. In January 2008, Maggiacomo's broker-dealer began requiring the annuitants to complete an "Acknowledgement of the Annuitant" form in which the terminally-ill annuitants certified that they had not received any compensation for allowing the owner to use them as annuitants and that they understood that they would derive no benefit whatsoever from being named annuitants. Maggiacomo submitted these forms along with the variable annuity applications to his broker-dealer, even though he knew that certain of the annuitants and/or their family members had received sums of money from someone other than Maggiacomo at or about the time they provided their signatures and identifying information. Moreover, Maggiacomo knew that if his broker-dealer had been told that the annuitants were compensated, directly or indirectly, in connection with the variable annuity transactions, his broker-dealer would not have approved the transactions.

11. After the broker-dealer approved the sale of the variable annuity and the insurance company issued the variable annuity, the broker-dealer paid Maggiacomo a share of the commission that it received on each variable annuity sale. Maggiacomo, in turn, shared a portion of his commission with Caramadre. Specifically, Maggiacomo received more than $619,292 in commissions, of which he shared approximately 65% with Caramadre, leaving Maggiacomo with at least $216,752.21. Thus, Caramadre actively solicited investors in exchange for compensation that was entirely dependent on the successful completion of the securities transactions. Maggiacomo knew that Caramadre was not an associated person of a registered broker-dealer.

12. As a result of the conduct described above, Maggiacomo willfully violated Section 10(b) of the Exchange Act and Rule 10b-5(b) thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities. Further, Maggiacomo willfully aided and abetted Caramadre's violation of Section 15(a) of the Exchange Act, which makes it unlawful for any broker or dealer to use the mails or any other means of interstate commerce to "effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless that broker or dealer is registered with the Commission in accordance with Section 15(b) of the Exchange Act.

IV.

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

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, Section 203(f) of the Investment Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Maggiacomo cease and desist from committing or causing any violations and any future violations of Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Maggiacomo be, and hereby is:

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

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

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

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.

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 received at least \$619,292 in commissions, of which he gave \$402,539.82 (or 65%) to Caramadre, leaving Respondent with \$216,752.21. Respondent shall pay disgorgement of \$216,752.21, with prejudgment interest of \$46,445.70, for a total payment of \$263,197.91. However, subject to receipt of proof of payment by Commission staff no later than 30 days from the date of this Order, this amount will be offset by \$263,197.91, the amount that Maggiacomo has agreed to pay to settle related claims. Accordingly, subject to receipt of proof of payment by Commission staff no later than 30 days from the date of this Order, no money is owed to the Commission at this time.

By the Commission.

Brent J. Fields
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. 3949 / October 15, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16198

In the Matter of **GAETON S. DELLA PENNA,** **Respondent.**	**ORDER INSTITUTING PUBLIC 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 Gaeton S. Della Penna ("Respondent" or "Della Penna").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. From 2008 through 2013, Della Penna controlled and managed three private investment funds: A-G Hedge Group, LLC ("A-G"), The Contrarian Fund, LLC ("Contrarian"), and The New Economy Fund, LLC (collectively, the "Funds"). Della Penna acted as the unregistered investment adviser to the Funds during the relevant period, maintaining control over their investment portfolios and making all final investment decisions on the Funds' behalf. Della Penna received compensation both through fees for his advisory services and through misappropriation of money from the Funds. Della Penna, 61, resides in Sarasota, Florida.

B. ENTRY OF THE INJUNCTION

2. On September 24, 2014, a final judgment by default was entered against Della Penna, permanently enjoining him from future violations of 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 Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8(a) thereunder, in the civil action entitled Securities and Exchange Commission v. Gaeton S. Della Penna, et al., Civil Action Number 8:14-cv-1203-T-30MAP in the United States District Court for the Middle District of Florida.

3. The Commission's complaint alleged that, from 2008 through 2013, Della Penna defrauded investors in three companies he controlled. Della Penna solicited individuals to purchase notes in these companies on the representation the companies would use the money to trade in securities, in which Della Penna claimed to have been engaging successfully. In fact, Della Penna lost almost all of the money through a combination of unsuccessful investments, use of investor money to pay his personal expenses, including mortgage payments and payments to his girlfriend, and, in Ponzi-scheme fashion, use of later investors' money to pay fake "returns" to prior investors. Della Penna covered up his fraud by sending investors documents falsely showing positive returns at a time when they were losing money. Della Penna also solicited money from other investors on the representation he would use their money to invest in small companies, but he stole most of that money as well. In total, of the approximately $3.8 million Della Penna raised, he pocketed $1.1 million and used $1.4 million to pay prior investors.

III.

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

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

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

IV.

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

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

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

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

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.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73369 / October 16, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3950 / October 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16199

In the Matter of

ATHENA CAPITAL RESEARCH, LLC,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(e) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING 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") and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act"), against Athena Capital Research, LLC ("Athena" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940, Making

11 of 49

Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. Athena, an algorithmic, high-frequency trading firm based in New York City, used complex computer programs to carry out a familiar, manipulative scheme: marking the closing price of publicly-traded securities. Through a sophisticated algorithm, Athena manipulated the closing prices of thousands of NASDAQ-listed stocks over a six-month period.

2. Between at least June through December 2009 (the "Relevant Period"), Athena made large purchases or sales of the stocks in the last two seconds before NASDAQ's 4:00 p.m. close in order to drive the stocks' closing prices slightly higher or lower. The manipulated closing prices allowed Athena to reap more reliable profits from its otherwise risky strategies. Internally, Athena called the algorithms that traded in the last few seconds "Gravy."

3. By using high-powered computers, complex algorithms, and rapid-fire trades, Athena manipulated the closing prices of tens of thousands of stocks during the final seconds of almost every trading day during the Relevant Period.

4. Although Athena was a relatively small firm, it dominated the market for these stocks in the last few seconds. Its trades made up over 70% of the total NASDAQ trading volume of the affected stocks in the seconds before the close of almost every trading day.

5. Athena's manipulative trading focused on trading in order imbalances in securities at the close of the trading day. Imbalances for the close of trading occur when there are insufficient on-close orders to match buy and sell orders, *i.e.*, when there are more on-close orders to buy shares than to sell shares (or *vice versa*), for any given stock.

6. Every day at the close of trading, NASDAQ runs a closing auction to fill all on-close orders at the best price, one that is not too distant from the price of the stock in the continuous book. Leading up to the close, NASDAQ begins releasing information, called Net Order Imbalance Indicator ("Imbalance Message"), concerning the closing auction to help facilitate filling all on-close orders at the best price. At 3:50:00 p.m., NASDAQ issues its first Imbalance Message.

7. Athena's general strategy for trading based on Imbalance Messages worked as follows: Immediately after the first Imbalance Message, Athena would issue an Imbalance Only

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

on Close order to fill the imbalance. These orders are only filled if there is an imbalance in a security at the close. Athena would then purchase or sell securities on the continuous book on the opposite side of its on-close order, until 3:59:59.99, with the goal of holding no positions (being "flat") by the close. It called this process "accumulation," and the algorithms that accumulated these positions were called "accumulators."

8. Athena was acutely aware of the price impact of some its strategies, particularly its last second trading Gravy strategies. Athena used these strategies and its configurations to give its accumulation an extra push, to help generate profits.

9. For example, in April 2009, an Athena manager ("Manager 1"), after analyzing trading in which Gravy accumulated only approximately 25% of its accumulation, and, thus, had no price impact on the stock, emailed another Athena manager ("Manager 2") and Athena's Chief Technology Officer ("CTO") suggesting that they: "**make sure we always do our gravy with enough size**." (emphasis added). In fact, Athena traded nearly 60% of its accumulation in the final 2 seconds of the trading day.

10. With the helping hand of its Gravy strategy, Athena refined a method to manipulate the daily process, known as the "Closing Cross," that NASDAQ uses to set the closing price of stocks listed on the exchange. Manipulating the closing process can increase market volatility (thereby frustrating the very purpose of the closing auction) and throw off critical metrics linked to the closing price of stocks. A stock's closing price is the data point most closely scrutinized by investors, securities analysts, and the financial media, and is used to value, and assess management fees on mutual funds, hedge funds, and individual investor portfolios.

11. Athena, however, did not want to push the price of the stocks it traded too much because it created certain trading risks, but also because Athena was concerned about scrutiny from regulators as result of its last second trading. NASDAQ issued an automated Regulatory Alert for "Scrutiny on Expiration and Rebalance Days," which provided that "Suspicious orders or quotes that are potentially intended to manipulate the opening or closing price will be reported immediately to FINRA." Athena's CTO forwarded this alert to Manager 1 and Manager 2 and wrote: "**Let's make sure we don't kill the golden goose.**" (emphasis added).

Respondent

12. Athena is a Delaware limited liability company with its office in New York, New York. It serves as the general partner and investment manager for its master and feeder funds, which traded using the relevant algorithmic strategies. During the Relevant Period, the assets under management of the fund trading these strategies were approximately $40 million.

Background

13. In late 2003, two former colleagues from a large high-frequency trading firm formed Athena as an algorithmic, high-frequency trading firm.

14. In 2007, Athena sought someone with practical trading experience to help enhance its strategies and develop new ones. In late 2007, Athena hired the Manager 2, as a portfolio manager. Manager 2 introduced Athena to strategies that he and others at Athena referred to as the "Mach" strategies.

15. Athena's Mach strategies focused on trading in securities that were likely to have order imbalances — that is, more orders to buy than sell or vice versa — at the 4:00 p.m. market close.

NASDAQ's Closing Auction and Imbalances

16. During at least the Relevant Period, NASDAQ traders could place several types of orders, known as "on-close" orders, that were only filled at the market close. These order types are not published by any exchange and traders do not know if their orders will be filled until the close. They included:

a. Limit-On-Close Orders, orders to buy or sell a stock within a specific price range when the market closed;

b. Market-On-Close Orders, orders to buy or sell a stock at the closing price, regardless of what the price was, when the market closed; and

c. Imbalance-Only-On-Close Orders ("Imbalance-Only Orders"), limit orders that would be executed when the market closed, but only if there was an imbalance at the close.

17. Every day at approximately 4:00:00 p.m., NASDAQ ran a closing auction, known as the "closing cross." NASDAQ's proprietary auction algorithm generally set the closing price of each stock to match as many buyers and sellers on the close as possible at a price nearest the last trade on the continuous book, the trades before the close, to reduce volatility.

18. Based on the existing on-close orders for a particular stock, including limit-on-close orders, a closing imbalance of buy or sell orders could occur or disappear as the stock price fluctuated. Leading up to the close, NASDAQ calculated whether, at the then-existing market price for each security, such a closing imbalance would occur.

19. To improve liquidity by encouraging market participants to help fill potential imbalances, NASDAQ informed market participants about the size and direction of predicted closing imbalances during the ten minutes before the close. At 3:50:00 p.m., NASDAQ released a message called a Net Order Imbalance Indicator ("Imbalance Message"). The Imbalance Message contained information for each ticker for which NASDAQ predicted an imbalance based on the then-market price of that stock. The Imbalance Message included the imbalance direction (buy or sell), the size (number of shares predicted to be unfilled at the close), and certain price ranges that could help sophisticated participants estimate the likelihood of an imbalance at a certain closing

price. NASDAQ then updated the Imbalance Message, based on the changing market prices and changing on-close orders, every five seconds until the last message at 3:59:55 p.m.

The Mechanics of Athena's Trading Strategy

20. Traders often try to profit from trading on imbalances by taking advantage of expected price increases or decreases when there is more demand for buying a stock than for selling a stock, or vice versa. For example, when an Imbalance Message shows a buy imbalance for a particular stock, meaning there are orders to buy more shares at the close than orders to sell shares at the close, traders often expect that the stock's closing price will rise to reflect the excess buyer demand. Conversely, when there is a sell imbalance, meaning there are orders to sell more shares at the close than orders to buy shares at the close, traders often expect a lower closing price.

21. Athena's early trading on Imbalance Messages was fairly simple. For example, if the Imbalance Message showed a buy imbalance of 10,000 shares in a particular stock, Athena placed a sell Imbalance-Only Order for 10,000 shares and then tried to accumulate those 10,000 during the next ten minutes before the close. If the Imbalance Message showed a sell imbalance of 10,000 shares, Athena placed a buy Imbalance-Only Order for 10,000 shares and then tried to accumulate a short position of 10,000 shares over the next ten minutes. Athena would exit its position by its on-close order, which, due to the on-close imbalance, was expected to be filled at a better price than the average price at which it accumulated shares.

22. Over time, Athena developed sophisticated strategies for the timing and quantity of its accumulation. Athena's accumulation pattern often involved placing a large order right after the first Imbalance Message, to capture the expected price move due to the published imbalance, then accumulating small amounts of stock over the next nine minutes, followed by a large burst of orders in the final seconds and milliseconds of trading.

23. Athena referred to its accumulation immediately after the first Imbalance Message as "Meat," and to its last second trading strategies as "Gravy." In early 2009, Manager 2 described this pattern in an internal Athena email as follows: **"We have a desired accumulation pattern which includes grabbing stock at the beginning, a period of 'average price' accumulation, and a crescendo at the end."** (emphasis added).

24. During the Relevant Period, Athena used a version of Gravy that placed limit orders in six phases during the last two seconds. For example, Gravy placed the first order at 3:59:58.35 p.m., the second at 3:59:58.50 p.m., and so on until the sixth order at 3:59:59.95 p.m., just milliseconds before the close.

25. If a competing order filled the imbalance, Athena was left with large positions of shares that it had accumulated between 3:50 p.m. through 3:59:59.999 p.m. In other words, if Athena was not flat at the end of the day, it would incur overnight risk, and the price of the stock would often move in an unfavorable direction, resulting in losses, sometimes significant. Athena referred to this as being "stuck" with those positions.

26. This was particularly problematic for the Gravy strategy – as Manager 2 pointed out in an email to Manager 1 and the CTO: "**We can have some aggressive gravy if we know we have a 100% chan[c]e of getting the fill.**" (emphasis added).

27. Accordingly, Athena took measures to gain priority over competing limit-on-close orders and Imbalance-Only Orders. As Athena knew, not all closing trade orders are necessarily executed during the Closing Cross, and trade orders placed earlier in time are given priority in the Closing Cross over orders placed later in time. Similarly, better priced orders are given priority over inferior priced orders.

28. Athena, therefore, performed sophisticated quantitative analyses which it used to place Imbalance-Only Orders prior to 3:50 p.m. It called this strategy, "Collars."

29. By way of illustration, Athena's trading in shares of EBAY stock on November 25, 2009, occurred as follows:

- Prior to **3:50 p.m.**, Athena began entering its Collars orders.

- **3:50:00 p.m.** – NASDAQ issued its first Imbalance Message, which included a 224,638 Buy Imbalance for shares of EBAY. At the time, shares of EBAY were trading at $23.55.

- **3:50:00.578** – Athena placed a Sell Imbalance-Only Order for 224,638 shares at $.01, and simultaneously placed a buy order of 85,300 shares at $23.56 to begin its accumulation. 16,000 shares were filled almost instantly.

- Between **3:50:07.004** and **3:59:58.112** – Athena placed over 140 limit orders to buy between 100 and 5800 shares of EBAY, purchasing an additional 64,000 shares.

- Milliseconds before 3:59:58, the National Best Offer for EBAY was $23.58, at which point, *Gravy* kicked in, consisting of the following buy orders:

Time	Order Price	Quantity	Exchange
15:59:58.355	$23.81	11,200	BATS
15:59:58.503	$23.81	22,400	BATS
15:59:59.403	$23.81	33,600	BATS
15:59:59.705	$23.81	5,600	NASDAQ
15:59:59.870	$23.81	28,000	BATS
15:59:59.950	$23.81	11,200	NASDAQ

- During this time, Athena bought 112,000 shares (for an average price of $23.594) which constituted over 71% of the entire market volume for EBAY stock in the final two seconds of trading, overwhelming available liquidity and driving up its price.

- **3:59:58.510** – the National Best Offer moved up to $23.59, and at 3:59:59.963, it was

$23.60.

- **4:00:03.348** – NASDAQ ran its Closing Cross auction. Athena's Sell Imbalance-Only Orders were filled by selling 233,979 shares for $23.61, $.03 or 13 bps, higher than the best offer in the milliseconds prior to Gravy.

30. As a result of these steps, during the Relevant Period, Athena's Imbalance-Only Orders were filled at least partially over 98% of the time and the firm traded on the entire imbalance of almost every imbalance it wanted. Athena referred to this in internal emails as "**dominating the auction**" and "**owning the game.**" (emphasis added).

31. Athena's ability to predict with a higher degree of probability that it would get filled on almost every imbalance order it placed, removed a major element of uncertainty and allowed Athena to fine-tune its strategies to maximize its profits. For example, Athena rolled out the six phase Gravy configuration shortly afterwards. In addition, as its Imbalance-Only Order submissions became more sophisticated, Athena was able to ramp up its trading from approximately 1,000-3,000 tickers traded per month during the final months of 2008 to 12,844 symbols in November 2009.

Athena's Manipulative Gravy Trading

32. On average during the Relevant Period, Athena waited until the two seconds before the close to fill nearly 56% of its accumulation — meaning it accumulated, on average, almost 5600 of every 10,000 shares it accumulated in the two seconds before the close.

33. During the Relevant Period, Athena's trading in the last two seconds accounted for 73% of the entire NASDAQ market volume, on average, for the stocks it traded during those two seconds. These massive volumes, relative to other market participants in the last two seconds, allowed Athena to overwhelm the market's available liquidity and push the market price — and therefore the closing price —in Athena's direction.

34. Athena employees knew and expected that Gravy impacted the price of shares it traded, and at times Athena monitored the extent to which it did. For example, in August 2008, Athena employees compiled a spreadsheet containing information on the price movements caused by an early version of Gravy. They titled the spreadsheet "**gravy [average] move by symbol**[.]" (emphasis added).

35. That same month, an analyst at Athena emailed Manager 2 the day's overall results and a breakdown of Athena's profits from Gravy: "PM Gravy made 5.3k, trading on 33 symbols, **biggest dollar move** NTRS $.12 (.15%), **percentage move** PCBC $.06 (.41%)." Manager 2, who was out of the office on vacation, responded affirmatively: "**Looks like we have some Mach chips....going to Vegas tonight....**" (All emphasis added).

36. Importantly, Athena configured Gravy so that it would have a price impact.

37. In April 2009, Manager 1 emailed Manager 2 and the CTO about a preliminary version of a strategy for trading lower-priced stocks. After that day's trading, including through Gravy, resulted in losses, the Manager 1 conducted an analysis of the trades and provided suggestions on moving forward:

> Bad #3) (I[n]M[y]O[pinion], the biggest bad) Both the dd and the wn [two earlier-stage accumulators] accumulated all the shares they wanted before 3:55:00. **So at 3:59:58, gravy kicked in . . . To try to get a whopping 1000 shares. 1000 shares had 0.0 price impact, but 2000 shares would probably move it a few cents**, I'm guessing . . . With 4300 imbal shares to play and a near guarantee that we are going to get the whole print, **we should tax a little more**, up to some cap… This last item is my biggest [Manager 2] recommendation – let's use the discount shares or some other way **to make sure we always do our gravy with enough size**. (All emphases added).

38. Athena therefore knew that Gravy, which accumulated shares in the last few seconds before the close, had a greater price impact than its earlier accumulators. Athena sought to take advantage of Gravy's price impact by accumulating more shares in the last few seconds before the close and fewer shares earlier in the ten-minute period.

39. In early 2009, Athena hired an officer ("the Officer") whose duties were primarily to market the firm. Although he was not privy to the firm's trading strategies, the Officer observed some of the trading activity that occurred near the close of the day and told the CTO that he was concerned that Athena was "**punching the stock**." (emphasis added).

40. The CTO relayed the Officer's statement to Manager 2. By email, the CTO explained that the Officer had warned him that Athena should get a legal opinion on its trading strategies and that he should use certain search terms to research Athena's trading "**at home, not here.**" (emphasis added).

41. The CTO and Manager 2 then ceased their email exchange on Athena's email servers and resumed their email exchange using their personal email addresses.

42. Athena never obtained a legal opinion on its Gravy algorithms.

Protection Orders

43. Because Gravy was critical to the success of Athena's trading based on Imbalance Messages, Athena devised several strategies to ensure that its Gravy program could be traded with maximum efficiency.

44. Although Athena profited from Gravy's price impact, pushing the price too far created additional risks for Athena when the price of a ticker reached critical points which would result in Athena's Imbalance-Only Orders not being filled.

45. The Imbalance Message's contains a field called "far price."[2] Athena observed that if stocks it traded moved closer to the far price, competing limit-on-close orders, and not Athena's Imbalance-Only Orders, would likely fill the imbalance.

46. Another problem occurred when published imbalances changed from a buy to a sell or *vice versa*. Athena called this "flipping." When this happened, Athena also did not get filled on its Imbalance-Only Orders, and was stuck with large amounts of stock it accumulated. When a stock hit the flip price points during any phase of the accumulation, it was problematic for Athena. Gravy causing the stock price to flip was even more problematic, because there were no subsequent Imbalance Messages, and Athena would not know that the imbalance flipped.

47. As a result, Athena devised strategies called "Protection Orders" which enabled Athena to use Gravy to push the price in conjunction with the placement of a large order to exit the firm's accumulated position when the price of a security approached the far or flip prices.

48. Protection Orders were an important tool for Athena to trade its Gravy strategy. Manager 2 emailed Manager 1 and Athena's CTO: "**Protection orders are probably necessary in order to gravy up some of the thinner issues, but since we rank them largely according to volume, we should certainly be able to ramp those guys up**." (emphasis added).

49. Athena continuously grappled with the challenge of balancing the beneficial price impact of its last second strategies, such as Gravy, with the detrimental consequences of getting "stuck" by pushing the price of the stocks too far.

50. On the last Friday of June each year, the Russell Investment Group rebalances the individual share components of its stock indices, causing large index mutual funds to buy and sell substantial portions of their portfolios to match the indices. This typically creates large imbalances across many stocks, fertile ground for Athena's imbalance-trading strategies.

51. On the 2009 Russell rebalancing day, however, Athena had its worst trading day as-of-that-date, and lost approximately \$2-3 million. Several weeks later, Manager 2 wrote a "post-mortem" providing several explanations as to why he believed this occurred. In the post-mortem, which he emailed to Manager 1 and the CTO, he explained that the Gravy strategy caused a price impact that, while generally desired by Athena, could have negative financial consequences:

> ...The net result, in some cases, was that when it came time to blast away at the end to square its positions, it thought that it only wanted

[2] The "far price" by definition is the price at which all On-Close orders would be filled if the auction occurred at the time of the Imbalance Message. This is an indicator of where limit-on-close orders are priced.

> 3,100 shares instead of the 25,000 it really wanted (to use CHEV as an example). This was particularly bad, because the lack of the blast resulted in large positions in these names, and **the lack of the blast resulted in extremely poor prices (we essentially gave someone else all the liquidity they wanted with no price impact at all).** (emphasis added)

Gravy Causing Flips

> This is a risk that we imagined going into the day: **Not knowing the flip price going into the gravy phase, then having the gravy push us over the price; thereby changing the direction of the print.** The problem is relatively simple, and before the event, we knew that there was not much we could do about it. In all, this happened in 45 stocks. My feelings on this are mixed, in that it is a good number of stocks. On the other hand, it was the devil we knew, and I can't say that I would have done anything differently (none of these were enormous losers). (emphasis added)

52. In other words, when Athena's Gravy "blasts" at the end of the trading day were too small, the Imbalance-Only Orders were filled at bad prices, but when Gravy pushed the price too far, the imbalances flipped. The latter point, however, was predictable and was a trading outcome Athena was willing to accept.

53. Athena was also concerned about regulatory scrutiny of its last-second trades. On this and other index rebalance or options expiration dates, NASDAQ issued an automated regulatory alert for "Scrutiny on Expiration and Rebalance Days." It alerted market participants that "[s]uspicious orders or quotes that are potentially intended to manipulate the opening or closing price will be reported immediately to FINRA."

54. In September 2008, the CTO received the alert by email and forwarded it to Manager 1 and Manager 2. He wrote: "**Let's make sure we don't kill the golden goose.**"

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

IV.

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

Accordingly, pursuant to Section 21C of the Exchange Act of 1934 and Section 203(e) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Athena 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 Athena is censured.

C. Respondent shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $1,000,000 to the Securities and Exchange Commission. 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 Athena Capital Research, LLC 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 Michael J. Osnato, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY, 10281.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

Commissioner Aguilar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73377 / October 16, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3952 / October 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16200

In the Matter of

DENNIS F. WRIGHT,

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 Dennis F. Wright ("Wright" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.1., III.2., and III.4. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Wright was a registered representative who, from approximately 1983 to June 14, 2012, was associated with AXA Advisors, LLC ("AXA"), a registered broker-dealer and investment adviser with the Commission. Wright, 67 years old, is a resident of Lewistown, Pennsylvania.

2. On October 9, 2014 a final judgment was entered by consent against Wright, 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, and ordering him liable for disgorgement and prejudgment interest thereon, in the civil action entitled Securities and Exchange Commission v. Dennis F. Wright, Civil Action Number 1:14-cv-01896-SHR, in the United States District Court for the Middle District of Pennsylvania.

3. The Commission's complaint alleged that, while associated with AXA, Wright engaged in a scheme to defraud his customers. Wright misappropriated customer funds, falsely stated to customers that their funds were invested, and sent out false account statements indicating that customer funds were fully invested and earning returns. However, Wright never invested customer funds as promised but instead deposited the funds in a bank account he controlled and used the investor funds to pay his personal expenses as well as to fund customer withdrawals.

4. On September 30, 2014, a plea agreement was filed in which Wright agreed to plead guilty to one count of securities fraud in violation of Title 18 United States Code, Section 1348 before the United States District Court for the Middle District of Pennsylvania, in United States v. Dennis F. Wright, Crim. Information No. 1:14-cr-00252-SHR ("the criminal action").

5. The count in the criminal action to which Wright agreed to plead guilty alleged, inter alia, that Wright devised and intended to devise a scheme and artifice to defraud AXA and its customers in connection with securities offered by AXA and to obtain money and property from AXA and its customers by means of false and fraudulent pretenses, representations and promises in connection with the purchase and sale of securities offered by AXA.

IV.

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

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

Brent J. Fields
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. 73378 / October 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16201

In the Matter of **JOHN W. KOSOLCHAROEN,** **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 John W. Kosolcharoen ("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 is 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. Kosolcharoen, 41 years old, is a resident of Rancho Santa Margarita, California. He was the primary salesman of investment contracts offered by Global Corporate Alliance, Inc. During the relevant period, Kosolcharoen acted as an unregistered broker in violation of Section 15(a) of the Exchange Act.

2. On October 10, 2014, a final judgment was entered by consent against Kosolcharoen, permanently enjoining him from future violations of Sections 5 and 17(a)(2) and (3) 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. Duncan J. MacDonald, III, et al., Civil Action Number 3:13-cv-2275, in the United States District Court for the Northern District of Texas.

3. The Commission's complaint alleged that, in connection with the sale of investment contracts, Kosolcharoen made material misstatements to investors to solicit their investment in the overage program offered by Global Corporate Alliance, Inc., and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors. The complaint also alleged that Kosolcharoen, while not registered as a broker or associated with a registered broker, sold unregistered securities.

IV.

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

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

Pursuant to Section 15(b)(6) of the Exchange Act Respondent Kosolcharoen be, and hereby is barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

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

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9665 / October 16, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73379 / October 16, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3953 / October 16, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31292 / October 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16202

In the Matter of

GEORGE N. KRINOS, KRINOS HOLDINGS, INC. and FORDGATE ACQUISITION CORP.

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 21C and 12(j) 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 George N. Krinos ("Krinos"), Krinos Holdings, Inc. ("Krinos Holdings"), and Fordgate Acquisition Corp. ("Fordgate").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. This matter involves fraudulent misrepresentations by George N. Krinos ("Krinos") and Krinos Holdings, Inc. ("Krinos Holdings" or the "company") in the offer and sale of securities of Krinos Holdings. From January, 2012, through at least November, 2013, Krinos, through Krinos Holdings, raised approximately $1 million from at least 18 investors through the unregistered sale of common stock and secured convertible debenture notes. Throughout this period, Krinos made materially false and misleading representations to investors about the use of investor funds and Krinos Holdings' business operations and prospects.

2. In addition, throughout 2012 and 2013, Krinos made material misrepresentations to existing and potential investment advisory clients about the scope, experience, and assets under management, of Krinos Financial Group, Ltd., Inc. ("Krinos Financial"), a subsidiary of Krinos Holdings that was formerly registered with the Commission as an investment adviser, and filed a false Form ADV with the Commission.

3. Finally, Fordgate Acquisition Corp. ("Fordgate"), a shell company whose common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act, was acquired by Krinos in June, 2013, and has failed to file Forms 10-Q for the periods ending June 30, 2013, September 30, 2013, March 31, 2014, June 30, 2014, and its Form 10-K for 2013.

B. RESPONDENTS

4. Krinos, age 36, resides in Campbell, Ohio. He is the founder, CEO, and President of Krinos Holdings. Krinos Financial, a subsidiary of Krinos Holdings, was registered as an investment adviser with the Commission until October, 2013. From 2007 until 2010, Krinos was also a registered representative associated with several broker dealers registered with the Commission. During that time, he also owned Krinos Financial Group, Inc., which purportedly sold insurance products and was an investment adviser registered with the State of Ohio from September, 2010, until its registration was terminated December 31, 2010, for insufficient renewal funds. Krinos is also the founder, president, and CEO of Krinos Venture Capital, Krinos Investment Group, Krinos Financial Group Ltd., Inc., and Krinos Wealth Management, Inc., which are all subsidiaries of Krinos Holdings.

5. Krinos Holdings is a Nevada corporation with its principal place of business in Poland, Ohio. Krinos Holdings was formed by Krinos in early 2012 for the purpose of operating as a holding company owning 100% of the membership interests in operating subsidiaries engaged in venture capital and various financial services. At all times, Krinos was the president, CEO and controlling shareholder of Krinos Holdings, controlling all aspects of Krinos Holdings and its subsidiaries. Neither Krinos Holdings nor its securities have ever been registered with the Commission.

6. Fordgate Acquisition Corporation is a Delaware Corporation with its principal place of business in Poland, Ohio. Fordgate is a shell company whose common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act. Fordgate is required to file 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. On or about June 27, 2013, Fordgate issued 1,000,000 shares of stock to Krinos, making him the majority shareholder of Fordgate. Krinos is the sole director, president, and secretary of Fordgate.

C. BACKGROUND

7. Krinos incorporated Krinos Holdings in February, 2012, purportedly to provide venture capital to American start-up companies and serve as the parent company for approximately a half dozen subsequently formed subsidiaries that claimed to offer a variety of financial services. At the time Krinos Holdings was formed, Krinos was the sole officer and employee.

8. Shortly after forming Krinos Holdings, Krinos began raising capital through the unregistered offering of $1 million in common stock at $.10 per share, and $1 million in secured convertible debenture notes at $1,000 per share with a term of 36 months and an annual 7% simple interest rate.

9. From at least January, 2012, through November, 2013, Krinos sold more than $1,000,000 in common stock and secured convertible debenture notes to at least 18 investors, most of whom were former clients of Krinos as a result of his past employment.

10. Krinos was personally responsible for providing investors with information about Krinos Holdings and the purchase of stock and debenture notes. Krinos gave investors a Private Placement Memorandum ("PPM") and a business plan ("Business Plan") that described the investments.

11. Krinos also used the internet to promote and solicit investments in Krinos Holdings. For example, on July 1, 2012, on the Krinos Financial website, he announced that he had created a "controlled risk investment trust" that was "designed as a vehicle to fund high-profit, worthy, new projects or start-ups while assuring investors a larger than usual, highly-risk managed, return."

12. On September 27, 2012, a Krinos Financial Twitter post said, "Interested in investing in our company? Check out our website!!"

13. On November 8, 2012, Krinos advertised on the Krinos Financial Twitter feed that "With our new capital rate, you can earn 5% APY for 5 years. PRINCIPAL INSURED."

14. Krinos also solicited investors in newspapers advertisements. For example, in November, 2012, Krinos published a newspaper article in Youngstown, Ohio offering an

investment product with an annual interest rate of 3% to 8%, depending on the term of the product.

15. Throughout 2012 and 2013, during in-person discussions, on the Internet, and in PPMs, Business Plans, investor questionnaires, and subscription agreements, provided to investors, Krinos made materially false and misleading representations to investors about the use of investor funds, and Krinos Holdings' venture capital plan, scope of operations, and likelihood of success.

D. KRINOS MISAPPROPRIATED AND MISREPRESENTED THE USE OF INVESTOR FUNDS

16. Both the common stock and debenture PPMs that Krinos gave to investors represented that the proceeds from the offering would be used to pay general overhead expenses, consulting and management fees, the costs required to establish the marketing and sales/leasing force to sell the products and services, and for working capital.

17. The Business Plan that Krinos gave to investors represented that investor funds would be used as "seed money" to assist Krinos Holdings and to help position it to become a publicly traded company.

18. The PPM represented that Krinos would receive a $50,000 salary in 2012, and that officers would be reimbursed for "business, travel and business entertainment expenses incurred in the performance of their duties on behalf of the Company."

19. Krinos also personally told investors that the funds from the sale of securities would be used for business expenses or to invest in other companies.

20. In reality, none of the funds obtained from investors were provided to start-up companies, and a significant portion were spent by Krinos on personal expenses.

21. Of the $320,000 that Krinos raised in 2012 from the sale of Krinos Holdings stock and debenture notes, he received more than $45,000 in salary, and spent $14,600 at restaurants and bars, $50,600 at casinos and strip clubs, $2,000 on other personal expenses such as clothing and jewelry, and withdrew almost $14,000 in cash at ATMs, including some at addresses of bars and strip clubs. Krinos also spent $7,200 on car service, parts, and gasoline, even though there was not a company car, and thousands of dollars on rental cars and hotels in the Youngstown, Ohio area.

22. In October, 2012, Krinos began using $40,000 of investor funds to conduct foreign currency trading in an attempt to generate income for the company, of which more than $11,000 was lost through trading.

23. Shortly after being hired in July, 2012, the company's CFO and accountant learned that Krinos was spending large sums of company funds on personal expenses, including restaurants, bars, strip clubs, retail stores, and casinos.

24. During Summer, 2012, the CFO, accountant, and other Krinos Holdings employees, confronted Krinos about these expenditures, sought business justifications, and asked him to stop using company funds for personal purposes. Krinos did not provide adequate support for these expenditures and continued to use company funds for personal purposes.

25. The CFO and accountant began to keep track of the company funds that Krinos used for personal expenses in a "Note to Shareholder" category in the company's general ledger. By December, 2012, this category reflected approximately $92,000 in unreimbursed personal expenses incurred by Krinos.

26. In February, 2013, approximately two days before a scheduled shareholder meeting, Krinos instructed the CFO and accountant to prepare financial statements for distribution to the shareholders. Krinos instructed the CFO and accountant to assign expenses from the "Note to Shareholder" category to other business expense categories in the financial statements. As a result, the "Note to Shareholder" category was reduced to only $22,031.

27. Because of the changes to the financial statements ordered by Krinos, the CFO and accountant told Krinos they did not believe the financial statements were accurate and objected to distributing them to shareholders. Krinos ignored these concerns and distributed the financial statements to investors at the February 2013 meeting.

28. The financial statements given to investors were materially misleading. The balance sheet for the year ended December 31, 2012, included a "note receivable from shareholder" of only $22,031, and the income statement falsely reflected that all company funds had been used for company expenses. The financial statements also represented that Krinos' annual salary was $50,000 from the founding of the company to the "present."

29. Krinos did not tell investors that the "note receivable from shareholder," or any of the other categories of expenses in the statements, included his personal expenditures. Further, neither the financial statements nor Krinos himself disclosed that approximately $40,000 had been invested in foreign currency, $11,000 of which had been lost through trading. Krinos also failed to disclose that in January, 2013, he had invested an additional $50,000 in foreign currency trading and had loaned more than $30,000 to a friend to purchase a home.[1]

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[1] Although both PPMs further represented that offering proceeds not immediately utilized could be placed in "any investment that management considers in the best interest of the company," and the debenture PPM further specified that such offering proceeds could be invested in, among other things, "foreign currency trading, loans, [or] purchase of real estate," investors did not understand, and the PPMs did not disclose, that Krinos would engage in foreign currency trading as a primary business strategy or make risky real estate loans to his friends, which Krinos began doing in October of 2012. None of the individuals trading foreign currency with investor funds had any prior professional experience.

30. At the meeting, Krinos also failed to disclose to investors that he had awarded himself a substantial raise for 2013.

31. Shortly after the investor meeting, Krinos fired the company's CFO and accountant. Between February 2013, and May 2013, Krinos Holdings did not have anyone maintaining its books and records.

32. In mid-May, 2013, Krinos hired a new accountant, however, he did not provide her with access to any company financial information until approximately two months later. When the new accountant was finally provided access to this information, she learned that Krinos had continued to spend company funds on personal expenses.

33. The new accountant asked Krinos for business justifications for the personal expenses, but he ignored the request and told her that he could use the funds for any purposes because he was the CEO.

34. During 2013, Krinos sold approximately $700,000 of stock and debenture notes of Krinos Holdings. Most of the purchasers were existing investors. Of that amount, Krinos paid himself approximately $77,000 in salary, spent nearly $16,000 at bars and restaurants, more than $35,000 at casinos and strip clubs, more than $12,000 on retail purchases, more than $4,000 to re-upholster his boat, and at least $2,700 on sporting goods and clothing, and withdrew more than $15,000 in cash. Krinos also spent more than $5,400 on travel expenses, including a trip to Atlantic City, NJ, hotels and rental cars located near Youngstown, OH, and spent an additional $2,500 on a DUI attorney and $2,500 on concert tickets.

35. From January through May, 2013, Krinos also used a total of more than $150,000 of investor funds for foreign currency trading, and more than $3,500 was lost through trading. In April, 2013, Krinos paid $5,500 to a restaurant owned by the same friend to whom he had previously loaned $30,000 in January, 2013.

36. Krinos and Krinos Holdings never provided any money to any start-up companies and did not disclose to investors that their money was being used to pay Krinos' personal expenses, investing primarily in foreign currency, or to make loans to friends of Krinos.

E. <u>KRINOS AND KRINOS HOLDINGS MADE MATERIAL MISREPRESENTATIONS ABOUT THE VENTURE CAPITAL BUSINESS</u>

37. Both the common stock and debenture PPMs that Krinos gave to investors represented that Krinos Holdings was a venture capital firm, committed to helping businesses pursue their goals by offering a wide range of loan services to business owners.

38. The Business Plan that Krinos gave to investors represented that Krinos Holdings and its subsidiaries would create a hedge fund to raise money and loan it to other American-based companies.

39. In discussions, Krinos told investors that his plan was to take Krinos Holdings public, in which case the stock could be worth anywhere between $2-10 per share.

40. Krinos also told investors that Krinos Holdings would be investing in American companies that would create American jobs.

41. The Business Plan given to investors represented that the company would "thoroughly examine the needs and abilities of potential clients with a team of business analysts both within the [Krinos Venture Capital] family as well as other companies...that are in the business of finding financing for funding new ideas." During Summer, 2012, Krinos Holdings made representations on various Internet websites and social media, whose content was controlled by Krinos, that companies funded by Krinos Holdings "must meet strenuous funding requirements and rigorous due diligence" and a "team of business analysts" would "thoroughly examine" the needs and abilities of the companies to be funded.

42. Between at least June, 2012, and January, 2013, Krinos Holdings' websites and social media represented that Krinos Holdings was funding a number of start-up companies. For example, on July 13, 2012, the Krinos Financial website announced that it was "in the final stages of funding [Company A]." On September 27, 2012, it announced on Twitter that "Krinos Financial Group is funding [Company A]..." Throughout the Summer, 2012 until at least January, 2013, Krinos Holdings claimed that the company was "in the funding process" for other start-up companies.

43. Krinos also touted Krinos Holdings and its venture capital business through press conferences and the press. For example, on or about September 5, 2012, Krinos participated in a press conference where he claimed Krinos Holdings "will fund" a waste-to-fuel plant in Michigan for one of the start-up companies, Company B.

44. During the September 5, 2012 press conference, Krinos claimed that he had a "proprietary financing method, very unique in nature" and said that in the next few months Krinos Holdings would be working with "a multitude of businesses, start-ups or businesses that are looking to expand and putting out about two to two-and-a-half billion in financing" that would create approximately 40,000 American jobs.

45. On or about September 7, 2012, Krinos participated in another press conference in Huntington, Ohio, where he claimed that Krinos Holdings would be financing another plant in Indiana for Company B. During the September 7, 2012 press conference, Krinos also claimed that his financing method was "proprietary" and could not be discussed because of SEC restrictions. Krinos claimed he was preparing to take Krinos Holdings public and was planning to list the company on NASDAQ by the end of 2012.

Krinos also claimed that he had lined up approximately $2.5 billion in investments that would create approximately 40,000 new jobs.

46. In November, 2012, a newspaper article quoted Krinos as claiming that, "[m]y business experience and knowledge of the industry…and our ability to raise capital is second to none…."

47. Krinos told investors that he had a good relationship with large institutional investors, including Firm A, which would either invest in Krinos Holdings or market its hedge fund.

48. At shareholder meetings in October, 2012, and February, 2013, Krinos portrayed the company's prospects, including its venture capital plan, in a positive light.

49. The above representations about Krinos Holdings' venture capital business and its prospects were materially false and misleading.

50. Krinos orally, in PPMs, and in business plans given to investors and posted on company websites, falsely represented that Krinos Holdings was a start-up venture capital firm which, through its subsidiaries, would offer a variety of financial services to individuals and provide loans to American business owners.

51. From the outset, Krinos knew, or was reckless in not knowing, that Krinos Holdings would not and could not provide these services. Krinos himself lacked the experience and expertise to do so, and he knowingly or recklessly hired or worked with individuals whom he knew, or was reckless in not knowing, lacked the experience to perform their job duties or the represented services.

52. At no time did Krinos have the funds, or a reasonable expectation of obtaining the funds, necessary to fully finance even one of the start-up companies, and he ultimately never provided any financing to any of the start-up companies.

53. Krinos did not have a good relationship with any institutional investors, such as Firm A, and had received no interest from institutional investors to fund or market a hedge fund for Krinos Holdings.

54. Krinos also misrepresented the process for selecting companies to fund, and the experience and ability of the staff involved in that process. Applicants for funding were chosen based on a cursory review of information by Krinos' brother-in-law, an industrial engineer with no business experience, who was occasionally assisted by the company's COO, whose prior business experience was managing a health club. In fact, neither Krinos, nor any of his staff, had any experience in venture capital or had ever raised any capital for another start-up company.

55. Krinos also misrepresented the status of the start-up company funding projects on company websites and in the press. Although Krinos Holdings executed

funding agreements with six start-up companies in August, 2012, and a seventh in September, 2012, the agreements with the start-up companies were never finalized, and Krinos Holdings never entered into a funding process with, or provided any funding to, any of the start-up companies, and never had sufficient funds to do so.

56. On November 16, 2012, Krinos Holdings informed the start-up companies by e-mail that it did not have the money to meet its funding commitments and did not expect to be able to provide funding until mid-2013. Investors were not told about this funding delay or warned that the start-up companies might seek funding elsewhere.

57. In Spring, 2013, Krinos asked some of the start-up companies to pay $25,000 for Krinos Holdings to prepare a PPM, but none of the companies expressed interest in that offer. Instead, several of the companies, including Company B, explicitly informed Krinos that they were terminating their relationship with Krinos Holdings. The terminations were not disclosed to shareholders.

58. Moreover, Krinos raised an additional $584,986 from March, 2013, through at least November, 2013, after he had been informed that several of the start-up companies had terminated their relationships with Krinos Holdings.

59. Ultimately, Krinos never provided any funding to any start-up companies, and the only business conducted by Krinos Holdings was foreign currency trading and risky real estate loans to one of Krinos' friends, which was not successful or disclosed to investors.

F. KRINOS AND KRINOS HOLDINGS MADE MATERIAL MISREPRESENTATIONS ABOUT THE SCOPE OF THE COMPANY'S OPERATIONS AND STAFF QUALIFICATIONS

60. Krinos also misrepresented the experience of Krinos Holdings employees and the nature and scope of its business operations on company websites and in the press.

61. For example, on September 19, 2012, the Krinos Holdings Twitter page represented that "agents" at Krinos Financial "have extensive investment advisory experience and are licensed to sell a variety of investment and insurance products." Krinos repeated this representation on the Krinos Holdings Facebook page on September 19, 2012 and November 1, 2012.

62. In a November 18, 2012 newspaper article about the Company B projects, Krinos said that "Krinos Group is a multifaceted financial firm offering insurance, venture capital and financial consulting services with more than a decade of experience." Krinos further claimed, "My business experience and knowledge of the industry…and our ability to raise capital is second to none."

63. In November, 2012, Krinos also placed advertisements in newspapers in the Youngstown, Ohio area selling an investment product, which suggested that Krinos Holdings had branches in Boardman, Ohio, Cleveland, Ohio, and Columbus, Ohio.

64. In October, 2012, Krinos Holdings also announced on its Twitter and Facebook pages that it had opened new offices in Columbus, Ohio and Cleveland, Ohio.

65. In fact, these representations about the company's operations and experience were false.

66. Among other things, at the time of these representations, Krinos Financial did not have licensed staff with extensive investment advisory experience. Krinos, who had only limited investment advisory experience himself, was the only person at Krinos Holdings with any alleged investment advisory experience. Although Krinos had hired individuals with investment advisory experience, they had all left the company by September 15, 2012, and at least two of them did not have current licenses while they were employed by Krinos Holdings.

67. Krinos also had only one staffed office in Poland, Ohio and did not have offices in Columbus or Cleveland.

G. KRINOS ACQUIRED FORDGATE, ISSUED A FALSE PRESS RELEASE, AND FORDGATE FAILED TO MAKE REQUIRED FILINGS

68. On May 10, 2013, Krinos wired $30,000 from Krinos Holdings to Company C, to purchase the controlling interest in Fordgate, a shell company registered with the Commission and owned by Company C.

69. On approximately June 27, 2013, pursuant to an agreement with Krinos and Krinos Holdings, the principals of Company C resigned their positions as directors of Fordgate, Fordgate issued additional shares of stock making Krinos the company's controlling shareholder, and Krinos became Fordgate's sole officer and director.

70. On July 1, 2013, using information provided by Krinos, Fordgate filed with the Commission a press release on a Form 8-K announcing the acquisition of Fordgate by Krinos and its anticipated merger with Krinos Holdings and its subsidiaries. The Form 8-K was signed by Krinos.

71. The press release contained multiple material misrepresentations regarding the nature and scope of Krinos Holdings' business. For example, the press release falsely represented that Krinos Financial had approximately $20 million in assets under management.

72. The press release also falsely represented that Krinos Holdings was a "diversified financial services firm designed to provide innovative financial advisory

services to individuals, businesses, and employees in both the private and public sectors" and that it offered "total financial advisory services in addition to and including insurance services, private equity and hedge fund management, wealth management, IRA administration, and estate coordination, trust and trustee services." As discussed in more detail above, in reality, Krinos Holdings and its subsidiaries did not offer most of these services.

73. Fordgate also failed to make required annual and quarterly filings with the Commission for the periods ended June 30, 2013, September 30, 2013, December 31, 2013, March 31, 2014, and June 30, 2014.

H. KRINOS AND KRINOS FINANCIAL FILED A FALSE FORM ADV AND MISLED INVESTORS AND CLIENTS

74. Throughout 2012 and 2013, Krinos did business, and held himself out, as an investment adviser. For example, Krinos provided investment advice to at least several individuals, and was identified as an investment adviser on several accounts held at Company D and Company E, during this time.

75. Krinos also held several investment seminars, during this time, where he offered to teach attendees about how to "protect yourself and your retirement," "increase your returns," "reduc[e] risk, and navigat[e] today's economy," and solicited one-on-one meetings to discuss these objectives.

76. During this time, Krinos also advertised investment advisory and wealth management services on Krinos Holdings websites and on social media.

77. On September 28, 2012, Krinos filed a Form ADV with the Commission, on behalf of Krinos Financial Group, seeking registration as an investment adviser.

78. In the Form ADV, Krinos represented that he had a "reasonable expectation" that Krinos Financial would become eligible for registration by acquiring $100 million in assets under management within 120 days. The application was granted, and Krinos Financial became registered as an investment adviser, on October 15, 2012.

79. In fact, Krinos did not have a reasonable expectation that Krinos Financial would obtain $100 million in assets under management. At most, during the prior year, Krinos managed less than $200,000 in assets for fewer than a dozen clients, and neither Krinos, nor Krinos Financial, were ever in a position to accumulate assets sufficient to meet the registration requirements.

80. In January, 2013, and April, 2013, Krinos was informed by Commission staff members that Krinos Financial was required to withdraw its registration because it did not have sufficient assets under management, but Krinos Financial did not withdraw its registration until October 3, 2013.

81. As noted in Paragraphs 71 and 72, the false press release that Krinos caused Fordgate to issue, misrepresented to current and potential clients of Krinos and Krinos Financial the amount of assets Krinos Financial managed and the scope of services it offered.

I. VIOLATIONS

82. As a result of the conduct described above, Krinos and Krinos Holdings 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.

83. As a result of the conduct described above, Krinos and Krinos Holdings willfully violated Section 17(a)(1) of the Securities Act, which prohibits any person, in the offer or sale of any security, from employing any device, scheme, or artifice to defraud; Section 17(a)(2) of the Securities Act, which prohibits any person, in the offer or sale of any security, from obtaining money or property by means of any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading; and Section 17(a)(3) of the Securities Act, which prohibits any person, in the offer or sale of any security, from engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

84. As a result of the conduct described above, Krinos willfully violated: Sections 206(1) and 206(2) of the Advisers Act, which make it unlawful for any investment adviser, by use of the mails or any means or instrumentality of interstate commerce, directly or indirectly, to employ any device, scheme, or artifice to defraud any client or prospective client, or to engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client; and Section 207 of the Advisers Act, which makes it unlawful for any person to willfully make any untrue statement of a material fact in any registration application or report filed with the Commission under Section 203, or 204, or to willfully omit to state in any such application or report any material fact which is required to be stated therein.

85. As a result of the conduct described above, Krinos aided and abetted and caused Krinos Financial's violations of Section 203A of the Advisers Act, which generally prohibits an adviser that is regulated or required to be regulated in the state in which it has its principal office and place of business from registering with the Commission, unless it has assets under management in excess of $100 million or advises a registered investment company.

86. As a result of the conduct described above, Fordgate failed to comply with Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, which requires issuers to file annual and quarterly reports with the Commission.

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 Krinos pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, including, but not limited to, disgorgement and civil penalties pursuant to Sections 8A(e) and 8A(g) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, and Sections 203(i) and 203(j) of the Advisers Act;

C. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Krinos should be ordered to cease and desist from committing or causing violations and any future violations of Section 17 of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 207 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Krinos pursuant to Section 9(b) of the Investment Company Act;

E. What, if any, remedial action is appropriate in the public interest against Krinos Holdings pursuant to Section 8A of the Securities Act and 21C of the Exchange Act, including but not limited to, disgorgement pursuant to Section 8A of the Securities Act and Sections 21B and 21C of the Exchange Act;

F. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Krinos Holdings should be ordered to cease and desist from committing or causing violations and any future violations of Section 17 of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

G. Whether it is necessary and appropriate for the protection of investors to suspend or revoke the registration of securities registered pursuant to Section 12 of the Exchange Act of Fordgate as described in Section II hereof;

H. Whether, pursuant to Section 21C of the Exchange Act, Fordgate should be ordered to cease and desist from committing or causing violations and any future violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 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 file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

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

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

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

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

By the Commission.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9666 / October 17, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73381 / October 17, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3954 / October 17, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31293 / October 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16203

In the Matter of **ANTHONY CORONATI and BIDTOASK LLC,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940 AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Anthony Coronati ("Coronati") and Bidtoask LLC ("Bidtoask") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Section 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, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. From at least 2009 through 2013, Coronati raised over $2 million from investors in several fraudulent securities offerings and misappropriated over $400,000 of that amount.

2. To raise money from investors in his first fraudulent offering, Coronati held himself out as an investment adviser to a hedge fund that he claimed would invest in equity securities. Unbeknownst to investors, the hedge fund was fictitious, and Coronati used the money for his own purposes.

3. To raise money from investors in other fraudulent offerings, Coronati and Bidtoask offered investors membership interests in Bidtoask. They represented that Bidtoask would invest or had invested in promising technology companies that had yet to hold initial public offerings ("IPOs"). Although Bidtoask did make two genuine investments — with significant fees that Coronati and Bidtoask concealed from investors — Coronati misappropriated some of the funds.

4. On occasion, Coronati used money he misappropriated from investors in one offering to pay back investors in another offering, in Ponzi-like fashion.

5. In late 2013, to conceal that he had misappropriated an investor's funds, Coronati sent the investor a phony account statement. The statement falsely showed that the investor's position in the purported fund was worth over $120,000, based on certain valuable securities the fund held. In fact, the fund held no such securities.

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

Respondents

6. **Coronati**, 45, is a resident of Staten Island, New York. At all times, Coronati has owned, managed, and controlled Bidtoask. From at least 2008 through 2011, Coronati also purported to serve as chairman and chief executive officer of Corsac Inc. ("Corsac"), an investment adviser to a fictitious hedge fund, Corsac Group Limited. Coronati also operates a website called bidtoask.com, which offers stock recommendations to its subscribers.

7. **Bidtoask** is a New Jersey limited liability company that Coronati formed on December 23, 2011. Coronati controls Bidtoask and is its sole managing member and employee.

Other Relevant Entities

8. **Corsac** was a Delaware corporation that Coronati formed in July 2009. At all times, Coronati single-handedly owned, managed, and operated Corsac, which purported to serve as an investment adviser to Corsac Group Limited. The State of Delaware declared Corsac void in 2011. By approximately 2012, Coronati had dissipated and closed Corsac's bank account.

9. **Corsac Group Limited** ("Corsac Fund"), also known as Corsac Limited, is a purported partnership and fictitious hedge fund that offered units to investors. Private placement memoranda represented that Coronati was Corsac Fund's chairman and chief executive officer, that he created Corsac Fund, and that Corsac Fund's managing partner was Corsac.

Coronati's Fraudulent Offerings Involving Corsac

10. Coronati's first two fraudulent offerings involved Corsac.

11. From at least 2008 through 2011, Coronati offered investors units in Corsac Fund, the purported hedge fund whose investment adviser was Corsac.

12. Coronati signed and sent private placement memoranda to potential investors representing that Corsac Fund would invest primarily in United States equity securities and that its "[m]anagers are looking for 30% return with minimal risk."

13. In fact, as Coronati knew, the Corsac Fund did not exist or have any managers other than Coronati, and Coronati did not use the investors' money to invest in any such hedge fund.

14. Based on these and other material misrepresentations, at least eleven investors invested in the fictitious Corsac Fund.

15. Coronati directed the investors' funds to a bank account in Corsac's name (the "Corsac Account"), which Coronati controlled.

16. Coronati commingled investors' funds and other funds in the Corsac Account. He then used the funds for his own purposes. For example, he withdrew some of the funds in cash. He used some of the funds to pay personal and business expenses. He used a portion of the funds to purchase securities in a personal brokerage account he held in his own name.

17. As he ran out of money, Coronati devised a new fraud using Corsac.

18. In approximately late 2011 through early 2012, Coronati offered investors shares in Corsac at a price of $5 per share. Coronati told investors that Corsac would itself hold an IPO by the third quarter of 2012 and that the IPO share price would be much higher than $5. For example, he told at least one investor that Corsac's share price would reach $30.

19. In fact, as Coronati knew, he had no basis for representing that Corsac would soon hold an IPO or that its stock would soon be worth many times the price investors had paid.

20. Based on those and other material misrepresentations by Coronati, at least six investors invested in Corsac.

21. Coronati again directed the investors' funds to the Corsac Account and used the funds for his own purposes, including making Ponzi-like re-payments to certain investors in the Corsac Fund.

22. After draining the Corsac Account, Coronati closed it in August 2012.

23. Many investors in the Corsac schemes never received any funds back from Coronati.

Coronati's Fraudulent Offering Involving Facebook

24. In early 2012, as the proceeds from his Corsac schemes began drying up, Coronati began soliciting investors for investments in Facebook, Inc., the social media company, before its IPO.

25. On behalf of Bidtoask, Coronati offered investors membership interests in Bidtoask. Coronati and Bidtoask falsely represented that Bidtoask would invest directly in pre-IPO Facebook shares without charging any fees, commissions, or mark-ups.[2]

26. Based on these and other material misrepresentations, Bidtoask obtained approximately $1.75 million from approximately forty-four investors for investments in Facebook.

27. Of this amount, Coronati misappropriated approximately $100,000 for his own purposes, including personal and business expenses, unbeknownst to investors.

28. Bidtoask invested the remaining $1.65 million in two investment funds (the "Facebook Funds") that held genuine pre-IPO Facebook shares. As Coronati knew, the Facebook Funds charged Bidtoask fees — undisclosed to Bidtoask investors — that reduced Bidtoask's investments in the Facebook Funds to less than $1.55 million.

[2] Towards the end of the scheme, Coronati and Bidtoask implied in certain communications with investors that Bidtoask might charge a fee of no more than 3.75%.

29. After Facebook's IPO, Facebook's stock price declined.

30. The Facebook Funds distributed Facebook shares to Bidtoask, commensurate with its $1.55 million investments. Coronati and Bidtoask sold most of the shares and distributed the proceeds to Bidtoask investors. However, Coronati diverted some of the shares to his personal brokerage account, sold them at a loss, and misappropriated the proceeds.

31. Although Coronati distributed the proceeds from his sales of the Facebook shares — less the amounts he had misappropriated — to most of the Bidtoask investors, he failed to distribute any proceeds to three investors.

Coronati's Final Fraudulent Offerings

32. From approximately mid-2012 through mid-2013, Coronati and Bidtoask offered investments in two other privately-owned technology companies (the "Tech Companies").

33. Once again, Coronati and Bidtoask offered investors membership interests in Bidtoask. They represented that Bidtoask held shares in the Tech Companies and that one of the Tech Companies had an IPO "pending."

34. In fact, as Coronati knew, Bidtoask held no shares in either of the Tech Companies, and neither Tech Company was (or has since been) in the process of an IPO.

35. Based on these and other material misrepresentations, Bidtoask raised funds from ten investors.

36. Bidtoask and Coronati did not use the funds to invest in the Tech Companies or to make any other investments.

37. Coronati simply misappropriated the funds for his own purposes, including for personal expenses such as a Caribbean vacation and plastic surgery.

Coronati's Ponzi-Like Payments and Phony Account Statements

38. As Coronati's schemes unraveled, Coronati faced increasing concerns from investors.

39. To placate certain investors, Coronati used money he misappropriated from Bidtoask and Corsac investors to re-pay investors in the purported Corsac Fund, in Ponzi-scheme fashion.

40. In late 2013, to conceal his fraud from a Corsac Fund investor, Coronati fabricated and sent an account statement to the investor. The statement purported to show that the investor's position in the Corsac Fund was worth over $120,000 and that over 80% of the Corsac Fund was invested in well-known public companies such as Apple Inc.

41. The account statement was entirely fictitious. As Coronati knew, the Corsac Fund never existed and, as of late 2013, neither Coronati nor the Corsac Fund held any of the securities listed on the statement.

The Commission's Prior Court Proceedings Against Coronati

42. On July 9 and October 4, 2013, during the Division of Enforcement's ("Division's") investigation, Division counsel issued and later personally served Coronati with two investigative subpoenas seeking documents and testimony from him.

43. Coronati ignored both subpoenas.

44. On November 4, 2013, the Commission filed an application in the United States District Court for the Southern District of New York to enforce Coronati's compliance with the subpoenas. The Commission successfully served Coronati with the court papers after Coronati tried to evade service by running from the process server.

45. Judge Kimba M. Wood later entered an order requiring Coronati to comply with the subpoenas by producing documents and appearing for investigative testimony.

46. Coronati ignored Judge Wood's order.

47. On December 5, 2013, the Commission filed an application in the same court for an order holding Coronati in civil contempt.

48. On January 17, 2014, Judge William H. Pauley III issued an order holding Coronati in civil contempt, ordering him to pay certain costs and fines to the Commission, and directing the United States Marshals Service ("Marshals") to arrest Coronati.

49. On January 23, 2014, the Marshals arrested Coronati. Later that day, Judge Pauley ordered Coronati to be released on a $50,000 personal recognizance bond signed by Coronati's brother and brother-in-law.

50. Coronati thereafter invoked his Fifth Amendment privilege against self-incrimination during the investigation.

Violations

51. As a result of the conduct described above, Coronati willfully violated, and Bidtoask violated, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

52. As a result of the conduct described above, Coronati willfully violated Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which prohibit certain fraudulent conduct by an investment adviser.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, 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. Coronati and Bidtoask cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and Coronati cease and desist from committing or causing any violations and any future violations of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

B. Coronati 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 Coronati 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 Coronati, 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. Coronati shall pay disgorgement of $292,646.36, prejudgment interest of $7,353.64 and civil penalties of $100,000 to the Securities and Exchange Commission. Payment shall be made in the following installments: Coronati shall pay $150,000 within 10 days of the entry of this Order, and the remaining $250,000 within 364 days of the entry of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Coronati may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Coronati 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) Coronati 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 Anthony Coronati 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 Adam Grace, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, Room 400, New York, NY 10281.

E. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest and penalties referenced in paragraph IV.D above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Coronati 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 his payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Coronati 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 Securities and Exchange Commission. 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 Coronati 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.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9667 / October 17, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73386 / October 17, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3955 / October 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15766

In the Matter of **CLEAN ENERGY CAPITAL, LLC and SCOTT A. BRITTENHAM,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

On February 25, 2014, the Securities and Exchange Commission ("Commission") instituted proceedings pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), 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 Respondents Clean Energy Capital, LLC ("CEC") and Scott A. Brittenham ("Brittenham") (collectively "Respondents").

II.

Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act ("Order"), as set forth below.

III.

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

Summary

1. This proceeding involved breaches of fiduciary duty and materially misleading statements and omissions by CEC, an investment adviser formerly registered with the Commission, and its founder, president, and main portfolio manager, Scott A. Brittenham ("Brittenham"), with respect to 20 private equity funds sold and managed by CEC, primarily under the name Ethanol Capital Partnership, L.P. (the "ECP Funds").

2. From 2008 to the present, CEC and Brittenham committed a number of violations with respect to the ECP Funds arising from the following negligent actions: First, CEC and Brittenham allocated certain CEC expenses, including the majority of Brittenham's own compensation, to the ECP Funds without adequate disclosure to investors. Second, CEC and Brittenham caused the funds to borrow money from CEC without notice to investors, pledging the ECP Funds' own assets as collateral. Third, beginning in August 2011, CEC changed the calculation of dividend distributions for certain of the Funds, adversely affecting the dividends received by investors in Series A, B and C. Fourth, in 2009, CEC and Brittenham accepted an investment in a new ECP Fund from a prior investor after misrepresenting the amounts of the investments by Brittenham and another co-founder ("Co-Founder") in the new fund. Fifth, CEC violated the custody rule by failing to use a qualified custodian and failing to segregate ECP Fund assets. Sixth, and relatedly, CEC's compliance policy was inadequate to the extent it incorrectly described the custody rule, resulting in the above violation. Seventh, for the ECP Funds offered in late 2008-2010 – Funds R, T and V – CEC omitted Co-Founder's SEC disciplinary history in the offering documents for the funds.

Respondents

3. **CEC** is a limited liability company based in Tucson, Arizona that was organized in Delaware in 2004 under the name Ethanol Capital Management, LLC. On October 26, 2007, CEC registered with the Commission as an investment adviser. In 2009, CEC changed its name to Clean Energy Capital, LLC. In 2012, CEC determined that it was ineligible to register with the Commission because of the size of its assets under management, and as of March, 2014, CEC is no longer registered.

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

4. **Brittenham** is CEC's co-founder, CEO and control person. Brittenham has an 85% ownership interest in CEC and a 50% voting interest, and is also an investor in two ECP Funds managed by CEC. At all relevant times, Brittenham was responsible for the management of CEC's business.

Other Relevant Entities

5. **Ethanol Capital Partners, L.P.,** a Delaware limited partnership, was organized on May 27, 2004. CEC marketed 19 separate private equity funds to investors using this partnership, offering each as separate "series" that were named Ethanol Capital Partners, L.P. Series A, B, C, D, E, G, H, I, J, L, M, N, O, P, Q, R, S, T, and V. CEC also marketed a fund named Tennessee Ethanol Partners, L.P. ("TEP"), which is a Delaware limited partnership that was organized on June 10, 2005. In total, the 20 ECP Funds raised $64 million from hundreds of investors.

Background

6. CEC, which was founded by Brittenham and Co-Founder, is the investment adviser for the private equity funds, ECP Funds. The 20 ECP Funds all have the same investment strategy: investment in private ethanol production plants through various portfolio companies.

7. Investments in the ECP Funds (in the form of limited partnership interests) are primarily governed by two documents created for each of the Funds: private placement memoranda ("PPMs") and limited partnership agreements ("LPAs"). Brittenham had final authority over these offering documents.

CEC and Brittenham Misallocated Certain CEC Expenses to the ECP Funds

8. From at least 2008 to the present, CEC and Brittenham allocated certain CEC overhead expenses, including compensation paid to Brittenham, to the ECP Funds.

9. The ECP Funds are separate legal entities that own interests in private entities; because of the nature of these vehicles, the ECP Funds do not have any officers or employees. They pay CEC a management fee of 1.5% to 3% of Fund assets, and also pay CEC portions of the dividends the Funds received from the portfolio companies and portions of the proceeds from sales of portfolio company stock.

10. All of the expenses incurred by CEC and the ECP Funds were grouped into three broad categories: (i) CEC-only expenses; (ii) ECP Fund-only expenses; and (iii) expenses split between CEC and the ECP Funds. For the third category (the "Split Expenses"), CEC generally allocated 70% of the Split Expenses to all of the ECP Funds identically based on each Fund's net capital contributions, although the actual expense may not have been incurred by a particular Fund, and 30% to CEC (the "Split Ratio"). This 70-30 Split Ratio was used because CEC had

determined that roughly two-thirds of its expenses related to the operation of the ECP Funds. As a result, even though the Split Ratio was applied to each Fund, the ratio was not derived from expenses actually attributable to a particular Fund.

11. Brittenham's compensation accounted for approximately $1.1 million of the Split Expenses from at least 2008 to 2011, including 70% of a $100,000 bonus he received in 2009.

12. For 8 of the Funds, the PPMs and the LPAs did not disclose that these Funds would bear the Split Expenses, and the PPMs stated that CEC would pay its own overhead costs.

13. In addition, CEC's Forms ADV, Part 2 filed on July 20, 2011 and March 30, 2012 did not disclose the sharing of expenses between CEC and the ECP Funds, and did not disclose the Split Expenses. Specifically, item 5 of Part 2A describes the fees charged to manage the Funds as being no greater than 3% annually, and did not mention any sharing of expenses, or that the ECP Funds were paying the majority of Brittenham's compensation through the Split Expenses.

14. CEC also did not expressly disclose the Split Ratio to investors. Further, while the Funds' audited financial statements included a line item for "office overhead," the financial statements did not adequately explain the nature of the Split Expenses. Moreover, Fund investors did not receive audited financial statements until January 2013.

15. By allocating the majority of Brittenham's compensation to the ECP Funds, CEC and Brittenham breached their fiduciary duties to the ECP Funds. The allocation of these expenses to the ECP Funds constituted a conflict of interest that was not expressly disclosed in the Funds' PPMs or LPAs. Also, as 85% owner of CEC, Brittenham took distributions from CEC's profits, and thus also benefitted from the undisclosed misallocation of other CEC expenses to the ECP Funds through the Split Expenses.

16. As a co-founder and controlling owner of CEC, and with ultimate authority over the Fund disclosures, Brittenham knew or should have known that the Split Expenses were not expressly disclosed in the PPMs or LPAs. Brittenham also knew or should have known that the Split Expenses were not reasonable operational expenses of the ECP Funds and were not adequately disclosed to its investors. Because Brittenham is CEC's co-founder and CEO, his negligence is attributable to CEC.

17. Brittenham, as a co-founder and controlling owner of CEC and as a signatory of the Forms ADV, over which he had ultimate authority, and CEC omitted material facts regarding the Split Expenses from the Forms ADV. The misstatements and omissions concerning the Split Expenses in the PPMs and LPAs were material because they impacted investors' investment returns.

CEC and Brittenham Issued Unauthorized Loans to the ECP Funds Collateralized by Securities Owned by the ECP Funds

18. From September 2008 through September 2012, CEC issued loans to 17 ECP Funds. At the time, these Funds had insufficient cash reserves to pay their expenses. The loans were thus needed to continue allocating the Split Expenses to the ECP Funds.

19. CEC set the interest rates on the loans, ranging from 11.86% to 17.38% annually. CEC entered into pledge agreements with these 17 ECP Funds giving CEC a first priority security interest in the respective Funds' assets, consisting of limited liability company interests in privately held portfolio companies. Brittenham executed the promissory notes pertaining to the loans and the pledge agreements on behalf of both CEC and the ECP Funds.

20. CEC had a conflict of interest in issuing the loans and having the ECP Funds pledge their assets as collateral, thereby misusing Fund assets. CEC financially benefitted from the loans and set the interest rate.

21. Each of the 17 ECP Funds had closed to new investors at the time it received the loan from CEC. The LPAs for 14 of the 17 ECP Funds did not permit the Funds to borrow money and issue promissory notes to pay expenses after the Fund had closed. Brittenham unilaterally and without notice to Fund investors amended the LPAs of these 14 ECP Funds to permit loans after the Funds had closed. Even if the LPAs had permitted such unilateral amendments, CEC, as the holder of the notes and security interest, had a conflict of interest and could not consent to the loans and pledges on behalf of the Funds without adequate disclosure to the investors.

22. As a co-founder and controlling owner of CEC, and with ultimate authority over the Fund disclosures, Brittenham knew or should have known that the loans or amendments to the LPAs were not disclosed to the investors. He also acted with negligence by knowingly executing the notes and pledge agreements, and unilaterally and without notice amending the LPAs. Because Brittenham is CEC's co-founder and CEO, his negligence is attributable to CEC.

23. Brittenham's and CEC's failure to disclose any information about the loans, pledges of Fund assets or the unilateral LPA amendments allowing for them was material.

24. Brittenham's and CEC's actions in taking pledges of the 17 ECP Funds' limited liability interests in their portfolio companies constituted principal transactions between CEC and the 17 ECP Funds. Neither CEC nor Brittenham provided written notice to or obtained consent from the 17 ECP Funds prior to each such transaction. CEC's knowledge and execution of the pledge agreements is insufficient to satisfy the notice and consent requirements given CEC's substantial conflict of interest relative to the ECP Funds with respect to the pledges.

CEC and Brittenham Changed CEC's Distribution Calculations Without Adequate Disclosure

25. Beginning as early as 2011, CEC and Brittenham changed in several respects the way CEC calculated distributions, to the detriment of Fund investors and with inadequate disclosure of these material changes to the investors.

26. The LPAs of the ECP Funds provided that the investors would receive distributions when a Fund received a dividend from one of its portfolio companies, or when a Fund sold the stock of its portfolio companies.

27. The LPAs disclosed that if a Fund had "distributable cash" as a result of a dividend, it would distribute that cash in a series of waterfall tiers. While the specific tiers varied among the different ECP Funds, they generally included a specified preferred return to the limited partners, a specified general partner "catch-up", and then a division of any remainder between the limited partners and the general partner according to a disclosed ratio. Section 1.1 of the LPAs defined "Distributable Cash" as the "excess of the sum of all cash receipts of all kinds over cash disbursements (or reserves therefore) for Partnership Expenses."

28. Before August 2011, CEC only calculated the amount available for distribution to a Fund's limited partners after first paying the Fund's operating expenses, while also reserving enough cash for future expenses ("working capital reserve").

29. However, in or around August 2011, CEC began treating the amounts used to replenish ECP Funds' working capital reserves as fulfilling the preferred return to the limited partners, and applied this change retroactively.

30. Also, beginning in at least August 2011, CEC improperly calculated the general partner catch-up. Instead of using the catch-up amount specified for CEC identified in the LPAs, CEC, without disclosure to investors, sometimes used higher catch-up amounts.

31. These changes to the distribution calculations adversely affected the dividends received by investors in Series A, B and C. CEC's and Brittenham's treatment of the distribution calculations and their failure to adequately disclose the treatment were material, as they directly affected investors' investment returns.

32. CEC and Brittenham knew or should have known that they calculated the distributions improperly and failed to disclose the distribution calculations adequately to the limited partners.

Misstatements by CEC and Brittenham Induced Investor A's Investment in Series R

33. During CEC's offering of Series R in September 2009, Investor A, a prospective and past investor in the ECP Funds, inquired about Brittenham's and Co-Founder's investments in the offering.

34. On or about September 21, 2009, Brittenham told Investor A that he and Co-Founder were investing $100,000 each.

35. On or about September 23, 2009, CEC's then-CFO and Chief Compliance Officer forwarded emails he had received from Investor A to Brittenham, which conveyed that (i) Brittenham's and Co-Founder's investments of $100,000 each were important to Investor A's decision to invest and (ii) Investor A believed that each of them was investing $100,000.

36. Based on his belief that both Brittenham and Co-Founder were investing $100,000 each, Investor A invested $250,000 in Series R on or about September 24, 2009. Brittenham and Co-Founder each invested $25,000 in Series R.

37. The amounts of Brittenham's and Co-Founder's investments were material. Investor A expressly stated that the amounts of Brittenham's and Co-Founder's co-investments were important to him.

38. Brittenham knew or should have known that Investor A was mistaken concerning how much he and Co-Founder were investing and that it was important to Investor A's decision to invest, and Brittenham did not take steps to inform Investor A of the true amounts of the co-investments. Because Brittenham is CEC's co-founder and CEO, his negligence is attributed to CEC.

CEC Failed to Use a Qualified Custodian and Did Not Segregate Client Assets

39. Rather than utilize a qualified custodian, CEC kept original stock certificates for securities owned by the ECP Funds in its office. CEC did not send audited financial statements to the limited partners of the ECP Funds until January 2013, at which time it sent audited financial statements for fiscal year 2011. CEC has also never obtained a surprise exam.

40. In addition to the improper custody of the stock certificates, from August 2010 to September 2013, CEC kept the ECP Funds' cash assets in a single "master" bank account. Notwithstanding the existence of a separate subaccount at the bank for each ECP Fund, only one entity, identified as Ethanol Capital Partners, LP, owned all the assets of the subaccounts through the master account. TEP, which is a separately registered limited partnership, shared the same bank account as the other ECP Funds. As a result, the cash assets held by the ECP Funds were commingled.

CEC's Compliance Policies Were Inadequate

41. CEC's compliance policies dated February 2008, October 2009 and March 2010, in describing the private offering exception to the custody rule, Rule 206(4)-2(b) under the Advisers Act, incorrectly substituted the word "or" for the word "and," and therefore incorrectly stated that the adviser need only comply with *one* of the three prongs, rather than *all* three. The

May 2012 policy corrected the description of Rule 206(4)-2(b)(2)(i) to require that all three prongs be satisfied, but inaccurately went on to state that the "securities must fall into one of the above-described exceptions."

42. The description of the exception did not provide that, even if the Funds satisfied the exception in Rule 206(4)-2(b)(2)(i), CEC would still need to comply with the provision in Rule 206(4)-2(b)(2)(ii) relating to the preparation and distribution of audited financial statements. CEC did not so comply.

<u>CEC and Brittenham Negligently Omitted Co-Founder's Prior SEC Violations from the Offering Documents for Three ECP Funds</u>

43. The PPMs for Series R, T and V offerings of the ECP Funds, which were offered and sold to investors from December 2008 through June 2010, did not disclose Co-Founder's previous disciplinary settlement with the Commission. In 2002, the Commission found that Co-Founder violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and caused and willfully aided and abetted violations of Sections 206(1) and (2) of the Advisers Act. The Commission censured Co-Founder and ordered him to cease and desist from committing or causing any violations and/or future violations of the foregoing provisions, and pay a civil penalty of $25,000. This matter had been disclosed in prior PPMs for the other ECP Funds.

44. This omission was material, because during these offerings, Co-Founder was a control person for CEC. He was one of CEC's principals and solicited investors for the ECP Funds.

45. As a co-founder and controlling owner of CEC, and with ultimate authority over the Fund disclosures, Brittenham knew or should have known that Co-Founder's disciplinary history was material and was not disclosed in the PPMs for these three ECP Funds. Because Brittenham is CEC's co-founder and CEO, his negligence is attributed to CEC.

<u>Violations</u>

46. As a result of the conduct described above, CEC and Brittenham willfully violated Section 17(a)(2) of the Securities Act, which makes it unlawful for any person in the offer or sale of securities, directly or indirectly, to "obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading."

47. As a result of the conduct described above, CEC and Brittenham willfully violated Section 206(2) of the Advisers Act, which makes it unlawful for any investment adviser, directly or indirectly, to "engage in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client."

48. As a result of the conduct described above, CEC and Brittenham willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which makes it unlawful for any investment adviser to a pooled investment vehicle to "[m]ake any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle" or "engage in any act, practice, or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle."

49. As a result of the conduct described above, CEC and Brittenham willfully violated Section 206(3) of the Advisers Act, which makes it unlawful for any investment adviser, directly or indirectly, "acting as principal for his own account, knowingly to sell any security to or purchase any security from a client...without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."

50. As a result of the conduct described above, CEC willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2 promulgated thereunder, which prohibit a registered investment adviser from having custody of clients' funds or securities, unless, among other requirements, a "qualified custodian" maintains those funds and securities in a separate account for each client under that client's name or in accounts that contain only the clients' funds and securities under the adviser's name as an agent or trustee for the clients.

51. As a result of the conduct described above, CEC willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 promulgated thereunder, which require investment advisers to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act and its rules.

52. As a result of the conduct described above, CEC and Brittenham willfully violated Section 207 of the Advisers Act, which makes it "unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission . . . or willfully to omit to state in any such application or report any material fact which is required to be stated therein."

Undertakings

Respondents have undertaken to:

1. Retain, not later than 45 days after the date of this Order, at CEC's expense, an independent consultant not unacceptable to the Commission's staff (the "Independent Consultant"). CEC shall require the Independent Consultant to:

   a. conduct a comprehensive review of CEC's current policies, procedures, and systems with respect to accounting and financial statements, disclosure, custody and compliance (collectively the "Policies/Systems");

b. make recommendations for changes or improvements to the Policies/Systems and a procedure for implementing the recommended changes or improvements; and

c. conduct an annual review, for each of the following two years from the date of the issuance of the Independent Consultant's initial report, to assess whether CEC is complying with its revised Policies/Systems and whether the revised Policies/Systems are effective in achieving their stated purposes, and make additional recommendations for changes or improvements to the Policies/Systems, if needed.

2. No later than 10 days following the date of the Independent Consultant's engagement, provide to the Commission staff a copy of an engagement letter detailing the Independent Consultant's responsibilities pursuant to paragraph 1 above. To ensure independence, CEC shall not have the authority to terminate the Independent Consultant without prior written approval of the Commission's staff.

3. Arrange for the Independent Consultant to issue its first report within 90 days after the date of the engagement. For the annual reviews conducted for each of the following two years, arrange for the Independent Consultant to issue each of these reports 365 days following the preceding report. Within 10 days after the issuance of each of the reports, CEC shall require the Independent Consultant to submit to Marshall Sprung, Co-Chief, Asset Management Unit, of the Commission's Los Angeles Regional Office a copy of the Independent Consultant's reports. The Independent Consultant's reports shall describe the review performed and the conclusions reached and shall include any recommendations deemed necessary to make the Policies/Systems adequate and address the deficiencies set forth in Section III of the Order.

4. Within thirty days of receipt of the Independent Consultant's reports, adopt all recommendations contained in the reports and remedy any deficiencies in its written policies, procedures, and systems; provided, however, that as to any recommendation that CEC believes is unnecessary or inappropriate, CEC may, within fifteen days of receipt of the reports, advise the Independent Consultant in writing of any recommendations that it considers to be unnecessary or inappropriate and propose in writing an alternative policy or procedure designed to achieve the same objective or purpose.

5. With respect to any recommendation with which CEC and the Independent Consultant do not agree, attempt in good faith to reach an agreement with the Independent Consultant within thirty days of receipt of the reports. In the event that CEC and the Independent Consultant are unable to agree on an alternative proposal acceptable to the Commission's staff, CEC will abide by the original recommendation of the Independent Consultant.

6. Within thirty days after the date of the Independent Consultant's second annual report, submit an affidavit to the Commission's staff stating that it has implemented any and all

recommendations of the Independent Consultant, or explaining the circumstances under which it has not implemented such recommendations.

7. Cooperate fully with the Independent Consultant and provide the Independent Consultant with access to its files, books, records and personnel as reasonably requested for the Independent Consultant's review.

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

9. Certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondents agree to provide such evidence. The certification and supporting material shall be submitted to Marshall Sprung, Co-Chief, Asset Management Unit, of the Commission's Los Angeles Regional Office, 444 S. Flower Street, Los Angeles, California, 90071, 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, and for the protection of investors to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b) of the Exchange Act, and Sections 203(e), 203(f) and 203(k) of the Advisers Act, it is hereby ORDERED that:

A. Respondent CEC shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Sections 206(2), 206(3), 206(4) and 207 of the Advisers Act and Rules 206(4)-2, 206(4)-7, and 206(4)-8 promulgated thereunder.

B. Respondent Brittenham shall cease and desist from committing or causing any violations and any future violations of Section 17(a)(2) of the Securities Act and Sections 206(2), 206(3), 206(4) and 207 of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

C. Respondents CEC and Brittenham are censured.

D. Respondents shall pay disgorgement and prejudgment interest as follows:

1. Respondents shall pay disgorgement of $1,918,157.00 and prejudgment interest of $102,873.91 (the "Disgorgement Amount").

2. A total of $957,587.73 and prejudgment interest of $51,436.95 of the Disgorgement Amount shall be paid to ECP Funds Series A, B and C or their investors. Such Funds will sell the equity of their portfolio companies and make final distributions to investors. Those distributions shall include reimbursement of all amounts collected in payment of expenses, including amounts attributable to the changes in the calculation of distributions in 2011. To the extent such Funds do not sell the equity of their portfolio companies and make final distributions to investors within forty-five (45) days after the entry of this Order, any unreimbursed portion shall added to and augment the Disgorgement Fund referred to in paragraph IV.D.3 below. Respondents shall provide the Commission staff with evidence of such reimbursement in a form acceptable to the Commission staff.

3. A total of $960,569.27 and prejudgment interest of $51,436.96 of the Disgorgement Amount (the "Disgorgement Fund"), shall be disgorged consistent with the provisions of this Subsection D. Within forty five (45) days of entry of this Order, Respondents shall deposit the full amount of the Disgorgement Fund into an escrow account acceptable to the Commission staff and Respondents shall provide the Commission staff with evidence of such deposit in a form acceptable to the Commission staff. If timely deposit is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

4. Respondents shall be responsible for administering the Disgorgement Fund. Respondents shall pay applicable portions of the Disgorgement Fund to affected ECF Funds, or to investors in those ECP Funds that have been terminated, pursuant to a disbursement calculation (the "Calculation") that has been submitted to, reviewed and approved by the Commission staff in accordance with this Subsection D. If the total amount otherwise payable to a payee is less than $25.00, Respondents shall instead pay such amount to the Commission for transmittal to the United States Treasury as provided in this Subsection D.

5. Respondents shall, within sixty (60) days from the entry of this Order, submit a proposed Calculation to the Commission staff for its review and

approval that identifies, at a minimum: (i) the name of each affected fund or the name of each ECP Fund investor and the ECP Fund in which the investor invested; (ii) the exact amount of the payment to be made to the ECP Fund or ECP Fund investor; and (iii) a description of the transactions ("Relevant Transactions") to which the payment relates. Respondents also shall provide to the Commission staff such additional information and supporting documentation relating to the Relevant Transactions as the Commission staff may request for the purpose of its review. No portion of the Disgorgement Fund shall be paid to any fund or fund investor directly or indirectly in the name of or for the benefit of CEC, Brittenham, or any other person with an ownership interest in CEC; provided, however, that this provision is not intended to affect the allocation and/or distribution of profits and losses of any ECP Fund as required by its limited partnership agreements. In the event of one or more objections by the Commission staff to Respondents' proposed Calculation and/or any of its information or supporting documents, Respondents shall submit a revised Calculation for the review and approval of the Commission staff and/or additional information or supporting document within ten (10) days of the date that Respondents are notified of the objection, which revised Calculation shall be subject to all of the provisions of this Subsection D.

6. Respondents shall complete the transmission of all amounts otherwise payable to affected ECP Funds and ECP Fund investors pursuant to a Calculation approved by the Commission staff within one hundred and twenty (120) days of the entry of this Order, unless such time period is extended as provided in paragraph (9) of this Subsection D.

7. If Respondents do not distribute or return any portion of the Disgorgement Fund for any reason, including an inability to locate an affected ECP Fund or ECP Fund investor or any factors beyond Respondents' control, or if Respondents have not transferred any portion of the Disgorgement Fund to a payee because that payee is due less than $25.00, Respondents shall transfer any such undistributed funds to the Commission for transmittal to the United States Treasury after the final accounting provided for in this Subsection D is approved by the Commission. 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 CEC or Brittenham 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 Marshall Sprung, Division of Enforcement, Securities and Exchange Commission, 444 S. Flower Street, 9th Floor, Los Angeles, California, 90071.

8. Respondents shall be responsible for any and all tax compliance responsibilities associated with the Disgorgement Fund and may retain any professional services necessary. The costs and expenses of any such professional services shall be borne by Respondents and shall not be paid out of the Disgorgement Fund.

9. Within two hundred and ten (210) days after the date of entry of this Order, Respondents shall submit to the Commission staff for its approval a final accounting and certification of the disposition of the Disgorgement Fund, which final accounting and certification shall be in a format to be provided by the Commission staff. The final accounting and certification shall include, but not be limited to: (i) the amount paid to each payee; (ii) the date of each payment; (iii) the check number or other identifier of money transferred; (iv) the date and amount of any returned payment; (v) a description of any effort to locate a prospective payee whose payment was returned or to whom payment was not made for any reason; and (vi) any amounts to be forwarded to the Commission for transfer to the United States Treasury. Respondents shall submit proof and supporting documentation of such payment (whether in the form of cancelled checks, or otherwise) in a form acceptable to the Commission staff and under a cover letter that identifies CEC and Brittenham as the Respondents in these proceedings and the file number of these proceedings to Marshall S. Sprung, Division of Enforcement, Securities and Exchange Commission, 444 S. Flower Street, 9th Floor, Los Angeles, CA 90071. Respondents shall provide any and all supporting documentation for the accounting and certification to the Commission staff upon its request and shall cooperate with any additional requests by the Commission staff in connection with the accounting and certification.

10. After Respondents have submitted the final accounting to the Commission staff, the staff shall submit the final accounting to the Commission for approval and shall request Commission approval to send any remaining amount to the United States Treasury.

11. The Commission staff may extend any of the procedural dates set forth in this Subsection D for good cause shown. Deadlines for dates relating to the Disgorgement Fund 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.

E. Respondents shall, within 45 days of the entry of this Order, pay a civil money penalty in the amount of $225,000 to the Securities and Exchange Commission. This penalty is owed jointly and severally by Respondents CEC and Brittenham. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondents may 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 CEC or Brittenham 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 Marshall Sprung, Division of Enforcement, Securities and Exchange Commission, 444 S. Flower Street, 9th Floor, Los Angeles, California, 90071.

F. Respondents shall comply with the undertakings enumerated in Section III above.

By the Commission.

Brent J. Fields
Secretary

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

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73388; File No. SR-FICC-2014-801)

October 17, 2014

Self-Regulatory Organizations; The Fixed Income Clearing Corporation; Notice of No Objection to Advance Notice Filing, as Amended by Amendment No. 1, Concerning the Government Security Division's Inclusion of GCF Repo® Positions in Its Intraday Participant Clearing Fund Requirement Calculation, and Its Hourly Internal Surveillance Cycles

On January 10, 2014, The Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-FICC-2014-801 ("Advance Notice") pursuant to Section 806(e)(1)(A) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act" or "Title VIII")[1] and Rule 19b-4(n)(1)(i) of the Securities Exchange Act of 1934 ("Act").[2] The Advance Notice was published for comment in the Federal Register on February 10, 2014.[3] On March 10, 2014, the Commission staff sent FICC a letter, pursuant to Section 806(e)(1)(D)[4] and Commission authorization, requesting

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1 12 U.S.C. 5465(e)(1)(A). The Financial Stability Oversight Council designated FICC a systemically important financial market utility on July 18, 2012. *See* Financial Stability Oversight Council 2012 Annual Report, Appendix A, http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf. Therefore, FICC is required to comply with Title VIII of the Payment, Clearing and Settlement Supervision Act.

2 17 CFR 240.19b-4(n)(1)(i).

3 Securities Exchange Act Release No. 71469 (Feb. 4, 2014), 79 FR 7722 (Feb. 10, 2014) (SR-FICC-2014-801).

4 12 U.S.C. 5465(e)(1)(D).

additional information regarding this advance notice.[5] FICC filed an amendment to the Advance Notice on August 11, 2014, which was published for comment in the Federal Register on September, 26, 2014.[6] The Commission received no comments on the Advance Notice. This publication serves as a notice of no objection to the changes proposed in the Advance Notice.

I. **Description of the Advance Notice**

The Advance Notice concerns a proposal by FICC's Government Securities Division ("GSD") to include GCF Repo®[7] positions in its intraday (i.e., noon) participant Clearing Fund requirement calculation ("CFR"), and its hourly internal surveillance cycles. FICC intends for this enhancement to align GSD's risk management calculations and monitoring with the changes that have been implemented to the tri-party infrastructure by the Tri-Party Repo Infrastructure Reform Task Force ("Task Force")[8] specifically, with respect to locking up of GCF Repo® collateral until 3:30 p.m. (ET)

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5 The Commission received a response to this request for additional information August 19, 2014, at which time a 60 day review period for the Advance Notice began pursuant to Section 806(e)(1)(G). 12 U.S.C. 5465(e)(1)(G)

6 Securities Exchange Act Release No. 73187 (September 23), 79 FR 58007 (September 26, 2014) (SR-FICC-2014-801).

7 The GCF Repo® service enables dealers to trade general collateral repos, based on rate, term, and underlying product, throughout the day without requiring intra-day, trade-for-trade settlement on a Deliver-versus-Payment ("DVP") basis. The service fosters a highly liquid market for securities financing.

8 The Task Force was formed in September 2009 under the auspices of the Payments Risk Committee, a private-sector body sponsored by the Federal Reserve Bank of New York. The Task Force's goal is to enhance the repo market's ability to navigate stressed market conditions by implementing changes that help better safeguard the market. FICC has worked in close collaboration with the Task Force on its reform initiatives.

rather than 7:30 a.m. (ET). The Advance Notice also provides FICC the ability to account for an altered intraday risk profile of members as a result of a member's substitution of cash for securities that were used as collateral for a GCF Repo® position the prior day ("Cash Substitution") or a clearing bank unwind of the cash lending side of the transaction for an inter-bank GCF Repo ® transaction at 7:30 a.m. (ET) ("Early Unwind") by implementing an Early Unwind Intraday Charge ("EUIC") where appropriate.

(i) Historical Background

Prior to the changes implemented by the Task Force, the underlying collateral pertaining to the GCF Repo® positions was locked up each afternoon (approximately 4:30 p.m. (ET)) and unwound at the beginning of the next business day (approximately 7:30 a.m. (ET)). Thus, the GCF Repo® positions were included in the end of day ("EOD") CFR calculations but not included in FICC's noon intraday CFR calculations. Because the GCF Repo® positions were not included in FICC's noon intraday CFR calculation, the noon calculation could result in an under-margined condition relative to the same EOD[9] CFR. Thus, FICC imposed a "higher-of" standard on GCF Repo® participants, whereby their noon intraday CFR was the higher of the actual noon intraday CFR calculation or its prior EOD CFR calculation.[10]

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9 As used herein "prior EOD" refers to the end of day cycle immediately preceding the current noon intraday cycle and "same EOD" refers to the cycle immediately subsequent to the current noon intraday cycle.

10 For example, in the extreme case where a participant's portfolio was comprised entirely of GCF Repo® positions, at each EOD margining cycle FICC could calculate a substantial margin requirement which had to be met by 9:30 a.m. (ET)

With the advent of the Task Force's reform, which resulted in moving the unwind from 7:30 a.m. (ET) to 3:30 p.m. (ET), details on the underlying collateral pertaining to GCF Repo® positions are now received from the clearing banks on an hourly basis and can be incorporated into the noon intraday CFR calculation. Substitutions of underlying collateral are now permitted between 8:30 a.m. (ET) and 3:30 p.m. (ET).[11]

(ii) Proposed Change

Because GCF Repo® collateral remains locked-up until 3:30 p.m. (ET), FICC proposed incorporating the underlying collateral pertaining to GCF Repo® positions in its noon intraday participant CFR calculation, and its hourly internal surveillance cycles.[12] This enhancement is intended to align FICC's risk management calculations

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the next morning. But at each intraday margining cycle, FICC would calculate a negligible margin requirement (because GCF Repo® positions were not included at intraday). This would allow the participant to withdraw substantially all its margin collateral before the same EOD. In this case, if the participant defaulted overnight, FICC would hold almost no margin collateral from the participant while having the exposure of liquidating losses on a substantial GCF Repo® portfolio. To prevent this potential under-margin condition, FICC imposed the "higher of" standard.

11 A key aspect of the GCF Repo® service is to give the repo side (cash borrower) the ability to retrieve its securities during the business day and deliver those securities to meet a delivery obligation. As a result, GCF Repo® was unwound in the morning. With the Tri-Party Reform's change in the unwind from 7:30 a.m. (ET) to 3:30 p.m. (ET), participants now have access to their securities during the day via collateral substitutions.

12 In the ordinary course of business, the "higher of" standard will not apply. However, this standard will remain available in the event that one or both clearing banks do not provide intraday underlying collateral pertaining to the GCF Repo® position data because such clearing bank, as applicable, is unable to provide the data.

and monitoring with the changes that have been implemented to the tri-party infrastructure by the Task Force.

In certain instances, Cash Substitutions, for repo and reverse repo positions and the Early Unwind of interbank allocations for reverse repo positions, could result in higher cash balances in the underlying collateral pertaining to GCF Repo® positions at noon intraday than the same EOD, and could present a potential under-margin condition because cash collateral is not margined but the cash likely will be replaced by securities in the next GCF Repo® allocation of collateral. The under-margin condition will exist overnight because the VaR on the GCF Repo® collateral in the same EOD cycle will not be calculated until after Fedwire is closed, thus precluding members from satisfying margin deficits until the morning of the next business day.

As a result, FICC amended its proposal[13] to include the EUIC to account for the altered intraday risk profile created by Cash Substitutions and Early Unwinds.[14] In order to determine whether an EUIC should be applied, FICC will take the following steps:

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13 See Securities Exchange Act Release No. 73187 (September 23), 79 FR 58007 (September 26, 2014) (SR-FICC-2014-801).

14 If a member is assessed an EUIC that is deemed unnecessary, FICC management will have the discretion to waive such charge.

1. At noon, FICC will compare the prior EOD VaR component of the CFR calculation with the current day's noon intraday VaR component of the CFR calculation.

2. If the current day's noon intraday VaR calculation is equal to or higher than the prior EOD's VaR calculation then GSD will not apply an EUIC. If however, the current day's noon calculation is lower, then FICC will proceed to the step 3 below.

3. FICC will review the GCF Repo® participant's DVP and GCF Repo® portfolio to determine whether the reduction in the noon calculation may be attributable to the GCF Repo® participant's intraday cash substitutions or early unwind of interbank allocations. If so, then FICC will apply the EUIC.

4. At the participant level, the EUIC[15] will be the lesser of (i) the net VaR decrease that may be deemed to be attributable to either Cash Substitutions and/or Early Unwinds of interbank allocations or (ii) the prior EOD VaR minus the noon intraday VaR.[16]

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15 The EUIC will be included in the noon intraday participant CFR, but not the same EOD CFR. This is because the risk associated with cash lockups exists at intraday, that is, at any time before at EOD. At EOD in the normal course of business, GCF Repo® positions consist of 100% eligible non-cash securities. GCF Repo® is used for overnight financing of securities inventory. Absent extraordinary circumstances, participants do not use cash to collateralized overnight cash loans. Cash Substitutions occur at intraday as participants substitute in cash to withdraw securities they need for intraday deliveries.

16 In the event that cash substitutions or early unwind of interbank allocations impacts the CFR, the prior end of day CFR is used as a proxy for the same end of day CFR for the portion of the portfolio that is impacted by such cash substitutions or early unwind of interbank allocations. The EUIC is designed to

The EUIC for Cash Substitutions will apply to both the repo side (cash borrower) and the reverse repo side (cash lender) of the transaction and the EUIC for the Early Unwinds of interbank allocations will apply to the reverse repo side only. The EUIC applies to the reverse repo side because although that side does not initiate the Cash Substitution or the Early Unwind of interbank allocations, these events change the reverse repo participants' risk profile and as a result, their noon intraday CFR could be unduly reduced. The EUIC for the Early Unwind of interbank allocations will only apply to the reverse repo side (cash lender) since it is only the reverse side whose lockup is unwound early. The securities subject to the Early unwind are not returned to the repo side (cash borrower) in connection with the early unwind of interbank allocations. The Early Unwind of interbank allocations is performed on the reverse repo side to ensure that the underlying collateral is available to the repo side at its settlement bank. Cash is returned to the reverse repo side and thus unwound early. There is no automatic unwind (return of securities) to the repo side. If the repo side needs its securities before the 3:30 p.m. (ET) scheduled unwind, it may perform a securities-for-securities substitution or a cash-for-securities substitution (in which case it may be subject to the EUIC).

II. Discussion and Commission Findings

Although the Payment, Clearing and Settlement Supervision Act does not specify a standard of review for an advance notice, the Commission believes its stated purpose is

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prevent the impact of cash substitutions and early unwind of interbank allocations from unduly reducing noon intraday CFR relative to the prior EOD CFR calculation, thus the EUIC will not increase the noon intraday CFR above the prior EOD CFR calculation. (But the noon intraday CFR calculation exclusive of EUIC could be higher than the prior EOD CFR calculation).

instructive.[17] The stated purpose 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 ("FMU") and strengthening the liquidity of systemically important FMUs.[18]

Section 805(a)(2) of the Payment, Clearing, and Settlement Supervision Act[19] 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 Payment, Clearing, and Settlement Supervision Act[20] 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 has adopted risk management standards under Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act[21] ("Clearing Agency

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17 See 12 U.S.C. 5461(b).

18 Id.

19 12 U.S.C. 5464(a)(2).

20 12 U.S.C. 5464(b).

21 12 U.S.C. 5464(a)(2).

Standards").[22] The Clearing Agency Standards became effective on January 2, 2013 and require registered 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.[23] As such, it is appropriate for the Commission to review advance notices against these Clearing Agency Standards and the objectives and principles of these risk management standards as described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act.[24]

Because it was based on the previous pre-reform unwinding process described above, FICC's intraday risk calculation does not currently capture the GCF Repo® positions on an intraday basis. The change to incorporate the underlying collateral pertaining to the GCF Repo® positions in its noon intraday participant CFR calculation, and its hourly internal surveillance cycles, should improve FICC's risk management by providing a more accurate and timely view of member positions and their corresponding

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22 Rule 17Ad-22, 17 CFR 240.17Ad-22. Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11).

23 The Clearing Agency Standards are substantially similar to the risk management standards established by the Board of Governors of the Federal Reserve System ("Federal Reserve") governing the operations of designated DFMUs 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 (August 2, 2012).

24 12 U.S.C. 5464(b).

exposures and may help ensure that FICC collects sufficient clearing fund deposits to safeguard itself in the event of a member default. Further, incorporating GCF Repo® positions into intraday participant CFR calculations and hourly surveillance cycles may better reflect the actual risk in its members' portfolios. Moreover, the inclusion of the EUIC may allow FICC to use more accurate position information in its margin calculations and mitigate the effects of Cash Substitutions and Early Unwinds that occur during the intraday period.

The Commission believes that including GCF Repo® positions in FICC's intraday participant clearing fund calculations and hourly internal surveillance meets the objectives and principles for the risk management standards prescribed under Section 805(a). The inclusion of GCF® Repo positions may provide FICC with a more accurate view of members' intraday exposures and more accurate risk profiles. Additionally, the EUIC allows FICC to account for risks posed by intraday VaR fluctuations that are caused by Cash Substitutions and Early Unwinds and may allow FICC to better manage intraday risk. Thus, the proposal promotes robust risk management and safety and soundness of FICC's risk management systems, reduces systemic risk, and supports the stability of the broader financial system.[25]

The proposed change is also consistent with Rule 17Ad-22[26] of the Clearing Agency Standards which establishes the minimum requirements regarding how registered clearing agencies must maintain effective risk management procedures and controls.

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25 12 U.S.C. 5464(b).

26 17 CFR 240.17Ad-22.

Specifically, Rule 17Ad-22(b)(1) requires a clearing agency that performs CCP services to establish, implement, maintain and enforce written policies reasonably designed to measure its credit exposures at least daily and to limit exposures to potential losses from defaults by participants under normal market conditions so that the operations of the clearing agency should not be disrupt and non-defaulting participants would not be exposed to losses that they cannot anticipate or control.[27] Rule 17Ad-22(b)(2) requires FICC to establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set margin requirements.[28] To these ends, the change may provide FICC with a more accurate measurement of daily credit exposure using a risk-based model and is designed to address exposures that may occur from intraday activity. In sum, FICC's more accurate and timely calculations around and monitoring of GCF Repo® activity may better enable FICC to respond in the event that a member defaults.

27 17 CFR 240.17Ad-22(b)(1).

28 17 CFR 240.17Ad-22(b)(2).

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Payment, Clearing and Settlement Supervision Act,[29] that the Commission DOES NOT OBJECT to advance notice proposal (SR-FICC2014-801) and that FICC is AUTHORIZED to implement the proposal as of the date of this notice or the date of an order by the Commission approving a proposed rule change that reflects rule changes that are consistent with this advance notice proposal (SR-FICC-2014-01), whichever is later.

By the Commission.

Kevin M. O'Neill

Kevin O'Neill
Deputy Secretary

29 12 U.S.C. 5465(e)(1)(I).

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 232

[Release Nos. 33-9668; 34-73390; 39-2498; IC-31294]

Adoption of Updated EDGAR Filer Manual

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the Commission) is adopting revisions to the Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) Filer Manual and related rules to reflect updates to the EDGAR system. The updates are being made primarily to support the revision of the disclosure, reporting and offering process for asset-backed securities (ABS) to enhance transparency and better protect investors in the securitization market; system upgrade to be compatible with Internet Explorer (IE) version 8.0; revision of the N-SAR system requirements. The EDGAR system is scheduled to be upgraded to support this functionality on October 20, 2014.

EFFECTIVE DATE: [Insert date of publication in the Federal Register.] The incorporation by reference of the EDGAR Filer Manual is approved by the Director of the Federal Register as of [Insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: In the Division of Corporation Finance, for questions concerning the revisions for asset-backed securities contact Heather Mackintosh at (202) 551-3600; and in the Office of Information Technology, contact Tammy Borkowski at (202) 551-7208.

SUPPLEMENTARY INFORMATION: We are adopting an updated EDGAR Filer Manual, Volume I, Volume II, and Volume III. The Filer Manual describes the technical formatting requirements for the preparation and submission of electronic filings through the EDGAR system.[1] It also describes the requirements for filing using EDGARLink Online and the Online Forms/XML website.

The revisions to the Filer Manual reflect changes within Volume I entitled EDGAR Filer Manual, Volume I: "General Information," Version 18 (October 2014), Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 28 (October 2014), and Volume III entitled EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 4 (October 2014). The updated manual will be incorporated by reference into the Code of Federal Regulations.

The Filer Manual contains all the technical specifications for filers to submit filings using the EDGAR system. Filers must comply with the applicable provisions of the Filer Manual in order to assure the timely acceptance and processing of filings made in electronic format.[2] Filers may consult the Filer Manual in conjunction with our rules governing mandated electronic filing when preparing documents for electronic submission.[3]

The EDGAR system will be upgraded to Release 14.2 on October 20, 2014 and will introduce the following changes.

EDGAR will be updated to add new submission form types SF-1, SF-1/A, SF-3, SF-3/A, SF-3MEF, 424H, 424H/A, ABS-EE, and ABS-EE/A to the EDGAR Filing Website. These submission form types can be accessed by selecting the 'EDGARLink Online Form Submission' link on the EDGAR Filing Website. Additionally, filers may construct XML submissions for these

[1] We originally adopted the Filer Manual on April 1, 1993, with an effective date of April 26, 1993. Release No. 33-6986 (April 1, 1993) [58 FR 18638]. We implemented the most recent update to the Filer Manual on June 20, 2014. See Release No. 33-9600 (June 20, 2014) [79 FR 35280].

[2] See Rule 301 of Regulation S-T (17 CFR 232.301).

[3] See Release No. 33-9600 in which we implemented EDGAR Release 14.1. For additional history of Filer Manual rules, please see the cites therein.

submission form types by following the "EDGARLink Online XML Technical Specification" document.

New exhibits EX-102 (Asset Data File) and EX-103 (Asset Related Document) will be available on EDGARLink Online for submission form types ABS-EE and ABS-EE/A. Filers must construct an XML Asset-Backed Security (ABS) Asset Data File by following the new "EDGAR ABS XML Technical Specification" document. Each element listed in the Element/Attribute Name column in section 3.4 (Mapping of ABS Schemas to Asset Data Types) of the "EDGAR ABS XML Technical Specification" document corresponds to an Item number of Schedule AL - Asset-Level Information (17 CFR 229.1125). Schedule AL contains the complete title and description of each of the disclosure requirements and filers should refer to Schedule AL for a full description of the information that must be provided in any ABS Asset Data File.

Form 8-K Item 6.06 (Static Pool) will be available on EDGARLink Online for submission form types 8-K, 8-K/A, 8-K12B, 8-K12B/A, 8-K12G3, 8-K12G3/A, 8-K15D5, and 8-K15D5/A.

Exhibit EX-106 (Static Pool) will be available on EDGARLink Online and can be included with the following submission form types: S-1, S-1/A, S-1MEF, S-3, S-3/A, S-3ASR, S-3D, S-3DPOS, S-3MEF, SF-1, SF-1/A, SF-3, SF-3/A, and SF-3MEF. In addition, Exhibit EX-106 can also be included with the following submission form types if Item 6.06 is selected: 8-K, 8-K/A, 8-K12B, 8-K12B/A, 8-K12G3, 8-K12G3/A, 8-K15D5, and 8-K15D5/A.

The Login and Frequently Asked Questions (FAQ) screens for all EDGAR websites, the EDGAR Portal, and the EDGAR Company Database will be updated to specify Internet Explorer 8.0 as the recommended browser and Firefox 24.x as an additionally compatible browser.

EDGAR Filer Manual Volume I (General Information) and EDGAR Filer Manual Volume II (EDGAR Filing) will be updated to remove all references to leased line filings, as EDGAR no longer supports the leased line filing method.

Along with the adoption of the Filer Manual, we are amending Rule 301 of Regulation S-T to provide for the incorporation by reference into the Code of Federal Regulations of today's revisions. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51.

The updated EDGAR Filer Manual will be available for Web site viewing and printing; the address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. You may also obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

Since the Filer Manual and the corresponding rule changes relate solely to agency procedures or practice, publication for notice and comment is not required under the Administrative Procedure Act (APA).[4] It follows that the requirements of the Regulatory Flexibility Act[5] do not apply.

The effective date for the updated Filer Manual and the rule amendments is [Insert date of publication in the Federal Register]. In accordance with the APA,[6] we find that there is good cause to establish an effective date less than 30 days after publication of these rules. The EDGAR system upgrade to Release 14.2 is scheduled to become available on October 20, 2014. The Commission believes that establishing an effective date less than 30 days after publication of these

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4 5 U.S.C. 553(b).

5 5 U.S.C. 601 - 612.

6 5 U.S.C. 553(d)(3).

rules is necessary to coordinate the effectiveness of the updated Filer Manual with the system upgrade.

Statutory Basis

We are adopting the amendments to Regulation S-T under Sections 6, 7, 8, 10, and 19(a) of the Securities Act of 1933,[7] Sections 3, 12, 13, 14, 15, 23, and 35A of the Securities Exchange Act of 1934,[8] Section 319 of the Trust Indenture Act of 1939,[9] and Sections 8, 30, 31, and 38 of the Investment Company Act of 1940.[10]

List of Subjects in 17 CFR Part 232

Incorporation by reference, Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENT

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

PART 232 - REGULATION S-T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

1. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z–3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a–6(c), 80a–8, 80a–29, 80a–30, 80a–37, and 7201 et seq.; and 18 U.S.C. 1350.

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2. Section 232.301 is revised to read as follows:

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[7] 15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a).

[8] 15 U.S.C. 78c, 78l, 78m, 78n, 78o, 78w, and 78ll.

[9] 15 U.S.C. 77sss.

[10] 15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37.

§232.301 **EDGAR Filer Manual.**

Filers must prepare electronic filings in the manner prescribed by the EDGAR Filer Manual, promulgated by the Commission, which sets out the technical formatting requirements for electronic submissions.

The requirements for becoming an EDGAR Filer and updating company data are set forth in the updated EDGAR Filer Manual, Volume I: "General Information," Version 18 (October 2014). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 28 (October 2014). Additional provisions applicable to Form N-SAR filers are set forth in the EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 4 (October 2014).

All of these provisions have been incorporated by reference into the Code of Federal Regulations, which action was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. You must comply with these requirements in order for documents to be timely received and accepted.

The EDGAR Filer Manual is available for Web site viewing and printing; the address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. You can obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

You can also inspect the document at the National Archives and Records Administration (NARA). For information on the availability of this material at NARA, call 202–741–6030, or go to:

http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

October 20, 2014

Commissioner Gallagher
Not participating
Commissioner Piwowar
Disapproved

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 31300; 812-14116]

Precidian ETFs Trust, et al.; Notice of Application

October 21, 2014

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

Action: Notice of an application for exemptive relief.

Summary of Application: Applicants request an order under section 6(c) of the Investment Company Act of 1940 ("Act") for an exemption from sections 2(a)(32), 5(a)(1), 22(d) and 22(e) of the Act and rule 22c-1 under the Act, under sections 6(c) and 17(b) of the Act for an exemption from sections 17(a)(1) and 17(a)(2) of the Act, and under section 12(d)(1)(J) of the Act for an exemption from sections 12(d)(1)(A) and (B) of the Act. If granted, the requested order would permit several registered open-end investment companies that are actively managed exchange traded funds (each, an "ETF") to list and trade without being subject to the current daily portfolio transparency condition in actively managed ETF orders.

Applicants: Precidian ETFs Trust (the "Trust"), Precidian Funds LLC (the "Adviser") and Foreside Fund Services, LLC (the "Distributor") (together, the "Applicants").

Filing Dates: The application was filed on January 25, 2013, and amended on February 12, 2013 and July 23, 2013.

Hearing or Notification of 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 November 17, 2014, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Pursuant to rule 0-5 under the Act, hearing requests should state the nature of the writer's interest, any facts bearing upon the desirability of a hearing on the matter, 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. Absent a request for a hearing that is granted by the Commission, the Commission intends to issue an order under the Act denying the application.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants: c/o Precidian Funds LLC, 350 Main Street, Suite 9, Bedminster, New Jersey 07921-2689.

For Further Information Contact: Deepak T. Pai, Senior Counsel; Kay-Mario Vobis, Senior Counsel; or Dalia Osman Blass, Assistant Chief Counsel, at (202) 551-6821 (Division of Investment Management, Chief Counsel's Office).

Supplementary Information: The following is 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.

I. Introduction

1. Applicants seek to introduce a novel type of actively managed exchange-traded fund ("ETF") that would not be required to disclose its portfolio holdings on a daily basis. Due to their characteristics, ETFs (including those proposed by Applicants) are only permitted to operate subject to Commission orders that provide exemptive relief from certain provisions of

the Act and rules thereunder.[1] Accordingly, Applicants seek an order under section 6(c) of the Act for an exemption from sections 2(a)(32), 5(a)(1), 22(d) and 22(e) of the Act and rule 22c-1 thereunder; and under sections 6(c) and 17(b) of the Act granting an exemption from sections 17(a)(1) and 17(a)(2) of the Act, and under section 12(d)(1)(J) for an exemption from sections 12(d)(1)(A) and (B) of the Act.

2. As discussed below, the Commission preliminarily believes that Applicants' proposed ETFs do not meet the standard for exemptive relief under section 6(c) of the Act. Section 6(c) allows the Commission to exempt any person, security, or transaction, or any class thereof, only "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the Act]."[2] Accordingly, the Commission preliminarily intends to deny the application.[3]

II. Background

A. Open-End Investment Companies and Net Asset Value

3. The Act defines an investment company as an "issuer" of "any security" which "is or holds itself out as being engaged primarily … in the business of investing … in

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1 The Commission first granted exemptive relief to operate ETFs in the early 1990s when the first index-based ETFs were developed. *See* SPDR Trust Series I, Investment Company Act Release Nos. 18959 (Sept. 17, 1992) (notice) and 19055 (Oct. 26, 1992) (order).

2 15 U.S.C. 80a-6(c).

3 For this reason, the Commission finds it unnecessary to consider whether the application meets the section 17(b) and section 12(d)(1)(J) standards for exemptive relief.

securities."[4] Shares in an investment company represent proportionate interests in its investment portfolio, and their value fluctuates in relation to the changes in the value of that portfolio.

4. The most common form of investment company, the "open-end" investment company or mutual fund, is required by law to redeem its securities on demand at a price approximating their proportionate share of the fund's net asset value ("NAV") at the time of redemption.[5] These funds also continuously issue and sell new shares, thereby replenishing their investment capital.

5. Because open-end investment companies are required by law to redeem their shares based on investors' demands, shares of the funds have historically not traded on exchanges or in other secondary markets.[6]

B. <u>Exemptions under the Act for Actively Managed ETFs</u>

6. ETFs, including those proposed by Applicants, are a type of open-end fund. But unlike traditional open-end funds, ETFs are made available to investors primarily through secondary market transactions on exchanges.

7. In order for this to take place, ETFs require various exemptions from the provisions of the Act and the rules thereunder. Critically, in granting such exemptions to date,

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4 15 U.S.C. 80a-3(a); 80a-3(a)(1).

5 Section 22(d) of the Act prohibits a dealer from selling a redeemable security that is being offered to the public by or through an underwriter other than at a current public offering price described in the fund's prospectus. Rule 22c-1 under the Act requires open-end funds, their principal underwriters, and dealers in fund shares (and certain others) to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to buy or redeem. Together, these provisions are designed to require that fund shareholders be treated equitably when buying and selling their fund shares.

6 This stems from section 22(d) of the Act, which in effect fixes the prices at which redeemable securities, including open-end shares, are sold. The result is a system that precludes dealers from making a secondary market in open-end shares.

the Commission has required that a mechanism exist to ensure that ETF shares would trade at a price that is at or close to the NAV per share of the ETF.[7]

8. Such a mechanism is essential for ETFs to operate because ETFs do not sell or redeem their individual shares at NAV per share as required by the Act. Instead, large broker-dealers that have contractual arrangements with an ETF (each, an "Authorized Participant") purchase and redeem ETF shares directly from the ETF, but only in large blocks called "creation units." An Authorized Participant that purchases a creation unit of ETF shares first deposits with the ETF a "basket" of securities and other assets (*e.g.,* cash) identified by the ETF that day, and then receives the creation unit of ETF shares in return for those assets. The basket is generally representative of the ETF's portfolio and is equal in value to the aggregate NAV of ETF shares in the creation unit. After purchasing a creation unit, the Authorized Participant may sell the component ETF shares in secondary market transactions. Investors then purchase individual shares in the secondary market. The redemption process is the reverse of the purchase process: the Authorized Participant acquires a creation unit of ETF shares and redeems it for a basket of securities and other assets.

9. The combination of the creation and redemption process with the secondary market trading in ETF shares provides arbitrage opportunities that, if effective, keep the market price of the ETF's shares at or close to the NAV per share of the ETF.[8] For example, if an ETF's shares begin trading on national securities exchanges at a "discount" (a price below the NAV per

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7 This has been a required representation in all ETF orders since the Commission issued the first order. *See supra* note 1.

8 *See* Investment Company Institute, *2014 Investment Company Fact Book* (2014) ("ICI Fact Book"), at 60.

share of the ETF), an Authorized Participant can purchase ETF shares in secondary market transactions and, after accumulating enough shares to comprise a creation unit, redeem them from the ETF in exchange for the more valuable securities in the ETF's redemption basket. In addition to purchasing ETF shares, Authorized Participants also are likely to hedge their intraday risk. Thus, for example, when ETF shares are trading at a discount to the NAV per share of the ETF, an Authorized Participant may also simultaneously short the securities in the redemption basket. At the end of the day, the Authorized Participant will return the creation unit of ETF shares to the ETF in exchange for the ETF's redemption basket of securities and other assets, which it will then use to cover its short positions. Those purchases reduce the supply of ETF shares in the market, and thus tend to drive up the market price of the shares to a level closer to the NAV per share of the ETF.[9]

10. Conversely, if the market price for ETF shares reflects a "premium" (a price above the NAV per share of the ETF), an Authorized Participant can deposit a basket of securities in exchange for the more valuable creation unit of ETF shares, and then sell the individual shares in the market to realize its profit. An Authorized Participant may also hedge its intraday risk when ETF shares are trading at a premium. Thus, for example, when the shares of an ETF are trading at a premium, an Authorized Participant may buy the securities in the purchase basket in the secondary market and sell short the ETF shares. At the end of the day, the Authorized Participant will deposit the purchase basket of securities and other assets in exchange for a creation unit of ETF shares, which it will then use to cover its short positions. The

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[9] The Authorized Participant's purchase of the ETF shares in the secondary market, combined with the sale of the redemption basket securities, may also create upward pressure on the price of ETF shares and/or downward pressure on the price of redemption basket securities, driving the market price of ETF shares and the value of the ETF's portfolio holdings closer together.

Authorized Participant will receive a profit from having paid less for the ETF shares than it received for the securities in the purchase basket. These transactions would increase the supply of ETF shares in the secondary market, and thus tend to drive down the price of ETF shares to a level closer to the NAV per share of the ETF.[10]

11. Market participants can also engage in arbitrage activity without using the creation or redemption processes described above. For example, if a market participant believes that an ETF is overvalued relative to its underlying or reference assets, the market participant may sell short ETF shares and buy the underlying or reference assets, wait for the trading prices to move toward parity, and then close out the positions in both the ETF shares and the underlying or reference assets to realize a profit from the relative movement of their trading prices. Similarly, a market participant could buy ETF shares and sell the underlying or reference assets in an attempt to profit when an ETF's shares are trading at a discount to the ETF's underlying or reference assets. As discussed above, the trading of an ETF's shares and the ETF's underlying or reference assets may bring the prices of the ETF's shares and its portfolio assets closer together through market pressure.

12. In assessing whether to grant exemptive relief to actively managed ETFs in the past, the Commission has required a mechanism that would keep the market prices of ETF shares at or close to the NAV per share of the ETF. To date, this mechanism has been dependent on

[10] The Authorized Participant's purchase of the purchase basket securities, combined with the sale of ETF shares, may also create downward pressure on the price of ETF shares and/or upward pressure on the price of purchase basket securities, bringing the market price of ETF shares and the value of the ETF's portfolio holdings closer together.

daily portfolio transparency.[11] This transparency provides market makers and other market participants with an important tool to value the ETF portfolio on an intraday basis, which, in turn, enables them to assess whether an arbitrage opportunity exists. It is the exercise of such arbitrage opportunities that keeps the market price of ETF shares at or close to the NAV per share of the ETF. This close tie between market price and NAV per share of the ETF is the foundation for why the prices at which retail investors buy and sell ETF shares are similar to the prices at which Authorized Participants are able to buy and redeem shares directly from the ETF at NAV. In granting relief from section 22(d) of the Act and rule 22c-1 under the Act, the Commission relies on this close tie between what retail investors pay and what Authorized Participants pay to make the finding that the ETF's shareholders are being treated equitably when buying and selling shares.[12] The Commission therefore has granted such exemptive relief to date only to those actively managed ETFs that have provided daily transparency of their portfolio holdings.

III. The Application

A. The Applicants

13. The Trust is a statutory trust organized under the laws of Delaware and registered under the Act as an open-end management investment company with multiple series (each, a "proposed ETF"). Applicants propose to offer 15 initial proposed ETFs, each of which will use a

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11 The condition for daily portfolio transparency has consistently been one of the conditions to the exemptive relief issued to actively managed ETFs by the Commission. *See* PowerShares Capital Management LLC, et al., Investment Company Act Release Nos. 28140 (Feb. 1, 2008) (notice) and 28171 (Feb. 27, 2008) (order).

12 *See supra* note 5 and accompanying text.

variety of active management strategies to meet its investment objectives. The proposed ETFs include long/short funds.

14. The Adviser, a limited liability corporation organized under the laws of Delaware, is registered as an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act") and would serve as the investment adviser to the initial proposed ETFs. The Distributor, a Delaware limited liability company, is a registered broker under the Securities Exchange Act of 1934, as amended.

B. Applicants' Proposal

15. Applicants seek exemptive relief under section 6(c) of the Act to allow them to introduce several actively managed ETFs that would not disclose their portfolio holdings on a daily basis. Applicants note that actively managed ETFs with transparent portfolios are susceptible to "front running" and "free riding" by other investors and/or managers which can harm, and result in substantial costs to, the actively managed ETFs.[13]

16. As explained below, the Applicants propose to operate actively managed ETFs that would not disclose their portfolio holdings on a daily basis. Applicants state that the relief requested in their application is similar to the relief granted in exemptive orders issued to existing actively managed ETFs, except for certain differences permitting the proposed ETFs to operate on a non-transparent basis. These material differences are highlighted below:

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13 Application at 20. *See also* Murray Coleman, *Could a Stock ETF Cloak its Portfolio* (May 7, 2012), *available at* http://online.wsj.com/news/articles/SB10001424052702304432704577348261039833588 (noting that if traders can identify the shares in which a fund manager is building a position, they can start buying the shares ahead of the manager and drive up the price while the manager is still buying the stock).

a. Prospectus and Portfolio Disclosures: Applicants would *not* provide the daily disclosure of a proposed ETF's portfolio holdings that is a condition in all exemptive orders issued to existing actively managed ETFs. Applicants would instead only provide the standard portfolio and other disclosures required for traditional mutual funds. Traditional mutual funds are required to disclose their portfolio holdings only on a quarterly basis, with a lag of not more than 60 days.[14]

b. Indicative Intraday Value: Investors and others acquiring the proposed ETFs' shares would primarily have to rely on the intraday indicative value (the "IIV"), which would be disseminated by an exchange every 15 seconds during the trading day,[15] to assess the value of a proposed ETF due to the lack of portfolio transparency. The IIV would be calculated by a calculation agent who would receive the daily list of securities constituting the proposed ETF's portfolio from the ETF sponsor.[16] As acknowledged by the Applicants, the IIV is based on the value of the proposed ETF's portfolio and is calculated by the calculation agent using the last available market quotation or sale price of the proposed ETF's portfolio holdings.[17] As further acknowledged by the Applicants, the IIV is not the NAV; rather, it is a reference

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14 Shareholder reports, including a schedule of portfolio holdings, must be transmitted to shareholders semi-annually, within 60 days of the end of the second and fourth fiscal quarters. *See* Rule 30e-1. A complete schedule of portfolio holdings must be filed with the Commission on Form N-CSR within 10 days of the transmission of the shareholder report. *See* Rule 30d-1. Complete portfolio holdings also must be filed on Form N-Q within 60 days of the end of the first and third fiscal quarters. *See* Rule 30b1-5.

15 We note that the IIV is not disseminated during early and late trading sessions when market participants would still be trading the proposed ETFs' shares. Therefore, there would be no pricing signal at all for these trades.

16 *See infra* note 34.

17 Application at 15. *See also* Matt Hougan, *The Flaws in iNAV*, 104 EXCHANGE-TRADED FUNDS REPORT ("Hougan ETF Report"), 5, 10 (2009).

produced by a third party seeking to approximate the proposed ETF's underlying per share net asset value.[18] Applicants also concede that the IIV is not intended as a "real-time NAV" and (unlike the NAV) would not include extraordinary expenses or liabilities booked during the day.[19] As discussed below, an ETF's portfolio could contain securities and other assets all (or most) of which need to be fair valued in order for the IIV to be accurate.[20]

c. Blind Trust Mechanism: Applicants propose for creation unit purchases to be made in cash and for redemptions to be effected in-kind through a "blind trust" established for each Authorized Participant. Applicants assert that the delivery of redemption securities into the blind trust would allow the ETF to retain the benefits associated with in-kind redemptions,[21] while shielding the identity of the ETF's portfolio securities. Based on the standing instructions of the Authorized Participant, the blind trust would sell or otherwise manage the securities on behalf of the Authorized Participant without disclosing the contents of the underlying portfolio.

d. Back-up Redemption Option: Applicants have proposed a back-up mechanism that would allow retail investors to redeem individual shares directly from the proposed ETFs in the event of a significant deviation of closing market price from NAV. Under

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18 Application at 15.

19 *Id.*

20 *See infra* notes 37-42 and accompanying text.

21 Because redemptions from ETFs are often made in-kind, ETFs may offer certain tax efficiencies compared to traditional mutual funds by avoiding the need to sell assets and potentially experience a taxable event. In addition, ETFs do not bear the brokerage costs associated with liquidating portfolio instruments to meet redemption requests. We note that it is unclear whether Applicants' proposed ETFs would experience the same in-kind benefits experienced by existing ETFs. The blind trust structure is likely to introduce additional costs because, among other things, the Authorized Participants would not be able to manage the sale of the securities to enhance arbitrage profits. *See* Comment Letter of Gary Gastineau, File No. SR-NYSEArca-2014-10 (Mar. 18, 2014) ("Gastineau March 2014 Letter"), at 3-5 for a discussion of the potential issues presented by this structure.

the proposal, retail investors exercising the option would be subject to a redemption fee of up to 2% of the value of shares redeemed and would likely be charged additional brokerage commissions.

IV. Analysis of the Application

17. As noted above, the Applicants have sought exemptive relief under several provisions of the Act—each of which the Applicants would need to obtain in order to operate their proposed ETFs.

18. Applicants state that the relief requested in their application is similar to the relief granted in exemptive orders issued to existing actively managed ETFs, except for certain differences permitting the proposed ETFs to operate on a non-transparent basis.

19. As discussed below, however, the Commission preliminarily believes that the specific features proposed by the Applicants that would cause the proposed ETFs to operate without transparency fall far short of providing a suitable alternative to the arbitrage activity in ETF shares that is crucial to helping keep the market price of current ETF shares at or close to the NAV per share of the ETF.[22] Accordingly, the Commission preliminarily believes that it is not in the public interest or consistent with the protection of investors or the purposes fairly intended by the policy and provisions of the Act to grant the exemptive relief under section 6(c) that the Applicants seek.

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22 Staff in the Division of Economic and Risk Analysis provided advice and analyses relevant to the Commission's conclusions, discussed in more detail below.

A. ETF Prospectus Disclosure and IIV Dissemination

20. Applicants assert that ETF prospectus disclosure and the dissemination of the IIV every 15 seconds during the trading day would be sufficient to allow the arbitrage mechanism to function effectively after a few days of trading.[23] Applicants further assert that market participants do not need any additional information about the proposed ETF's portfolio so long as they are able to create correlations against and, over time, evaluate how various market factors affect the disseminated IIV. According to Applicants, this process is referred to as "reinforcement learning."[24]

21. ETF prospectus disclosure will not assist the arbitrage mechanism because such disclosure does not contain any material real-time information necessary to creating or facilitating effective arbitrage. Actively managed funds generally include very broad investment objectives and strategies in order to provide investment advisers with the maximum flexibility possible in managing the portfolio, and do not include more specific, current information about a fund's portfolio holdings.[25] The Commission preliminarily believes that it would be difficult, if

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23 Application at 19-21.

24 According to Applicants, reinforcement learning is dependent on statistical arbitrage. *See* text following *supra* note 10. Applicants assert that market makers would use the proposed ETF's market price, IIV and daily NAV to construct a hedging portfolio for the proposed ETF. The market makers would then engage in statistical arbitrage between their hedging portfolio and the shares of the proposed ETF – *i.e.*, buying and selling one against the other during the trading day and evaluating the effectiveness of their hedging portfolio at the day's end. Applicants further assert that after a few days of trading, there would be sufficient data for a market maker to run a statistical analysis that would result in the market maker's spreads being tightened substantially around the IIV. Application at 19-21.

25 For example, Form N-1A requires mutual funds to disclose in the prospectus and statement of additional information their investment objectives or goals, principal investment strategies, and the portfolio turnover rate during the most recent fiscal year. *See, e.g.*, Form N-1A, Items 2 to 4, and 9. As discussed above, mutual funds are required to disclose their portfolio holdings quarterly. *See supra* note 14 and accompanying text.

not impossible, for market participants to discern sufficient useful information from such broad disclosures. Therefore, the lack of more specific information with respect to the proposed ETF's investment objectives or principal investment strategies may not enable market makers to effectively assess whether real-time arbitrage opportunities in ETF shares exist and may discourage them from making markets in ETF shares that would keep the share prices at or close to the NAV per share of the ETF—a condition that may be exacerbated during times of market stress.

22. Dissemination of the IIV at 15 second intervals throughout the trading day does not fill this information void. Today, market makers calculate their own NAV per share of the ETF with proprietary algorithms that use an ETF's daily portfolio disclosure and available pricing information about the assets held in the ETF's portfolio.[26] They generally use the IIV, if at all, as a secondary or tertiary check on the values that their proprietary algorithms generate. If the daily portfolio holdings for the proposed ETFs are not available for market makers to calculate current values of a proposed ETF, they will be reliant principally on the IIV given the limitations of the prospectus and quarterly portfolio disclosures. Even though the IIV continues to be disseminated in conjunction with the full portfolio holdings and basket of existing ETFs, its reliability as a primary pricing signal for the proposed ETFs is questionable for the reasons discussed below.

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[26] *See* David J. Abner, *The ETF Handbook: How to Value and Trade Exchange Traded Funds* (2010), at 90 ("[s]ince stock trading now takes place in microseconds, a lot can happen between two separate 15-second quotes. Professional traders are not using published IIVs as a basis for trading. Most, if not all, desks that are trading ETFs are calculating their own [NAV of the ETF] based on real time quotes...that they are generating within their own systems."). *See also* Comment Letter of BGFA, File No. S7-07-08 (May 16, 2008) ("BGFA 2008 Letter"), at n.43; and ICI Fact Book, *supra* note 8, at 59.

23. *The IIV is stale data.* Unlike market maker proprietary algorithms, which rely on portfolio transparency and provide market makers with real-time data to effectively trade in today's fast moving markets, IIV dissemination frequency is inadequate for purposes of making efficient markets in ETFs.[27] Market makers operate at speeds calculated in fractions of a second.[28] In today's markets, 15 seconds is too long for purposes of efficient market making and could result in poor execution.[29] Because an ETF is a derivative security, its current value changes every time the value of any underlying component of the ETF portfolio changes.[30] Therefore, the IIV for a more frequently traded component security might not effectively take into account the full trading activity for that security, despite being available every 15 seconds.

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27 The Commission previously issued a proposing release on a proposed rule for certain ETFs. *See* Exchange-Traded Funds, Investment Company Act Release No. 28193 (Mar. 11, 2008) ("2008 ETF Rule Proposal"). Various industry members commenting on the 2008 ETF Rule Proposal noted that market makers did not rely on the IIV because of either its staleness or unreliability. *See, e.g.*, Comment Letter of NYSE Arca, Inc., File No. S7-07-08 (May 29, 2008) (the exchange noted that it "is not convinced that the [IIV] is a meaningful pricing tool for investors in light of the availability of other pricing information. In fact, we believe that it is the transparency of the portfolios [sic] holdings which permit [sic] market makers and other professionals to arbitrage efficiently and not the regular dissemination of an [IIV]. Some market participants may choose to generate an [IIV] for their own use, using their own calculation methodology to include financing costs, capital costs, etc., in kind trading or arbitrage. Importantly, the [IIV] generated by professionals is in real-time and not delayed by 15 or 60 seconds."); and BGFA 2008 Letter, *supra* note 26, at n. 43 and n. 92. *See also* Matt Hougan, *Ban iNAVs For ETFs* (June 24, 2013), *available at* http://www.indexuniverse.com/sections/blog/19037-hougan-ban-inavs-for-etfs.html.

28 *See* Comment Letter of ICI, File No. SR-NASDAQ-2012-117 (Nov. 8, 2012), ("ICI 2012 Letter"), at 4. *See also* ICI Fact Book, *supra* note 8.

29 *See, e.g.*, *How To Minimize Your Cost Of Trading ETFs* (June 22, 2009), ETF.com, *available at* http://www.etf.com/publications/journalofindexes/joi-articles/6042-how-to-minimize-your-cost-of-trading-etfs.html, at Figure 2 and related discussion. *See also* ICI 2012 Letter, *supra* note 28 ("Professional equity traders operate at speeds calculated in fractions of a second. In such markets, 15 seconds can be an eternity, and establishing an order price based on data that is nearly 15 seconds old could result in poor execution.").

30 In particularly volatile markets, the dissemination lag of IIV values (*i.e.*, every 15 seconds) may misrepresent the actual value of the ETF. *See Understanding iNAV*, ETF.com, *available at* http://www.etf.com/etf-education-center/21028-understanding-inav.html; Gary L. Gastineau, *Exchange-Traded Funds Manual*, Second Edition (2010), at 200-202.

For example, a large buy order for a component security held by the proposed ETF could temporarily spike the price of that security and, therefore, inflate the proposed ETF's contemporaneous IIV calculation.[31] The IIV for the proposed ETF cannot adjust for such variations, whereas the NAV would.[32] Therefore, relying on a stale IIV as a primary pricing signal for market making in Applicants' proposed ETFs would not result in an effective arbitrage mechanism.[33]

24. *The IIV is not subject to meaningful standards.* Because there are no uniform methodology requirements, the IIV can be calculated in different ways rendering it potentially arbitrary and inconsistent.[34] Also, Applicants acknowledge that no party has agreed to take responsibility for the accuracy of IIV calculation.[35] Therefore, the Commission's preliminary

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31 *See, e.g.*, ICI 2012 Letter, *supra* note 28.

32 *See, e.g.*, ICI 2012 Letter, *supra* note 28. *See also* Gastineau March 2014 Letter, *supra* note 21, at 10, for a more detailed discussion of why the IIV would at best be a "lagging indicator of actual portfolio values" during times of rapid market movement.

33 An IIV that is disseminated at more frequent intervals could present a different set of problems, as it may enable third parties to reverse engineer the underlying portfolio using data analysis. Therefore, changing the frequency of dissemination would not appear to be a viable option to the extent Applicants' objective is to prevent disclosure of the proposed ETF's portfolio. *See also infra* note 36 and accompanying text.

34 *See, e.g.*, ICI 2012 Letter, *supra* note 28 ("[M]any parties participate in the calculation, publication, and dissemination of [IIV]. The ETF sponsor provides an independent calculation agent with the daily list of securities constituting an ETF's creation basket (which for U.S. equity ETFs is typically, but not always, a pro rata slice of the ETF's portfolio). The calculation agent separately obtains market pricing information for each of the component securities from a third party source, such as the exchange or a pricing vendor, and calculates the estimated per-share value of an ETF share. *This process creates several opportunities for errors*: for example, an ETF may report a basket inaccurately; a calculation agent may receive faulty data from a pricing vendor; or an error may be made in the calculation process. *We understand that such errors are not infrequent.*" [*emphasis added*]).

35 Applicants explicitly disclaim making any warranty by the ETFs as to the accuracy of the IIV. The Adviser would merely use "commercially reasonable efforts to assure that the calculation agent has an accurate listing of all securities in each [f]und's portfolio as of the beginning of trading on each day the [f]und is traded." Similarly, "[a]lthough the calculation agent will not

conclusion is that the IIV calculation methodology is not appropriate for the IIV to be used as a primary pricing signal because it is potentially unreliable and susceptible to errors.[36]

25. *The IIV would be inaccurate for certain securities and asset classes.* Because the IIV is constructed using last available market quotations or sale prices and not fair value prices for the underlying assets, it can be inaccurate.[37] For example, as some securities do not trade frequently, the IIV would reflect the last quoted or sale price which could be stale and no longer reflect their current value.[38] Other securities may not have yet opened for trading on a particular trading day or may be subject to an intraday interruption in trading.[39]

26. Applicants note that up to 15% of the proposed ETFs' total assets could be in illiquid securities.[40] Illiquid securities often fall within the category of securities for which there is no readily available market quotation and their fair value must be determined in good faith by the fund's directors.[41] Therefore, a significant amount of illiquid securities in a proposed ETF's

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guarantee the accuracy of the IIV, the contract with the calculation agent will require that it use commercially reasonable efforts to calculate the IIV correctly…." Application at 15.

36 As is the case with more frequent dissemination, an IIV that is sufficiently accurate and precise may also enable third parties to reverse engineer the underlying portfolio using data analysis. Such an ETF would thus once again become vulnerable to front running if its portfolio can be reverse engineered by others. *See* Gastineau March 2014 Letter, *supra* note 21, at 15.

37 *See* Hougan ETF Report, *supra* note 17. NAV includes fair value pricing, and with daily portfolio disclosure, market makers can estimate fair value on their own for the holdings of current ETFs.

38 *See, e.g.*, ICI 2012 Letter, *supra* note 28.

39 *See* Gastineau March 2014 Letter, *supra* note 21 (noting that an exchange may institute a trading halt in a stock to address a significant order imbalance or in connection with release of important company news).

40 *See* Securities Exchange Act Release No. 34-71588 (Feb. 20, 2014), File No. SR-NYSEArca-2014-10.

41 15 U.S.C. 80a-2(a)(41)(B). *See also* Independent Directors Council, *Fundamentals for Newer Directors* (Feb. 2014), *available at* http://fundamentals.idc.org/specific/specific_pricing, at 27.

portfolio could exacerbate the deviation between the IIV and the NAV per share of the ETF because the accurate value of illiquid securities is determined by current fair valuation (reflected in the NAV) rather than use of stale pricing data (reflected in the IIV).[42]

27. *IIV inaccuracies can increase ETF tracking errors.* Errors in the IIV will likely lead to errors in estimating the factors that a market maker must consider when valuing a proposed ETF and constructing a hedging portfolio.[43] Therefore, market makers may not be able to construct accurate hedging portfolios for the ETF shares.[44] This would increase the tracking error associated with the hedging portfolios described above. As a result, tracking errors between intraday ETF prices and NAV per share of the proposed ETF would also likely increase because greater tracking errors in hedging portfolios would expose the market maker's position to greater risk.[45]

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42 ETF sponsors seek to minimize exposure to assets that could impact this deviation because they can make arbitrage opportunities more difficult to evaluate. *See* Comment Letter of ICI, File No. S7-07-08 (May 19, 2008). *See also* Comment Letter of The American Stock Exchange LLC, File No. S7-20-01 (Mar. 5, 2002) ("Ultimately it is in the interest of the sponsor and investment adviser to provide for effective arbitrage opportunities. It is unlikely that an ... ETF sponsor would be able to convince the critical market participants such as specialists, market makers, arbitragers and other Authorized Participants to support a product that contained illiquid securities to a degree that would affect the liquidity of the ETF, making it difficult to price, trade and hedge, ultimately leading to its failure in the marketplace.").

43 Such factors would include the market, asset class, sector and other risk factors. Market makers would need to estimate these exposures for a proposed ETF in order to construct hedging portfolios.

44 This calls into question the reinforcement learning process which may not perform adequately during periods of heightened market volatility. *See* Sanmay Das, *Intelligent Market-Making in Artificial Financial Markets*, Massachusetts Institute of Technology – Artificial Intelligence Laboratory, AI Technical Report 2003-005, at 37.

45 A commonly accepted assumption in economic models of market making is that market makers' bid-ask spreads compensate them for a number of costs including the risk they bear in their positions. *See* Maureen O'Hara, *Market Microstructure Theory*, First Edition (1998), at 35. Therefore, greater tracking errors in hedging portfolios for the proposed ETFs will likely result in

28. In addition, it may be more difficult for market makers to construct appropriate hedging portfolios from the IIV for proposed ETFs with higher portfolio turnover. In particular, changing portfolio allocations can cause the factors that a market maker must consider when valuing a proposed ETF and constructing a hedging portfolio to fluctuate more rapidly. This would in turn increase uncertainty around the market maker's estimates of these factors.[46] Therefore, proposed ETFs with more complex investment strategies involving dynamic factors will likely have higher tracking errors and bid-ask spreads if there is lack of sufficient information for market participants to construct tight hedges.[47]

29. *IIV inaccuracies can increase during periods of market stress or volatility.* Market stress can reduce liquidity in certain assets and consequently increase errors in IIV as the portfolio becomes increasingly illiquid and current market prices become more difficult to determine. In addition, volatility can increase errors around prices used in IIV calculations as volatility can increase the movement of prices.

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higher bid-ask spreads and greater tracking errors between intraday ETF prices and the NAV of the ETF.

46 In contrast, turnover would introduce no such uncertainty in ETFs with daily portfolio disclosure as the end-of-day NAV would be marked to the previously disclosed portfolio, which is known by market makers.

47 Applicants are seeking relief to launch, among others, long/short equity proposed ETFs. These types of funds have a higher portfolio turnover on average than that of actively managed equity funds. *See* Jing-Zhi Huang and Ying Wang, *Should Investors Invest in Hedge Fund-Like Mutual Funds? Evidence from the 2007 Financial Crisis*, 22 J. OF FINANCIAL INTERMEDIATION 482 (2013), *available at* http://dx.doi.org/10.1016/j.jfi.2012.11.004, at 486-487 (finding that average turnover across 130/30 equity mutual funds was 196% from June 2003 until December 2009 versus less than 70% across all actively managed mutual funds in a comparable time period). These proposed ETFs also could have more thinly traded securities that could be more susceptible to price volatility during stressed market conditions. Therefore, it may be difficult for market makers to construct appropriate hedging portfolios from the IIV, making the proposed ETFs also likely to have higher tracking errors and bid-ask spreads.

30. In stressed markets, confidence in the pricing of (and in turn, the knowledge of) the ETF portfolio becomes increasingly important for market makers to continue to quote prices in ETF shares.[48] By itself, the IIV of a proposed ETF likely will not instill such confidence in a proposed ETF's pricing because, as discussed above, the IIV is potentially unreliable and susceptible to errors.[49] Nevertheless, a market maker that questions the current market price or IIV for an ETF can check those numbers against the NAV per share of the ETF output from its proprietary algorithm if the ETF has a fully transparent portfolio. That same market maker, however, would not be able to run a similar cross-check on those figures against a non-transparent ETF like the ones proposed by Applicants. Due to the inherent weaknesses of the IIV as a stand-alone metric, Applicants' proposal (which relies heavily upon the IIV as a substitute for full portfolio transparency) likely will not offer enough information about the underlying portfolio. As discussed below, this, in turn, likely would discourage market makers from making markets that would keep the market price for the proposed ETF's shares at or close to the NAV per share of the ETF, particularly under stressed market conditions when the need for real-time and verifiable pricing information becomes more acute.[50]

31. Accordingly, the Commission's preliminary conclusion is that use of the IIV as a primary pricing signal for market making in Applicants' proposed ETFs would not result in an effective arbitrage mechanism.

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48 *See, e.g.*, *Report to the Joint Advisory Committee on Emerging Regulatory Issues*, Staffs of the CFTC and SEC (Sept. 20, 2010) ("Flash Crash Report"), at 4-6 (noting that buy-side and sell-side interest returned only after market makers were able to verify the integrity of their data and systems and that they had to assess the risks of continuing to trade during the events of May 6, 2010).

49 *See supra* notes 27-36 and accompanying text.

50 *See infra* Section V.

B. <u>Quarterly Release of Portfolio Holdings</u>

32. Applicants also propose providing their portfolio holdings disclosures on a quarterly basis, with a lag of not more than 60 days. But such disclosures would quickly lose their relevance for purposes of valuing or hedging the proposed ETFs because the content of their portfolios can change on a daily basis. This problem is heightened for ETFs with active management strategies that involve high portfolio turnover and alternative asset classes.[51] Again, this may discourage market makers from making markets that would keep the market price for the proposed ETF's shares at or close to the NAV per share of the ETF, particularly during times of market stress when the need for real-time pricing information becomes more acute.

C. <u>Back-Up Redemption Option</u>

33. In light of concerns about the effect on retail investors if the arbitrage mechanism failed to keep market prices at or close to the NAV of the proposed ETFs, Applicants proposed a redemption option that, in their view, would act as a "fail-safe" mechanism in the event of a significant deviation of closing market price from NAV. The redemption option would permit retail investors (but not institutional or other investors) to redeem their shares, in less than creation unit size, for cash directly from the proposed ETFs at NAV as of 4:00 p.m. (Eastern

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[51] Antti Petajisto, *Active Share and Mutual Fund Performance*, 69 FINANCIAL ANALYSTS JOURNAL 73 (2013), *available at* http://www.cfapubs.org/doi/pdf/10.2469/faj.v69.n4.7, at 83. The study found that annual turnover across U.S. all-equity mutual funds is 87%. As a result, approximately 14% of the portfolio changes over the 60 days following the portfolio disclosure (prorating annual turnover of 87% for 60 days) and an additional 22% of the portfolio changes over the course of the following quarter (prorating annual turnover of 87% for three months). Therefore, there may be significant tracking errors between an ETF's current portfolio holdings and its prior quarterly portfolio disclosure.

Time) each trading day.[52] For the reasons discussed below, the Commission preliminarily believes that this redemption option does not remedy the defects with Applicants' proposal outlined above such that exemptive relief would be appropriate.

34. Under the proposal, retail investors exercising the redemption option would be subject to redemption and brokerage fees, which would likely discourage use of the option. Specifically, retail investors exercising the redemption option would be subject to a redemption fee of up to 2% of the value of shares redeemed. In addition, retail investors would likely be charged additional brokerage commissions to exercise the option. These fees and costs may dissuade retail investors from exercising a redemption option meant to provide retail investors with the ability to transact with the ETF on an equal footing with the Authorized Participants.[53]

35. But even if Applicants were able to address the Commission's concerns about the retail redemption option, this would not address the Commission's more fundamental concerns about Applicants' proposal. As discussed above, Applicants are proposing an ETF model that

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52 Application at 12.

53 An economically rational investor who seeks to exercise the option is likely not to redeem until a trading discount to IIV in the secondary market exceeds the costs to redeem (*i.e.*, the redemption fee plus the brokerage charges). Given that typical bid/ask spreads for ETFs with underlying diversified domestic equity holdings average 4 basis points, a redemption fee set at 2% will cost the investor 200 basis points (not including brokerage charges) to exit the proposed ETFs. *See* Antti Petajisto, *Inefficiencies in the Pricing of Exchange-Traded Funds* (Sept. 20, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2000336, at Table III. This assumes that the investor has the information necessary (IIV, bid price for the shares, redemption fee, brokerage charges) to make the determination of whether to redeem directly from the proposed ETFs or sell on the market. *See generally,* Matt Hougan, *The Flaws in the iNAV,* Exchange-Traded Funds Report (July 2009), at 5 (noting that investors would have to have deep quantitative experience to create models to see if they were getting fair prices on ETF trades today); and John Beshears, James Choi, David Laibson, and Brigitte C. Madrian, *How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices?*, in *Explorations in the Economics of Aging,* edited by David A. Wise (2011) (noting that many retail investors lack the ability to perform even elementary calculations to compare investment options with differing sales fees).

the Commission preliminarily believes would not have a sufficiently effective arbitrage mechanism to consistently produce a secondary market price for investors that would approximate NAV per share of the ETF. The presence of a back-up retail redemption option does not cure the inherently flawed structure of the proposed ETFs here.[54]

V. The Commission's Preliminary View

36. As discussed above, the Commission preliminarily believes that Applicants have not provided an adequate substitute for portfolio transparency such that the proposed ETFs would consistently trade at or close to NAV. A close tie between market price and NAV per share of the ETF is the foundation for why the prices at which retail investors buy and sell ETF shares are similar to the prices at which Authorized Participants are able to buy and redeem shares directly from the ETF at NAV. This close tie between the prices paid by retail investors and Authorized Participants is important because section 22(d) and rule 22c-1 under the Act are designed to require that all fund shareholders be treated equitably when buying and selling their fund shares.[55] In fact, in granting relief from section 22(d) and rule 22c-1 under the Act, the Commission has relied on this close tie between what retail investors pay and what Authorized Participants pay to make the finding that the ETF's shareholders are being treated equitably when buying and selling shares.

37. The lack of portfolio transparency or an adequate substitute for portfolio transparency coupled with a potentially deficient back-up mechanism presents a significant risk

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[54] Applicants proposed the redemption option described above in response to the staff's suggestion. The Commission preliminarily believes that the inherent structural flaw of the proposed ETFs – *i.e.*, the potential lack of an effective arbitrage mechanism – cannot be solved by the proposed fail-safe mechanism.

[55] See *supra* note 5.

that the market prices of ETF shares may materially deviate from the NAV per share of the ETF—particularly in times of market stress when the need for verifiable pricing information becomes more acute. This would be contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act —that shareholders be treated equitably—and may, in turn, inflict substantial costs on investors, disrupt orderly trading and damage market confidence in secondary trading of ETFs.

A. <u>Substantial Costs to Investors</u>

38. One of the primary benefits of current ETFs is that investors are generally able to obtain a similar economic experience to investors in traditional open-end funds (*i.e.*, price at or close to NAV), but without certain of the costs associated with such funds (*e.g.*, transfer agency fees). The Commission preliminarily believes the proposed ETFs would not provide either element of this benefit if, as the Commission anticipates, the arbitrage mechanism does not function properly. A breakdown in the arbitrage mechanism could result in material deviations between market price and NAV per share of the ETF. Such deviations can hurt an investor. For example, if an investor places a buy order and the ETF is trading at a premium, this would result in a lower return for the investor as opposed to if the investor had bought the ETF when its prices were at or close to the NAV per share of the ETF or at a discount. As discussed above, the arbitrage mechanism inherent in the ETF structure keeps these differences small.

39. In this regard, the Commission finds it significant that market makers for Applicants expressed some skepticism during meetings with Commission staff that the IIV could be used as the primary pricing signal for ETFs with active management strategies that might

involve high portfolio turnover.[56] They indicated that they would likely use the pieces of information provided by the Applicants (IIV, quarterly portfolio holdings disclosure and prospectus disclosure) to construct hedge portfolios using sophisticated algorithms.[57] Their ability to construct hedge portfolios that are generally predictive of the portfolio holdings of the ETF is critical to their management of their exposure to the ETF. If there is a break in the alignment between the market makers' hedge portfolios and the NAV per share of the ETF, the market makers' risk of loss increases. The greater the risk of loss, the more the market makers will seek to cover that risk by quoting wider price spreads of the proposed ETFs. This would result in market prices, at which investors would buy and sell the ETF shares, not being at or close to the NAV per share of the ETF, which would be contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act that shareholders be treated equitably.

40. The Commission preliminarily believes that, even under normal market conditions, market makers could be unable to deconstruct the portfolio holdings of a proposed ETF with sufficient accuracy in order to construct a hedge portfolio that is closely aligned to the NAV per share of the ETF. The proposed disclosures by the Applicants would likely be useful in narrowing down the pool of securities and other assets that may be held by the ETF, but only to a limited extent. For example, prospectus disclosures of general risks and investment objectives provide little quantitative precision about an ETF's assets and risk exposures. The

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56 Commission staff met with market makers invited by the Applicants on December 4, 2013.

57 ETF market makers commonly use representative hedging portfolios instead of trading in basket securities because they may be easier to implement or more cost effective. They do this to offset market exposures as they build short or long positions in the ETFs intraday. The market maker will earn profits to the extent its hedge portfolio deviates from the NAV per share. *See* Gastineau March 2014 Letter, *supra* note 21, at 6.

proposed quarterly portfolio disclosures would provide little additional quantitative precision as a result of portfolio turnover, as discussed previously. Consequently, variability would inevitably be introduced into the proposed model. The Commission believes that this may lead to a break in alignment between a market maker's hedge portfolio and the NAV per share of the ETF; this could diminish the market maker's ability to manage its risks, which, in turn, could increase its risk of loss.[58] This greater risk of loss would be reflected in wider bid/ask spreads and result in intraday market prices that deviate from the NAV per share of the ETF, which would be contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act that shareholders be treated equitably.

41. The Commission also preliminarily believes that this potential price disparity could be even worse under times of market stress or volatility. Market makers would likely be heavily reliant on sophisticated algorithms to deconstruct the portfolio holdings of the proposed ETF in order to construct the hedge portfolio. During times of market stress or volatility, the Commission believes that reliance on these algorithms would not be sufficient for market making purposes in the proposed ETFs and the correspondence between the hedge portfolio and

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58 *See* Examining the Exchange-Traded Nature of Exchange-Traded Funds, Morningstar ETF Research (Feb. 11, 2013) ("Morningstar ETF Report"), at 21 ("To consider conducting an arbitrage transaction, arbitrageurs must be fairly confident that they will receive a return commensurate with the level of risk they are assuming. Therefore, it is likely that intraday changes to volatility (that is, risk) cause arbitrageurs to become more or less confident when transacting in the equity market for purposes of arbitrage and thus cause premiums or discounts to occur in the short term.... From the perspective of an arbitrageur, increased equity market volatility implies that the value of purchased equities relative to the value of the ETF's shares is at greater risk to fall and thus increases the potential that arbitrage trade will be less profitable, if at all. Therefore, when equity market volatility rises, it is likely that an arbitrageur would wait longer before acting to exploit an ETF premium. As a result, the ETF market price would outperform the NAV price on days when equity market volatility is increasing.... Arbitrageurs knowingly leave profits on the table for a short amount of time because the risk or cost to trade and profit is too high at that time.").

the NAV per share of the ETF might be expected to lag. This is because the market makers' hedge portfolio may deviate significantly from the actual portfolio of the proposed ETF, resulting in greater intraday market risk to the market maker and a corresponding widening of the bid/ask spread.[59] This would result in market prices, at which investors would buy and sell the ETF shares, not being at or close to the NAV per share of the ETF, which would be contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act that shareholders be treated equitably. Accordingly, although some market makers supporting Applicants noted that they should be able to construct hedge portfolios that were closely aligned (and would remain aligned) to the NAV per share of the ETF for the domestic equity ETFs proposed by Applicants, the Commission cannot fully agree with that conclusion.

42. Finally, although Applicants proposed a retail redemption option to address a significant deviation of market price to NAV, as discussed in detail above, the Commission preliminarily believes that this option is not sufficient to protect investors as required by the Act.

B. Potential Disruption of Orderly Trading and Damage to Market Confidence

43. In the absence of sufficient information for market makers to accurately assess the value of the underlying portfolio securities and to make markets in ETF shares at levels that are closely aligned to the NAV per share of the ETF, market makers are likely to trade in proposed ETFs with wide bid/ask spreads and variable premiums/discounts to the NAV per share of the ETF. This would be particularly the case during times of market stress and for active management strategies that might involve high portfolio turnover when there is a greater need for

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[59] Ron Delegge, *ETF Bid/Ask Spreads* (Apr. 23, 2013), *available at* http://investius.com/2013/04/23/etf-bidask-spreads/.

confidence in pricing signals.[60] Under particularly stressful or volatile market conditions, the inability to independently and accurately value an ETF's portfolio assets may cause market makers to withdraw from providing meaningful liquidity, which in turn can lead to the disruption of orderly trading in the ETF.[61] The Commission preliminarily believes that a structure that may lead market makers to make markets in the proposed ETFs at prices that are not closely aligned to the NAV per share of the ETF is not necessary or appropriate in the public interest, nor is it consistent with the protection of investors or with the foundational principle underlying section 22(d) and rule 22c-1 under the Act that shareholders be treated equitably.

44. Further, any breakdown in the pricing or the ability to price the proposed ETF may result in damage to market confidence in secondary trading of ETFs—not just in the proposed product, but in ETFs generally. Investors may exit the ETF market because of a loss of trust, particularly in actively managed ETFs, should the proposed ETFs fail to function in a manner similar to current ETFs.[62] For this additional reason, the Commission preliminarily believes that it is not necessary or appropriate, nor in the public interest or consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act, to grant the requested relief.

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60 *See supra* note 47 and accompanying text.

61 *See* Flash Crash Report, *supra* note 48, at 4-6. *See also* Morningstar ETF Report, *supra* note 58.

62 *See* Tamar Frankel, *Regulation and Investors' Trust in the Securities Markets*, 68 BROOK. L. REV. 439 (2002), at 448 (arguing that once investors' trust is lost, they will flee the stock markets and turn to other types of investments that "they can see, evaluate and guard for themselves.").

45. In light of the foregoing, the Commission remains unconvinced that Applicants' proposed ETFs meet the standard for relief under section 6(c) of the Act. Accordingly, absent a request for a hearing that is granted by the Commission, the Commission intends to deny Applicants' request for an exemption under section 6(c) of the Act as not necessary or appropriate in the public interest and as not consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73396; File No. PCAOB-2014-01)

October 21, 2014

Public Company Accounting Oversight Board; Order Granting Approval of Proposed Rules on Auditing Standard No. 18, Related Parties, Amendments to Certain PCAOB Auditing Standards Regarding Significant Unusual Transactions, and Other Amendments to PCAOB Auditing Standards

I. Introduction

On July 10, 2014, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "Commission"), pursuant to Section 107(b)[1] of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act") and Section 19(b)[2] of the Securities Exchange Act of 1934 (the "Exchange Act"), proposed rules to adopt Auditing Standard No. 18, *Related Parties*, amendments to certain PCAOB auditing standards regarding significant unusual transactions, and other amendments to PCAOB auditing standards, including required procedures to obtain an understanding of a company's financial relationships and transactions with its executive officers (collectively, the "Proposed Rules").[3] The Proposed Rules were published for comment in the Federal Register on July 24, 2014.[4] At the time the notice was issued, the Commission designated a longer period to act on the Proposed Rules, until October 22, 2014.[5] The Commission received three comment letters in response to the notice.[6] This order approves the Proposed Rules.

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[1] 15 U.S.C. 7217(b).

[2] 15 U.S.C. 78s(b).

[3] The Board originally proposed in February 2012 ("Original Proposal") and reproposed in May 2013 ("Reproposal") what became the Proposed Rules.

[4] See Release No. 34-72643 (July 18, 2014), 79 FR 43163 (July 24, 2014).

[5] Ibid.

II. Description of the Proposed Rules

Related party transactions, significant unusual transactions, and a company's financial relationships and transactions with its executive officers are included together in the Proposed Rules because the PCAOB believes the auditor's efforts in these areas are, in many ways, complementary. For example, the auditor's efforts to identify and evaluate a company's significant unusual transactions could identify information that indicates that a related party or relationship or transaction with a related party previously undisclosed to the auditor might exist. Likewise, obtaining an understanding of a company's financial relationships and transactions with its executive officers also could identify information that indicates that a related party or relationship or transaction with a related party previously undisclosed to the auditor might exist.

1. Related Parties

Auditing Standard No. 18 will supersede AU section 334, *Related Parties* ("AU sec. 334"), which primarily contains the existing requirements for auditing relationships and transactions with related parties. AU sec. 334 provides guidance and examples of procedures for the auditor's consideration in identifying and evaluating related party transactions. Auditing Standard No. 18 includes some auditing concepts and procedures from AU sec. 334, but is intended to strengthen auditor performance requirements for identifying, assessing, and responding to the risks of material misstatement associated with a company's relationships and transactions with its related parties by, among other things, requiring the auditor to:

[6] See letters to the Commission from Suzanne H. Shatto, dated July 23, 2014 ("Shatto Letter"); Tom Quaadman, Vice President, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, dated July 28, 2014 ("Chamber Letter"); and Deloitte & Touche LLP, dated August 11, 2014 ("Deloitte Letter").

- Perform specific procedures to obtain an understanding of the company's relationships and transactions with its related parties, including obtaining an understanding of the nature of the relationships between the company and its related parties and of the terms and business purposes (or the lack thereof) of transactions involving related parties. The new procedures are required to be performed in conjunction with the auditor's risk assessment procedures pursuant to Auditing Standard No. 12, *Identifying and Assessing Risks of Material Misstatement*.
- Evaluate whether the company has properly identified its related parties and relationships and transactions with its related parties. In making that evaluation, the auditor performs procedures to test the accuracy and completeness of management's identification, taking into account information gathered during the audit. If the auditor identifies information that indicates that undisclosed relationships and transactions with a related party might exist, the auditor is required to perform procedures necessary to determine whether undisclosed relationships or transactions with related parties in fact exist.
- Perform specific procedures if the auditor determines that a related party or relationship or transaction with a related party previously undisclosed to the auditor exists.
- Perform specific procedures regarding each related party transaction that is either required to be disclosed in the financial statements or determined to be a significant risk.[7]

[7] Auditing Standard No. 12 defines a significant risk as a "risk of material misstatement that requires special audit consideration."

- Communicate to the audit committee the auditor's evaluation of the company's identification of, accounting for, and disclosure of its relationships and transactions with related parties, and other significant matters arising from the audit regarding the company's relationships and transactions with related parties.

2. Significant Unusual Transactions

Existing auditing requirements regarding significant unusual transactions are principally contained in AU section 316, *Consideration of Fraud in a Financial Statement Audit* ("AU sec. 316").[8] Specifically, AU sec. 316 requires the auditor, if he or she becomes aware of significant unusual transactions during the course of the audit, to gain an understanding of the business rationale of such transactions and consider whether that rationale suggests the transactions may have been entered into to engage in, or conceal, fraud. The amendments regarding significant unusual transactions are intended to improve AU sec. 316 and other PCAOB auditing standards by, among other things:

- Requiring the auditor to perform procedures to identify significant unusual transactions;
- Requiring the auditor to perform procedures to obtain an understanding of, and evaluate, the business purpose (or the lack thereof) of identified significant unusual transactions; and
- Adding factors for the auditor to consider in evaluating whether significant unusual transactions may have been entered into to engage in fraudulent financial reporting or conceal misappropriation of assets.

[8] See AU secs. 316.66–.67.

In addition to targeted enhancements to AU sec. 316, the amendments regarding significant unusual transactions would revise Auditing Standard No. 12 and Auditing Standard No. 13, *The Auditor's Responses to the Risks of Material Misstatement*. These amendments include some changes intended to enhance the complementary linkages between the auditor's work relating to significant unusual transactions and related party transactions. The amendments regarding significant unusual transactions also include conforming changes to other PCAOB auditing standards to provide for consistency in the use of the term "significant unusual transactions" throughout the Board's standards.[9]

3. Other Amendments

Additional amendments are intended to provide for improved audit procedures in complementary areas, including requiring that the auditor perform procedures, as part of the auditor's risk assessment, to obtain an understanding of the company's financial relationships and transactions with its executive officers.[10] These new procedures are intended to heighten the auditor's attention to incentives or pressures for the company to achieve a particular financial position or operating result, recognizing the key role that a company's executive officers may play in the company's accounting decisions or in a company's financial reporting.

In response to requests for clarification received by the PCAOB as part of its comment process, the Proposed Rules explicitly provide that the auditor's work relating to a company's

[9] The Proposed Rules describe "significant unusual transactions" as "significant transactions that are outside the normal course of business for the company or that otherwise appear to be unusual due to their timing, size, or nature."

[10] The PCAOB notes that the other amendments do not change the existing requirement in its risk assessment standards for the auditor to consider obtaining an understanding of compensation arrangements with senior management as part of obtaining an understanding of the company. Rather, the Board states that the population for the procedures required by the other amendments is the list of "executive officers," as defined in Rule 3b-7 of the Exchange Act or included on Schedule A of Form BD, as applicable, while the existing requirement continues to apply to what may be a larger population of a company's management. 17 CFR 240.3b-7 and 17 CFR 249.501.

financial relationships and transactions with its executive officers does not include an assessment of the appropriateness or reasonableness of executive compensation arrangements. The Commission believes the PCAOB's clarification is responsive and appropriate since such assessments would have resulted in a significant unintended change to the current objectives of the audit, which are focused on risks of material misstatement of the financial statements.

In addition to the amendments relating to financial relationships and transactions with executive officers, the Board adopted amendments to revise other auditing standards to conform them to the Proposed Rules and, where appropriate, include new requirements that complement the Proposed Rules. For example, the Board adopted amendments to AU section 333, *Management Representations* ("AU sec. 333"), to require a representation that management has made available to the auditor the names of all related parties and relationships and transactions with related parties. Additionally, among others, the Board adopted amendments to AU sec. 333 to require a written representation from management that there are no side agreements or other arrangements (either written or oral) undisclosed to the auditor. Other new requirements complement the requirements in the Proposed Rules through improvements to the auditor's: (i) communications with a predecessor auditor; (ii) procedures during the period subsequent to the balance-sheet date, but prior to the issuance of the financial statements; and (iii) procedures during reviews of interim financial information.

The PCAOB has proposed application of its Proposed Rules to audits of all issuers, including audits of emerging growth companies ("EGCs"),[11] as discussed in Section IV. below.

[11] The term "emerging growth company" is defined in Secfion 3(a)(80) of the Exchange Act. 15 U.S.C. 78c(a)(80).

The Proposed Rules also would apply to audits of SEC-registered brokers and dealers.[12] The Proposed Rules would be effective for audits of financial statements for fiscal years beginning on or after December 15, 2014, including reviews of interim financial information within these fiscal years.

III. Comment Letters

As noted above, the Commission received three comment letters concerning the Proposed Rules. Two commenters expressed support for the Proposed Rules.[13] One of these commenters also expressed a desire for an earlier effective date.[14] The final commenter raised concerns regarding the substance of the PCAOB's economic analysis and consideration of cost-benefit analysis upon EGCs.[15]

1. Effective Date

The PCAOB describes the rationale as to the effective date, which was established to allow for sufficient time for registered firms to incorporate the new requirements into methodologies, guidance, audit programs, and staff training. The Commission believes the Proposed Rules' effective date is not unreasonable in order to provide sufficient time for proper implementation by registered firms.

2. Economic Analysis

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[12] On July 30, 2013, the Commission adopted amendments to Rule 17a-5 under the Exchange Act to require, among other things, that audits of brokers' and dealers' financial statements be performed in accordance with the standards of the PCAOB for fiscal years ending on or after June 1, 2014. 17 CFR 240.17a-5. See *Broker–Dealer Reports*, Release No. 34–70073, (July 30, 2013), 78 FR 51910 (August 21, 2013), available at http://www.sec.gov/rules/final/2013/34-70073.pdf.

[13] See Shatto Letter and Deloitte Letter.

[14] See Shatto Letter, which also raised a number of other points with respect to brokers and dealers, but those points are outside the scope of the PCAOB's Proposed Rules.

[15] See Chamber Letter.

One commenter raised concerns regarding the substance of the PCAOB's economic analysis and its consideration of EGCs. The commenter stated that it expressed these concerns in previous comment letters to the PCAOB, and in its opinion, those concerns have not been considered or addressed by the PCAOB. This commenter's principal concerns are addressed below.

- In its comment letter on the Original Proposal, the commenter stated that the proposal did not contain a cost-benefit analysis.

The Board presented, and sought comment on, an economic analysis in the Reproposal. Further, in response to comments on the economic analysis provided in the Reproposal, the Board revised its analysis as presented in its release accompanying the Proposed Rules ("Final Rule Release").

- In its comment letter on the Reproposal, the commenter stated that the economic analysis was composed of a number of assertions that were generic and speculative in nature, and were not linked to the elements of the proposal.

In the economic analysis provided in the Final Rule Release, the Board refined the analysis included with the Reproposal, including by linking the elements of the analysis closer to the elements of the Proposed Rules. Specifically, the Board's refined analysis set forth: (1) a description of the need for the standard-setting, and how the Proposed Rules address the need; (2) the baseline to consider the economic impacts of the Proposed Rules; (3) the Board's approach and consideration of alternatives; (4) the economic impacts of the Proposed Rules including benefits, costs, effects on different categories of audit firms and smaller companies, and responses to comments received on the economic analysis included with the Reproposal; and (5) economic considerations pertaining to audits of EGCs, including efficiency, competition and capital formation. The Board also acknowledged challenges in considering the economic impacts, such as the challenges of quantifying the economic impact of changes to audit standards, and explained how the Board addressed those challenges.

- In its comment letter on the Reproposal, the commenter stated that the economic analysis fails to explicitly articulate any appropriate economic baseline against which to measure the proposed requirements' likely economic impact.

The Board presented an economic baseline within Appendix 5 of the Final Rule Release, which the Board used in its economic analysis as a benchmark for comparing against the Proposed Rules. The Board's discussion of the baseline includes both existing requirements and current audit practices, where the latter is determined based on information from the Board's oversight activities, including its inspection findings. The Board's analysis of the baseline shows that audit practices associated with the areas addressed by the Proposed Rules are inconsistent across firms.

- In its comment letter on the Reproposal, the commenter stated that the Reproposal contains no substantive analysis of the economic impact of the proposed requirements on EGCs, EGCs vis-à-vis other companies, or companies generally.

The economic analysis presented in the Final Rule Release presents the Board's economic considerations of the Proposed Rules both for companies generally and specifically for EGCs. Broadly, the Board believes that the areas addressed by the Proposed Rules are challenging areas warranting additional audit effort and focus. The Board notes that EGCs will incur some incremental costs because costs may be disproportionately higher for smaller companies, including EGCs.[16] However, the Board notes that EGCs may benefit more from the Proposed Rules because, as compared to non-EGCs, related party transactions are more common

[16] See Section IV below for further information regarding the PCAOB's EGC analysis.

and there is a higher likelihood for control deficiencies, which may result in a higher risk of material misstatement associated with related party transactions.

The analysis includes the relevant views of those who commented on the Reproposal on the economic effects of the Proposed Rules on EGCs. Further, the Board notes that the Proposed Rules are designed to mitigate cost impacts by aligning the auditor's efforts with the risk assessment standards and providing opportunities for a scaled approach depending on the size and complexity of the company being audited. The Board states that this alignment with risk assessment allows auditors to integrate audit effort where appropriate and thereby avoid unnecessary audit effort. Finally, the Board's analysis takes into account the view from certain commenters on the Reproposal that it may be more costly not to apply the Proposed Rules to audits of EGCs because it would require firms to maintain two audit methodologies. The Commission believes that the Board's economic analysis reasonably addresses the comment raised, and as discussed further in Section IV, based on the analysis submitted, the Commission believes the information in the record is sufficient for the Commission to make the requested EGC determination in relation to the Proposed Rules.

- In its comment letter on the Reproposal, the commenter stated that the Reproposal does not adequately address potential alternatives.

The Final Rule Release discussed the Board's consideration of alternatives to the Proposed Rules. In response to the commenter's suggestion that the Reproposal did not discuss why PCAOB Staff Audit Practice Alert No. 5, *Auditor Considerations Regarding Significant Unusual Transactions* ("Practice Alert"),[17] was inadequate, the Board stated that the Practice Alert was issued to remind auditors of the risks associated with significant unusual transactions

[17] See http://pcaobus.org/Standards/QandA/04-07-2010_APA_5.pdf

and to compile selected, relevant requirements from existing PCAOB auditing standards into one document. Given that the Practice Alert only highlights circumstances for auditor consideration, it did not alter audit requirements with respect to significant unusual transactions. The Board concluded, based in part on the results of its oversight activities following the issuance of the Practice Alert, that it was appropriate to develop standards with more specific requirements to promote heightened scrutiny in the areas addressed by the Proposed Rules. Further, the Board stated that the need to improve the existing standards in these areas, including alignment with the Board's risk assessment standards, cannot be adequately addressed through staff interpretations of existing standards.

In response to the commenter's statement that the Board did not analyze why it chose not to converge the Proposed Rules with similar standards of the International Auditing and Assurance Standards Board ("IAASB") and the Auditing Standards Board of the American Institute of Certified Public Accountants ("ASB"), the Board states in its Final Rule Release that it considered the analogous standards of the IAASB and the ASB and incorporated a number of similar audit procedures and requirements that the Board believed were useful and appropriate.[18] The Board, however, determined that the areas addressed by the Proposed Rules require heightened scrutiny, and, thus, the Proposed Rules contain auditing requirements that are not reflected in the analogous standards of the IAASB and the ASB. Further, the Commission notes that the Board has received similar comments in the past and has thus previously addressed its consideration of the work of other standard-setters generally.[19] The Commission also addressed

[18] For examples of similar audit procedures and requirements, see footnote 86 on page A5-46 of the Final Rule Release. Additionally, Appendix 6 of the Final Rule Release compares certain significant differences between the objective and certain key requirements of the Proposed Rules and analogous standards of the IAASB and the ASB.

[19] For example, in the Board's adopting release for its risk assessment standards it stated the following:

similar comments in connection with its consideration of other rules proposed by the PCAOB.[20] As it relates to the Proposed Rules, the Commission notes the PCAOB's efforts to consider the analogous standards of the IAASB and the ASB. Thus, while the Commission continues to encourage the PCAOB to consider the work of other standard-setters, there remain a variety of reasons why the Board's standards may differ from the standards of the IAASB and ASB, and we believe the Board has provided a reasonable explanation for the differences here.

- Finally, in its comment letter to the Commission, the commenter recommended "that the SEC return the [Proposed Rules] to the PCAOB for a cost benefit analysis that complies with the [Jumpstart Our Business Startups] Act and allows stakeholders to understand the costs and benefits…" Further, the commenter stated that the Proposed Rules add to audit complexity and raise doubt that the proposed requirements would be cost-benefit effective.

The Commission notes that the Board provided a detailed qualitative analysis that took into account the views of commenters. As the Board explained, there was limited research and data available regarding economic costs and benefits of the Proposed Rules, making reliable quantification difficult. Further, as part of the Board's process through its issuance of the Original Proposal and the Reproposal, the Board requested empirical data regarding costs and benefits specific to the Proposed Rules, and commenters did not provide any. The Commission observes that Section 103(a)(3)(C) of the Sarbanes-Oxley Act, the relevant statutory provision added by the Jumpstart our Business Startups ("JOBS") Act, does not require a detailed,

"[B]ecause the Board's standards must be consistent with the Board's statutory mandate, differences will continue to exist between the Board's standards and the standards of the IAASB and ASB, e.g., when the Board decides to retain an existing requirement in PCAOB standards that is not included in IAASB or ASB standards. Also, certain differences are often necessary for the Board's standards to be consistent with relevant provisions of the federal securities laws or other existing standards or rules of the Board. Also, the Board's standards-setting activities are informed by and developed to some degree, in response to observations from its oversight activities."

See PCAOB Release No. 2010-004, August 5, 2010, pp. A10-91 – A10-92 (internal footnotes omitted).

[20] See Release No. 34-63606 (December 23, 2010), 75 FR 82417 (December 30, 2010) and Release No. 34-68453 (December 17, 2012), 77 FR 75689 (December 21, 2012).

quantitative cost-benefit analysis.[21] Consistent with the responses to the commenter's specific concerns enumerated above, the Board states that it designed the Proposed Rules to minimize complexity by aligning the auditor's efforts with the risk assessment standards and providing opportunities for a scaled approach depending on the size and complexity of the company being audited.

IV. The PCAOB's EGC Request

Section 103(a)(3)(C) of the Sarbanes-Oxley Act provides that any additional rules adopted by the PCAOB subsequent to April 5, 2012 do not apply to the audits of EGCs, unless the Commission determines that the application of such additional requirements is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.[22] Having considered those factors, and as explained further herein, the Commission finds that applying the Proposed Rules to audits of EGCs is necessary or appropriate in the public interest.

In proposing application of the Proposed Rules to audits of all issuers, including EGCs, the PCAOB requested that the Commission make the determination required by Section 103(a)(3)(C). To assist the Commission in making its determination, the PCAOB prepared and submitted to the Commission its own EGC analysis. The PCAOB's EGC analysis includes discussions of characteristics of self-identified EGCs and economic considerations pertaining to audits of EGCs, including efficiency, competition, and capital formation. In its analysis, the

[21] See National Association of Manufacturers v. SEC, 748 F.3d 359, 369 (D.C. Cir. 2014) (stating that "[a]n agency… need not conduct a 'rigorous, quantitative economic analysis' unless the statute explicitly directs it to do so"), partially overruled on other grounds by American Meat Institute v. U.S. Department of Agriculture, 760 F.3d 18 (D.C. Cir. 2014) (en banc).

[22] Section 103(a)(3)(C) of the Sarbanes-Oxley Act, as amended by Section 104 of the JOBS Act.

Board states, among other things, that applying the Proposed Rules to the audits of EGCs may be particularly pertinent because of the characteristics of EGCs (e.g., potential for higher rates of material weaknesses in internal control, use of related party transactions, and substantial doubt about the company's ability to continue as a going-concern). In fact, the Board's oversight activities have identified a significant number of findings regarding related party transactions in audits of financial statements of smaller public companies, which have characteristics that are similar to EGCs.

The PCAOB's EGC analysis was included in the Commission's public notice soliciting comment on the Proposed Rules.[23] Based on the analysis submitted, we believe the information in the record is sufficient for the Commission to make the requested EGC determination in relation to the Proposed Rules. The Commission also takes note, in particular, of the PCAOB's approach to the Proposed Rules, which are intended to build upon existing requirements in the areas addressed by them; align with the auditor's efforts in complying with the risk assessment standards; and provide opportunities for scaling based on the facts, circumstances, and risks of the particular company under audit.

V. Conclusion

The Commission has carefully reviewed and considered the Proposed Rules and the information submitted therewith by the PCAOB, including the PCAOB's EGC analysis, and the comment letters received. In connection with the PCAOB's filing and the Commission's review,

[23] One comment letter, as discussed above in Section III, was received relating to the PCAOB's EGC analysis. See Chamber Letter.

A. The Commission finds that the Proposed Rules are consistent with the requirements of the Sarbanes-Oxley Act and the securities laws and are necessary or appropriate in the public interest or for the protection of investors; and

B. Separately, the Commission finds that the application of the Proposed Rules to EGC audits is necessary or appropriate in the public interest, after considering the protection of investors and whether the action will promote efficiency, competition, and capital formation.

IT IS THEREFORE ORDERED, pursuant to Section 107 of the Sarbanes-Oxley Act and Section 19(b)(2) of the Exchange Act, that the Proposed Rules (File No. PCAOB-2014-01) be and hereby are approved.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

Commissioner Gallagher
Not participating
Commissioner Piwowar
Disapproved

SECURITIES AND EXCHANGE COMMISSION

[Investment Company Act Release No. 31301; 812-13953]

Spruce ETF Trust, et al.; Notice of Application

October 21, 2014

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

Action: Notice of an application for exemptive relief.

Summary of Application: Applicants request an order under section 6(c) of the Investment Company Act of 1940 ("Act") for an exemption from sections 2(a)(32), 5(a)(1), 22(d) and 22(e) of the Act and rule 22c-1 under the Act, under sections 6(c) and 17(b) of the Act for an exemption from sections 17(a)(1) and 17(a)(2) of the Act, and under section 12(d)(1)(J) of the Act for an exemption from sections 12(d)(1)(A) and (B) of the Act. If granted, the requested order would permit several registered open-end investment companies that are actively managed exchange traded funds (each, an "ETF") to list and trade without being subject to the current daily portfolio transparency condition in actively managed ETF orders.

Applicants: Spruce ETF Trust (the "Trust"), BlackRock Fund Advisors (the "Adviser") and BlackRock Investments, LLC (the "Distributor") (together, the "Applicants").

Filing Date: The application was filed on September 1, 2011.

Hearing or Notification of 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 November 17, 2014, and should be accompanied by proof of service on applicants, in the form of an affidavit or, for lawyers, a certificate of service. Pursuant to rule 0-5 under the Act, hearing requests should state the nature of the writer's interest, any facts bearing upon the desirability of a hearing on the matter, 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. Absent a request for a hearing that is granted by the Commission, the Commission intends to issue an order under the Act denying the application.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. Applicants: c/o BlackRock Fund Advisors, 400 Howard Street, San Francisco, California 94105.

For Further Information Contact: Deepak T. Pai, Senior Counsel; Kay-Mario Vobis, Senior Counsel; or Dalia Osman Blass, Assistant Chief Counsel, at (202) 551-6821 (Division of Investment Management, Chief Counsel's Office).

Supplementary Information: The following is 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.

I. Introduction

1. Applicants seek to introduce a novel type of actively managed exchange-traded fund ("ETF") that would not be required to disclose its portfolio holdings on a daily basis. Due to their characteristics, ETFs (including those proposed by Applicants) are only permitted to operate subject to Commission orders that provide exemptive relief from certain provisions of

the Act and rules thereunder.[1] Accordingly, Applicants seek an order under section 6(c) of the Act for an exemption from sections 2(a)(32), 5(a)(1), 22(d) and 22(e) of the Act and rule 22c-1 thereunder; and under sections 6(c) and 17(b) of the Act granting an exemption from sections 17(a)(1) and 17(a)(2) of the Act, and under section 12(d)(1)(J) for an exemption from sections 12(d)(1)(A) and (B) of the Act.

2. As discussed below, the Commission preliminarily believes that Applicants' proposed ETFs do not meet the standard for exemptive relief under section 6(c) of the Act. Section 6(c) allows the Commission to exempt any person, security, or transaction, or any class thereof, only "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of [the Act]."[2] Accordingly, the Commission preliminarily intends to deny the application.[3]

II. Background

A. Open-End Investment Companies and Net Asset Value

3. The Act defines an investment company as an "issuer" of "any security" which "is or holds itself out as being engaged primarily … in the business of investing … in

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1 The Commission first granted exemptive relief to operate ETFs in the early 1990s when the first index-based ETFs were developed. *See* SPDR Trust Series I, Investment Company Act Release Nos. 18959 (Sept. 17, 1992) (notice) and 19055 (Oct. 26, 1992) (order).

2 15 U.S.C. 80a-6(c).

3 For this reason, the Commission finds it unnecessary to consider whether the application meets the section 17(b) and section 12(d)(1)(J) standards for exemptive relief.

securities."[4] Shares in an investment company represent proportionate interests in its investment portfolio, and their value fluctuates in relation to the changes in the value of that portfolio.

4. The most common form of investment company, the "open-end" investment company or mutual fund, is required by law to redeem its securities on demand at a price approximating their proportionate share of the fund's net asset value ("NAV") at the time of redemption.[5] These funds also continuously issue and sell new shares, thereby replenishing their investment capital.

5. Because open-end investment companies are required by law to redeem their shares based on investors' demands, shares of the funds have historically not traded on exchanges or in other secondary markets.[6]

B. Exemptions under the Act for Actively Managed ETFs

6. ETFs, including those proposed by Applicants, are a type of open-end fund. But unlike traditional open-end funds, ETFs are made available to investors primarily through secondary market transactions on exchanges.

7. In order for this to take place, ETFs require various exemptions from the provisions of the Act and the rules thereunder. Critically, in granting such exemptions to date,

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4 15 U.S.C. 80a-3(a); 80a-3(a)(1).

5 Section 22(d) of the Act prohibits a dealer from selling a redeemable security that is being offered to the public by or through an underwriter other than at a current public offering price described in the fund's prospectus. Rule 22c-1 under the Act requires open-end funds, their principal underwriters, and dealers in fund shares (and certain others) to sell and redeem fund shares at a price based on the current NAV next computed after receipt of an order to buy or redeem. Together, these provisions are designed to require that fund shareholders be treated equitably when buying and selling their fund shares.

6 This stems from section 22(d) of the Act, which in effect fixes the prices at which redeemable securities, including open-end shares, are sold. The result is a system that precludes dealers from making a secondary market in open-end shares.

the Commission has required that a mechanism exist to ensure that ETF shares would trade at a price that is at or close to the NAV per share of the ETF.[7]

8. Such a mechanism is essential for ETFs to operate because ETFs do not sell or redeem their individual shares at NAV per share as required by the Act. Instead, large broker-dealers that have contractual arrangements with an ETF (each, an "Authorized Participant") purchase and redeem ETF shares directly from the ETF, but only in large blocks called "creation units." An Authorized Participant that purchases a creation unit of ETF shares first deposits with the ETF a "basket" of securities and other assets (*e.g.*, cash) identified by the ETF that day, and then receives the creation unit of ETF shares in return for those assets. The basket is generally representative of the ETF's portfolio and is equal in value to the aggregate NAV of ETF shares in the creation unit. After purchasing a creation unit, the Authorized Participant may sell the component ETF shares in secondary market transactions. Investors then purchase individual shares in the secondary market. The redemption process is the reverse of the purchase process: the Authorized Participant acquires a creation unit of ETF shares and redeems it for a basket of securities and other assets.

9. The combination of the creation and redemption process with the secondary market trading in ETF shares provides arbitrage opportunities that, if effective, keep the market price of the ETF's shares at or close to the NAV per share of the ETF.[8] For example, if an ETF's shares begin trading on national securities exchanges at a "discount" (a price below the NAV per

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7 This has been a required representation in all ETF orders since the Commission issued the first order. *See supra* note 1.

8 *See* Investment Company Institute, *2014 Investment Company Fact Book* (2014) ("ICI Fact Book"), at 60.

share of the ETF), an Authorized Participant can purchase ETF shares in secondary market transactions and, after accumulating enough shares to comprise a creation unit, redeem them from the ETF in exchange for the more valuable securities in the ETF's redemption basket. In addition to purchasing ETF shares, Authorized Participants also are likely to hedge their intraday risk. Thus, for example, when ETF shares are trading at a discount to the NAV per share of the ETF, an Authorized Participant may also simultaneously short the securities in the redemption basket. At the end of the day, the Authorized Participant will return the creation unit of ETF shares to the ETF in exchange for the ETF's redemption basket of securities and other assets, which it will then use to cover its short positions. Those purchases reduce the supply of ETF shares in the market, and thus tend to drive up the market price of the shares to a level closer to the NAV per share of the ETF.[9]

10. Conversely, if the market price for ETF shares reflects a "premium" (a price above the NAV per share of the ETF), an Authorized Participant can deposit a basket of securities in exchange for the more valuable creation unit of ETF shares, and then sell the individual shares in the market to realize its profit. An Authorized Participant may also hedge its intraday risk when ETF shares are trading at a premium. Thus, for example, when the shares of an ETF are trading at a premium, an Authorized Participant may buy the securities in the purchase basket in the secondary market and sell short the ETF shares. At the end of the day, the Authorized Participant will deposit the purchase basket of securities and other assets in exchange for a creation unit of ETF shares, which it will then use to cover its short positions. The

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9 The Authorized Participant's purchase of the ETF shares in the secondary market, combined with the sale of the redemption basket securities, may also create upward pressure on the price of ETF shares and/or downward pressure on the price of redemption basket securities, driving the market price of ETF shares and the value of the ETF's portfolio holdings closer together.

Authorized Participant will receive a profit from having paid less for the ETF shares than it received for the securities in the purchase basket. These transactions would increase the supply of ETF shares in the secondary market, and thus tend to drive down the price of ETF shares to a level closer to the NAV per share of the ETF.[10]

11. Market participants can also engage in arbitrage activity without using the creation or redemption processes described above. For example, if a market participant believes that an ETF is overvalued relative to its underlying or reference assets, the market participant may sell short ETF shares and buy the underlying or reference assets, wait for the trading prices to move toward parity, and then close out the positions in both the ETF shares and the underlying or reference assets to realize a profit from the relative movement of their trading prices. Similarly, a market participant could buy ETF shares and sell the underlying or reference assets in an attempt to profit when an ETF's shares are trading at a discount to the ETF's underlying or reference assets. As discussed above, the trading of an ETF's shares and the ETF's underlying or reference assets may bring the prices of the ETF's shares and its portfolio assets closer together through market pressure.

12. In assessing whether to grant exemptive relief to actively managed ETFs in the past, the Commission has required a mechanism that would keep the market prices of ETF shares at or close to the NAV per share of the ETF. To date, this mechanism has been dependent on

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10 The Authorized Participant's purchase of the purchase basket securities, combined with the sale of ETF shares, may also create downward pressure on the price of ETF shares and/or upward pressure on the price of purchase basket securities, bringing the market price of ETF shares and the value of the ETF's portfolio holdings closer together.

daily portfolio transparency.[11] This transparency provides market makers and other market participants with an important tool to value the ETF portfolio on an intraday basis, which, in turn, enables them to assess whether an arbitrage opportunity exists. It is the exercise of such arbitrage opportunities that keeps the market price of ETF shares at or close to the NAV per share of the ETF. This close tie between market price and NAV per share of the ETF is the foundation for why the prices at which retail investors buy and sell ETF shares are similar to the prices at which Authorized Participants are able to buy and redeem shares directly from the ETF at NAV. In granting relief from section 22(d) of the Act and rule 22c-1 under the Act, the Commission relies on this close tie between what retail investors pay and what Authorized Participants pay to make the finding that the ETF's shareholders are being treated equitably when buying and selling shares.[12] The Commission therefore has granted such exemptive relief to date only to those actively managed ETFs that have provided daily transparency of their portfolio holdings.

III. The Application

A. The Applicants

13. The Trust is a business trust organized under the laws of Delaware and will be registered under the Act as an open-end management investment company with multiple series (each, a "proposed ETF"). Applicants propose to offer 13 initial proposed ETFs, each of which will use a variety of active management strategies to meet its investment objectives. The

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11 The condition for daily portfolio transparency has consistently been one of the conditions to the exemptive relief issued to actively managed ETFs by the Commission. *See* PowerShares Capital Management LLC, et al., Investment Company Act Release Nos. 28140 (Feb. 1, 2008) (notice) and 28171 (Feb. 27, 2008) (order).

12 *See supra* note 5 and accompanying text.

proposed ETFs include long/short funds, and may invest a portion of their assets (up to a third of the total assets) in derivatives and foreign securities.[13]

14. The Adviser, a corporation organized under the laws of California, is registered as an investment adviser under the Investment Advisers Act of 1940 ("Advisers Act") and would serve as the investment adviser to the initial proposed ETFs. The Distributor, a Delaware limited liability company, is a registered broker-dealer under the Securities Exchange Act of 1934, as amended.

B. Applicants' Proposal

15. Applicants seek exemptive relief under section 6(c) of the Act to allow them to introduce several actively managed ETFs that would not disclose their portfolio holdings on a daily basis. Applicants note that actively managed ETFs with transparent portfolios are susceptible to "front running" and "free riding" by other investors and/or managers which can harm, and result in substantial costs to, the actively managed ETFs.[14]

16. As explained below, the Applicants propose to operate actively managed ETFs that would not disclose their portfolio holdings on a daily basis. Applicants state that the relief requested in their application is similar to the relief granted in exemptive orders issued to

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13 *See* Securities Exchange Act Release No. 34-72787 (Aug. 7, 2014), File No. SR-BATS-2014-018 ("19b-4 Notice"), at 14-15.

14 Application at 40. *See also* Murray Coleman, *Could a Stock ETF Cloak its Portfolio* (May 7, 2012), *available at* http://online.wsj.com/news/articles/SB10001424052702304432704577348261039833588 (noting that if traders can identify the shares in which a fund manager is building a position, they can start buying the shares ahead of the manager and drive up the price while the manager is still buying the stock).

existing actively managed ETFs, except for certain differences permitting the proposed ETFs to operate on a non-transparent basis. These material differences are highlighted below:

a. Prospectus and Portfolio Disclosures: Applicants would *not* provide the daily disclosure of a proposed ETF's portfolio holdings that is a condition in all exemptive orders issued to existing actively managed ETFs. Applicants would instead only provide the standard portfolio and other disclosures required for traditional mutual funds. Traditional mutual funds are required to disclose their portfolio holdings only on a quarterly basis, with a lag of not more than 60 days.[15]

b. Indicative Intraday Value: Investors and others acquiring the proposed ETFs' shares would primarily have to rely on the intraday indicative value (the "IIV"), which would be disseminated by an exchange every 15 seconds during the trading day,[16] to assess the value of a proposed ETF due to the lack of portfolio transparency. The IIV would be calculated by a calculation agent who would receive the daily list of securities constituting the proposed ETF's portfolio from the ETF sponsor.[17] As acknowledged by the Applicants, the IIV is based on the value of the proposed ETF's portfolio and is calculated by the calculation agent using the

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15 Shareholder reports, including a schedule of portfolio holdings, must be transmitted to shareholders semi-annually, within 60 days of the end of the second and fourth fiscal quarters. *See* Rule 30e-1. A complete schedule of portfolio holdings must be filed with the Commission on Form N-CSR within 10 days of the transmission of the shareholder report. *See* Rule 30d-1. Complete portfolio holdings also must be filed on Form N-Q within 60 days of the end of the first and third fiscal quarters. *See* Rule 30b1-5.

16 We note that the IIV is not disseminated during early and late trading sessions when market participants would still be trading the proposed ETFs' shares. Therefore, there would be no pricing signal at all for these trades.

17 *See infra* note 35.

last available market quotation or sale price of the proposed ETF's portfolio holdings.[18] As further acknowledged by the Applicants, the IIV is not the NAV; rather, it is a reference produced by a third party seeking to approximate the proposed ETF's underlying per share net asset value.[19] Applicants also concede that the IIV is not intended as a "real-time NAV" and (unlike the NAV) would not include extraordinary expenses or liabilities booked during the day.[20] As discussed below, an ETF's portfolio could contain securities and other assets all (or most) of which need to be fair valued in order for the IIV to be accurate.[21]

c. Blind Trust Mechanism: Applicants propose for creation unit purchases to be made in cash and for redemptions to be effected in-kind through a "blind trust" established for each Authorized Participant. Applicants assert that the delivery of redemption securities into the blind trust would allow the ETF to retain the benefits associated with in-kind redemptions,[22] while shielding the identity of the ETF's portfolio securities. Based on the standing instructions of the Authorized Participant, the blind trust would sell or otherwise manage the securities on behalf of the Authorized Participant without disclosing the contents of the underlying portfolio.

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18 Application at 32. *See also* Matt Hougan, *The Flaws in iNAV*, 104 EXCHANGE-TRADED FUNDS REPORT ("Hougan ETF Report"), 5, 10 (2009).

19 Application at 31.

20 *Id.*

21 *See infra* notes 38-45 and accompanying text.

22 Because redemptions from ETFs are often made in-kind, ETFs may offer certain tax efficiencies compared to traditional mutual funds by avoiding the need to sell assets and potentially experience a taxable event. In addition, ETFs do not bear the brokerage costs associated with liquidating portfolio instruments to meet redemption requests. We note that it is unclear whether Applicants' proposed ETFs would experience the same in-kind benefits experienced by existing ETFs. The blind trust structure is likely to introduce additional costs because, among other things, the Authorized Participants would not be able to manage the sale of the securities to enhance arbitrage profits. *See* Comment Letter of Gary Gastineau, File No. SR-NYSEArca-2014-10 (Mar. 18, 2014) ("Gastineau March 2014 Letter"), at 3-5 for a discussion of the potential issues presented by this structure.

d. Back-up Redemption Option: Applicants have proposed a back-up mechanism that would allow retail investors to redeem individual shares directly from the proposed ETFs in the event of a persistent and significant deviation of closing market price from NAV. Under the proposal, retail investors exercising the option would be subject to a redemption fee of up to 2% of the value of shares redeemed and would likely be charged additional brokerage commissions. Further, the redemption option would become available to retail investors only after the proposed ETF's shares have persistently been trading at a discount of at least 5% from NAV for 10 consecutive business days. The option would remain open for 15 days; if a discount persists, a new option would commence on the next business day.

IV. Analysis of the Application

17. As noted above, the Applicants have sought exemptive relief under several provisions of the Act—each of which the Applicants would need to obtain in order to operate their proposed ETFs.

18. Applicants state that the relief requested in their application is similar to the relief granted in exemptive orders issued to existing actively managed ETFs, except for certain differences permitting the proposed ETFs to operate on a non-transparent basis.

19. As discussed below, however, the Commission preliminarily believes that the specific features proposed by the Applicants that would cause the proposed ETFs to operate without transparency fall far short of providing a suitable alternative to the arbitrage activity in ETF shares that is crucial to helping keep the market price of current ETF shares at or close to

the NAV per share of the ETF.[23] Accordingly, the Commission preliminarily believes that it is not in the public interest or consistent with the protection of investors or the purposes fairly intended by the policy and provisions of the Act to grant the exemptive relief under section 6(c) that the Applicants seek.

A. <u>ETF Prospectus Disclosure and IIV Dissemination</u>

20. Applicants assert that ETF prospectus disclosure and the dissemination of the IIV every 15 seconds during the trading day would be sufficient to allow the arbitrage mechanism to function effectively after a few days of trading.[24] Applicants further assert that market participants do not need any additional information about the proposed ETF's portfolio so long as they are able to create correlations against and, over time, evaluate how various market factors affect the disseminated IIV. According to Applicants, this process is referred to as "reinforcement learning."[25]

21. ETF prospectus disclosure will not assist the arbitrage mechanism because such disclosure does not contain any material real-time information necessary to creating or facilitating effective arbitrage. Actively managed funds generally include very broad investment

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23 Staff in the Division of Economic and Risk Analysis provided advice and analyses relevant to the Commission's conclusions, discussed in more detail below.

24 Application at 37-43.

25 According to Applicants, reinforcement learning is dependent on statistical arbitrage. *See* text following *supra* note 10. Applicants assert that market makers would use the proposed ETF's market price, IIV and daily NAV to construct a hedging portfolio for the proposed ETF. The market makers would then engage in statistical arbitrage between their hedging portfolio and the shares of the proposed ETF – *i.e.*, buying and selling one against the other during the trading day and evaluating the effectiveness of their hedging portfolio at the day's end. Applicants further assert that after a few days of trading, there would be sufficient data for a market maker to run a statistical analysis that would result in the market maker's spreads being tightened substantially around the IIV. Application at 37-43.

objectives and strategies in order to provide investment advisers with the maximum flexibility possible in managing the portfolio, and do not include more specific, current information about a fund's portfolio holdings.[26] The Commission preliminarily believes that it would be difficult, if not impossible, for market participants to discern sufficient useful information from such broad disclosures. Therefore, the lack of more specific information with respect to the proposed ETF's investment objectives or principal investment strategies may not enable market makers to effectively assess whether real-time arbitrage opportunities in ETF shares exist and may discourage them from making markets in ETF shares that would keep the share prices at or close to the NAV per share of the ETF—a condition that may be exacerbated during times of market stress.

22. Dissemination of the IIV at 15 second intervals throughout the trading day does not fill this information void. Today, market makers calculate their own NAV per share of the ETF with proprietary algorithms that use an ETF's daily portfolio disclosure and available pricing information about the assets held in the ETF's portfolio.[27] They generally use the IIV, if at all, as a secondary or tertiary check on the values that their proprietary algorithms generate. If the daily portfolio holdings for the proposed ETFs are not available for market makers to

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26 For example, Form N-1A requires mutual funds to disclose in the prospectus and statement of additional information their investment objectives or goals, principal investment strategies, and the portfolio turnover rate during the most recent fiscal year. *See, e.g.,* Form N-1A, Items 2 to 4, and 9. As discussed above, mutual funds are required to disclose their portfolio holdings quarterly. *See supra* note 15 and accompanying text.

27 *See* David J. Abner, *The ETF Handbook: How to Value and Trade Exchange Traded Funds* (2010), at 90 ("[s]ince stock trading now takes place in microseconds, a lot can happen between two separate 15-second quotes. Professional traders are not using published IIVs as a basis for trading. Most, if not all, desks that are trading ETFs are calculating their own [NAV of the ETF] based on real time quotes…that they are generating within their own systems."). *See also* Comment Letter of BGFA, File No. S7-07-08 (May 16, 2008) ("BGFA 2008 Letter"), at n.43; and ICI Fact Book, *supra* note 8, at 59.

calculate current values of a proposed ETF, they will be reliant principally on the IIV given the limitations of the prospectus and quarterly portfolio disclosures. Even though the IIV continues to be disseminated in conjunction with the full portfolio holdings and basket of existing ETFs, its reliability as a primary pricing signal for the proposed ETFs is questionable for the reasons discussed below.

23. *The IIV is stale data.* Unlike market maker proprietary algorithms, which rely on portfolio transparency and provide market makers with real-time data to effectively trade in today's fast moving markets, IIV dissemination frequency is inadequate for purposes of making efficient markets in ETFs.[28] Market makers operate at speeds calculated in fractions of a second.[29] In today's markets, 15 seconds is too long for purposes of efficient market making and could result in poor execution.[30] Because an ETF is a derivative security, its current value

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28 The Commission previously issued a proposing release on a proposed rule for certain ETFs. *See* Exchange-Traded Funds, Investment Company Act Release No. 28193 (Mar. 11, 2008) ("2008 ETF Rule Proposal"). Various industry members commenting on the 2008 ETF Rule Proposal noted that market makers did not rely on the IIV because of either its staleness or unreliability. *See, e.g.*, Comment Letter of NYSE Arca, Inc., File No. S7-07-08 (May 29, 2008) (the exchange noted that it "is not convinced that the [IIV] is a meaningful pricing tool for investors in light of the availability of other pricing information. In fact, we believe that it is the transparency of the portfolios [sic] holdings which permit [sic] market makers and other professionals to arbitrage efficiently and not the regular dissemination of an [IIV]. Some market participants may choose to generate an [IIV] for their own use, using their own calculation methodology to include financing costs, capital costs, etc., in kind trading or arbitrage. Importantly, the [IIV] generated by professionals is in real-time and not delayed by 15 or 60 seconds."); and BGFA 2008 Letter, *supra* note 27, at n. 43 and n. 92. *See also* Matt Hougan, *Ban iNAVs For ETFs* (June 24, 2013), *available at* http://www.indexuniverse.com/sections/blog/19037-hougan-ban-inavs-for-etfs.html.

29 *See* Comment Letter of ICI, File No. SR-NASDAQ-2012-117 (Nov. 8, 2012), ("ICI 2012 Letter"), at 4. *See also* ICI Fact Book, *supra* note 8.

30 *See, e.g.*, *How To Minimize Your Cost Of Trading ETFs* (June 22, 2009), ETF.com, *available at* http://www.etf.com/publications/journalofindexes/joi-articles/6042-how-to-minimize-your-cost-of-trading-etfs.html, at Figure 2 and related discussion. *See also* ICI 2012 Letter, *supra* note 29 ("Professional equity traders operate at speeds calculated in fractions of a second. In such markets, 15 seconds can be an eternity, and establishing an order price based on data that is nearly 15 seconds old could result in poor execution.").

changes every time the value of any underlying component of the ETF portfolio changes.[31] Therefore, the IIV for a more frequently traded component security might not effectively take into account the full trading activity for that security, despite being available every 15 seconds. For example, a large buy order for a component security held by the proposed ETF could temporarily spike the price of that security and, therefore, inflate the proposed ETF's contemporaneous IIV calculation.[32] The IIV for the proposed ETF cannot adjust for such variations, whereas the NAV would.[33] Therefore, relying on a stale IIV as a primary pricing signal for market making in Applicants' proposed ETFs would not result in an effective arbitrage mechanism.[34]

24. *The IIV is not subject to meaningful standards.* Because there are no uniform methodology requirements, the IIV can be calculated in different ways rendering it potentially arbitrary and inconsistent.[35] Also, Applicants acknowledge that no party has agreed to take

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31 In particularly volatile markets, the dissemination lag of IIV values (*i.e.*, every 15 seconds) may misrepresent the actual value of the ETF. *See Understanding iNAV*, ETF.com, *available at* http://www.etf.com/etf-education-center/21028-understanding-inav.html; Gary L. Gastineau, *Exchange-Traded Funds Manual*, Second Edition (2010), at 200-202.

32 *See, e.g.*, ICI 2012 Letter, *supra* note 29.

33 *See, e.g.*, ICI 2012 Letter, *supra* note 29. *See also* Gastineau March 2014 Letter, *supra* note 22, at 10, for a more detailed discussion of why the IIV would at best be a "lagging indicator of actual portfolio values" during times of rapid market movement.

34 An IIV that is disseminated at more frequent intervals could present a different set of problems, as it may enable third parties to reverse engineer the underlying portfolio using data analysis. Therefore, changing the frequency of dissemination would not appear to be a viable option to the extent Applicants' objective is to prevent disclosure of the proposed ETF's portfolio. *See also infra* note 37 and accompanying text.

35 *See, e.g.*, ICI 2012 Letter, *supra* note 29 ("[M]any parties participate in the calculation, publication, and dissemination of [IIV]. The ETF sponsor provides an independent calculation agent with the daily list of securities constituting an ETF's creation basket (which for U.S. equity ETFs is typically, but not always, a pro rata slice of the ETF's portfolio). The calculation agent separately obtains market pricing information for each of the component securities from a third party source, such as the exchange or a pricing vendor, and calculates the estimated per-share

responsibility for the accuracy of IIV calculation.[36] Therefore, the Commission's preliminary conclusion is that the IIV calculation methodology is not appropriate for the IIV to be used as a primary pricing signal because it is potentially unreliable and susceptible to errors.[37]

25. *The IIV would be inaccurate for certain securities and asset classes.* Because the IIV is constructed using last available market quotations or sale prices and not fair value prices for the underlying assets, it can be inaccurate.[38] For example, as some securities do not trade frequently, the IIV would reflect the last quoted or sale price which could be stale and no longer reflect their current value.[39] Other securities may not have yet opened for trading on a particular trading day or may be subject to an intraday interruption in trading.[40]

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value of an ETF share. *This process creates several opportunities for errors*: for example, an ETF may report a basket inaccurately; a calculation agent may receive faulty data from a pricing vendor; or an error may be made in the calculation process. *We understand that such errors are not infrequent.*" [*emphasis added*]).

36 Applicants explicitly disclaim making any warranty by the ETFs as to the accuracy of the IIV. The Adviser would merely use "commercially reasonable efforts to assure that the calculation agent has an accurate listing of all securities in each [f]und's portfolio as of the beginning of trading on each day the [f]und is traded." Similarly, "[a]lthough the calculation agent will not guarantee the accuracy of the IIV, the contract with the calculation agent will require that it use commercially reasonable efforts to calculate the IIV correctly…." Application at 31.

37 As is the case with more frequent dissemination, an IIV that is sufficiently accurate and precise may also enable third parties to reverse engineer the underlying portfolio using data analysis. Such an ETF would thus once again become vulnerable to front running if its portfolio can be reverse engineered by others. *See* Gastineau March 2014 Letter, *supra* note 22, at 15.

38 *See* Hougan ETF Report, *supra* note 18. NAV includes fair value pricing, and with daily portfolio disclosure, market makers can estimate fair value on their own for the holdings of current ETFs.

39 *See, e.g.*, ICI 2012 Letter, *supra* note 29.

40 *See* Gastineau March 2014 Letter, *supra* note 22 (noting that an exchange may institute a trading halt in a stock to address a significant order imbalance or in connection with release of important company news).

26. Applicants note that up to 15% of the proposed ETFs' total assets could be in illiquid securities.[41] Illiquid securities often fall within the category of securities for which there is no readily available market quotation and their fair value must be determined in good faith by the fund's directors.[42] Therefore, a significant amount of illiquid securities in a proposed ETF's portfolio could exacerbate the deviation between the IIV and the NAV per share of the ETF because the accurate value of illiquid securities is determined by current fair valuation (reflected in the NAV) rather than use of stale pricing data (reflected in the IIV).[43]

27. Additionally, the proposed ETFs may invest a portion of their assets (up to a third of the total assets) in derivatives and foreign securities.[44] Thinly traded derivatives contracts may lack readily observable market prices that could be used to update the IIV in real time. Similarly, because international securities are often traded outside the ETF's regular trading hours, their last available market prices could be up to a day old and no longer reflect their current value.[45] Therefore, to the extent pricing inputs are unavailable or become stale for these

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41 *See* 19b-4 Notice, *supra* note 13.

42 15 U.S.C. 80a-2(a)(41)(B). *See also* Independent Directors Council, *Fundamentals for Newer Directors* (Feb. 2014), *available at* http://fundamentals.idc.org/specific/specific_pricing, at 27.

43 ETF sponsors seek to minimize exposure to assets that could impact this deviation because they can make arbitrage opportunities more difficult to evaluate. *See* Comment Letter of ICI, File No. S7-07-08 (May 19, 2008). *See also* Comment Letter of The American Stock Exchange LLC, File No. S7-20-01 (Mar. 5, 2002) ("Ultimately it is in the interest of the sponsor and investment adviser to provide for effective arbitrage opportunities. It is unlikely that an ... ETF sponsor would be able to convince the critical market participants such as specialists, market makers, arbitragers and other Authorized Participants to support a product that contained illiquid securities to a degree that would affect the liquidity of the ETF, making it difficult to price, trade and hedge, ultimately leading to its failure in the marketplace.").

44 *See* 19b-4 Notice, *supra* note 13.

45 *See, e.g.,* ICI 2012 Letter, *supra* note 29; Ari I. Weinberg, *An Extra Data Point on ETFs** (Aug. 4, 2013), *available at* http://online.wsj.com/news/articles/SB10001424127887323993804578611773169627276

alternative asset classes, the IIV would no longer be an accurate reflection of the NAV per share of the ETF.

28. *IIV inaccuracies can increase ETF tracking errors.* Errors in the IIV will likely lead to errors in estimating the factors that a market maker must consider when valuing a proposed ETF and constructing a hedging portfolio.[46] Therefore, market makers may not be able to construct accurate hedging portfolios for the ETF shares.[47] This would increase the tracking error associated with the hedging portfolios described above. As a result, tracking errors between intraday ETF prices and NAV per share of the proposed ETF would also likely increase because greater tracking errors in hedging portfolios would expose the market maker's position to greater risk.[48]

29. In addition, it may be more difficult for market makers to construct appropriate hedging portfolios from the IIV for proposed ETFs with higher portfolio turnover. In particular, changing portfolio allocations can cause the factors that a market maker must consider when

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(further noting that "[i]nternational markets also observe different holidays, meaning that a stock might not trade for several days even while an ETF that holds it is trading in the U.S. – leaving even more time for events that could result in a significantly different price when the stock starts trading again.").

46 Such factors would include the market, asset class, sector and other risk factors. Market makers would need to estimate these exposures for a proposed ETF in order to construct hedging portfolios.

47 This calls into question the reinforcement learning process which may not perform adequately during periods of heightened market volatility. *See* Sanmay Das, *Intelligent Market-Making in Artificial Financial Markets*, Massachusetts Institute of Technology – Artificial Intelligence Laboratory, AI Technical Report 2003-005, at 37.

48 A commonly accepted assumption in economic models of market making is that market makers' bid-ask spreads compensate them for a number of costs including the risk they bear in their positions. *See* Maureen O'Hara, *Market Microstructure Theory*, First Edition (1998), at 35. Therefore, greater tracking errors in hedging portfolios for the proposed ETFs will likely result in higher bid-ask spreads and greater tracking errors between intraday ETF prices and the NAV of the ETF.

valuing a proposed ETF and constructing a hedging portfolio to fluctuate more rapidly. This would in turn increase uncertainty around the market maker's estimates of these factors.[49] Therefore, proposed ETFs with more complex investment strategies involving dynamic factors will likely have higher tracking errors and bid-ask spreads if there is lack of sufficient information for market participants to construct tight hedges.[50]

30. *IIV inaccuracies can increase during periods of market stress or volatility.* Market stress can reduce liquidity in certain assets and consequently increase errors in IIV as the portfolio becomes increasingly illiquid and current market prices become more difficult to determine. In addition, volatility can increase errors around prices used in IIV calculations as volatility can increase the movement of prices.

31. In stressed markets, confidence in the pricing of (and in turn, the knowledge of) the ETF portfolio becomes increasingly important for market makers to continue to quote prices in ETF shares.[51] By itself, the IIV of a proposed ETF likely will not instill such confidence in a

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49 In contrast, turnover would introduce no such uncertainty in ETFs with daily portfolio disclosure as the end-of-day NAV would be marked to the previously disclosed portfolio, which is known by market makers.

50 Applicants are seeking relief to launch, among others, long/short equity proposed ETFs. These types of funds have a higher portfolio turnover on average than that of actively managed equity funds. *See* Jing-Zhi Huang and Ying Wang, *Should Investors Invest in Hedge Fund-Like Mutual Funds? Evidence from the 2007 Financial Crisis*, 22 J. OF FINANCIAL INTERMEDIATION 482 (2013), *available at* http://dx.doi.org/10.1016/j.jfi.2012.11.004, at 486-487 (finding that average turnover across 130/30 equity mutual funds was 196% from June 2003 until December 2009 versus less than 70% across all actively managed mutual funds in a comparable time period). These proposed ETFs also could have more thinly traded securities that could be more susceptible to price volatility during stressed market conditions. Therefore, it may be difficult for market makers to construct appropriate hedging portfolios from the IIV, making the proposed ETFs also likely to have higher tracking errors and bid-ask spreads.

51 *See, e.g.*, *Report to the Joint Advisory Committee on Emerging Regulatory Issues*, Staffs of the CFTC and SEC (Sept. 20, 2010) ("Flash Crash Report"), at 4-6 (noting that buy-side and sell-side interest returned only after market makers were able to verify the integrity of their data and

proposed ETF's pricing because, as discussed above, the IIV is potentially unreliable and susceptible to errors.[52] Nevertheless, a market maker that questions the current market price or IIV for an ETF can check those numbers against the NAV per share of the ETF output from its proprietary algorithm if the ETF has a fully-transparent portfolio. That same market maker, however, would not be able to run a similar cross-check on those figures against a non-transparent ETF like the ones proposed by Applicants. Due to the inherent weaknesses of the IIV as a stand-alone metric, Applicants' proposal (which relies heavily upon the IIV as a substitute for full portfolio transparency) likely will not offer enough information about the underlying portfolio. As discussed below, this, in turn, likely would discourage market makers from making markets that would keep the market price for the proposed ETF's shares at or close to the NAV per share of the ETF, particularly under stressed market conditions when the need for real-time and verifiable pricing information becomes more acute.[53]

32. Accordingly, the Commission's preliminary conclusion is that use of the IIV as a primary pricing signal for market making in Applicants' proposed ETFs would not result in an effective arbitrage mechanism.

B. Quarterly Release of Portfolio Holdings

33. Applicants also propose providing their portfolio holdings disclosures on a quarterly basis, with a lag of not more than 60 days. But such disclosures would quickly lose their relevance for purposes of valuing or hedging the proposed ETFs because the content of

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systems and that they had to assess the risks of continuing to trade during the events of May 6, 2010).

[52] *See supra* notes 28-37 and accompanying text.

[53] *See infra* Section V.

their portfolios can change on a daily basis. This problem is heightened for ETFs with active management strategies that involve high portfolio turnover and alternative asset classes.[54] Again, this may discourage market makers from making markets that would keep the market price for the proposed ETF's shares at or close to the NAV per share of the ETF, particularly during times of market stress when the need for real-time pricing information becomes more acute.

C. Back-Up Redemption Option

34. In light of concerns about the effect on retail investors if the arbitrage mechanism failed to keep market prices at or close to the NAV of the proposed ETFs, Applicants proposed a redemption option that, in their view, would act as a "fail-safe" mechanism in the event of a persistent and significant deviation of closing market price from NAV. For the reasons discussed below, the Commission preliminarily believes that this redemption option does not remedy the defects with Applicants' proposal outlined above such that exemptive relief would be appropriate.

35. Under the proposal, retail investors exercising the redemption option would be subject to redemption and brokerage fees, which would likely discourage use of the option. Specifically, retail investors exercising the redemption option would be subject to a redemption

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[54] Antti Petajisto, *Active Share and Mutual Fund Performance*, 69 FINANCIAL ANALYSTS JOURNAL 73 (2013), *available at* http://www.cfapubs.org/doi/pdf/10.2469/faj.v69.n4.7, at 83. The study found that annual turnover across U.S. all-equity mutual funds is 87%. As a result, approximately 14% of the portfolio changes over the 60 days following the portfolio disclosure (prorating annual turnover of 87% for 60 days) and an additional 22% of the portfolio changes over the course of the following quarter (prorating annual turnover of 87% for three months). Therefore, there may be significant tracking errors between an ETF's current portfolio holdings and its prior quarterly portfolio disclosure.

fee of up to 2% of the value of shares redeemed. In addition, retail investors would likely be charged additional brokerage commissions to exercise the option. These fees and costs may dissuade retail investors from exercising a redemption option meant to provide retail investors with the ability to transact with the ETF on an equal footing with the Authorized Participants.[55]

36. Moreover, the proposed redemption option is also problematic because it would become available to investors *only* after ETF shares have persistently been trading at a discount of at least 5% from NAV for 10 consecutive business days. This would result in disparate treatment of investors compared to Authorized Participants and would further restrict investors' ability to transact at prices at or near NAV. The Commission is concerned that forcing investors to remain invested in a product that is trading at a significant discount to NAV per share for two weeks before the redemption option is available may lead to significant investor harm in the interim.[56] Investors would not be able to exit or would have to exit at a price substantially below

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55 An economically rational investor who seeks to exercise the option is likely not to redeem until a trading discount to IIV in the secondary market exceeds the costs to redeem (*i.e.*, the redemption fee plus the brokerage charges). Given that typical bid/ask spreads for ETFs with underlying diversified domestic equity holdings average 4 basis points, a redemption fee set at 2% will cost the investor 200 basis points (not including brokerage charges) to exit the proposed ETFs. *See* Antti Petajisto, *Inefficiencies in the Pricing of Exchange-Traded Funds* (Sept. 20, 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2000336 ("Petajisto ETF Study"), at Table III. This assumes that the investor has the information necessary (IIV, bid price for the shares, redemption fee, brokerage charges) to make the determination of whether to redeem directly from the proposed ETFs or sell on the market. *See generally,* Matt Hougan, *The Flaws in the iNAV,* Exchange-Traded Funds Report (July 2009), at 5 (noting that investors would have to have deep quantitative experience to create models to see if they were getting fair prices on ETF trades today); and John Beshears, James Choi, David Laibson, and Brigitte C. Madrian, *How Does Simplified Disclosure Affect Individuals' Mutual Fund Choices?*, in *Explorations in the Economics of Aging,* edited by David A. Wise (2011) (noting that many retail investors lack the ability to perform even elementary calculations to compare investment options with differing sales fees).

56 *See, e.g.,* Petajisto ETF Study, *supra* note 55, at 18 (generally discussing economic magnitude of mispricings).

the NAV per share of the ETF, which would be contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act that all shareholders be treated equitably when buying and selling their fund shares.[57] In the meantime, Authorized Participants would have the advantage of transacting directly with the ETF on a daily basis at NAV.

37. But even if Applicants were able to address the Commission's concerns about the retail redemption option, this would not address the Commission's more fundamental concerns about Applicants' proposal. As discussed above, Applicants are proposing an ETF model that the Commission preliminarily believes would not have a sufficiently effective arbitrage mechanism to consistently produce a secondary market price for investors that would approximate NAV per share of the ETF. The presence of a back-up retail redemption option does not cure the inherently flawed structure of the proposed ETFs here.[58]

V. The Commission's Preliminary View

38. As discussed above, the Commission preliminarily believes that Applicants have not provided an adequate substitute for portfolio transparency such that the proposed ETFs would consistently trade at or close to NAV. A close tie between market price and NAV per share of the ETF is the foundation for why the prices at which retail investors buy and sell ETF shares are similar to the prices at which Authorized Participants are able to buy and redeem shares directly from the ETF at NAV. This close tie between the prices paid by retail investors and Authorized Participants is important because section 22(d) and rule 22c-1 under the Act are

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57 *See supra* note 5 and accompanying text.

58 Applicants proposed the redemption option described above in response to the staff's suggestion. The Commission preliminarily believes that the inherent structural flaw of the proposed ETFs – *i.e.*, the potential lack of an effective arbitrage mechanism – cannot be solved by the proposed fail-safe mechanism.

designed to require that all fund shareholders be treated equitably when buying and selling their fund shares.[59] In fact, in granting relief from section 22(d) and rule 22c-1 under the Act, the Commission has relied on this close tie between what retail investors pay and what Authorized Participants pay to make the finding that the ETF's shareholders are being treated equitably when buying and selling shares.

39. The lack of portfolio transparency or an adequate substitute for portfolio transparency coupled with a potentially deficient back-up mechanism presents a significant risk that the market prices of ETF shares may materially deviate from the NAV per share of the ETF—particularly in times of market stress when the need for verifiable pricing information becomes more acute. This would be contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act—that shareholders be treated equitably—and may, in turn, inflict substantial costs on investors, disrupt orderly trading and damage market confidence in secondary trading of ETFs.

A. Substantial Costs to Investors

40. One of the primary benefits of current ETFs is that investors are generally able to obtain a similar economic experience to investors in traditional open-end funds (*i.e.*, price at or close to NAV), but without certain of the costs associated with such funds (*e.g.*, transfer agency fees). The Commission preliminarily believes the proposed ETFs would not provide either element of this benefit if, as the Commission anticipates, the arbitrage mechanism does not function properly. A breakdown in the arbitrage mechanism could result in material deviations between market price and NAV per share of the ETF. Such deviations can hurt an investor. For

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59 *See supra* note 5.

example, if an investor places a buy order and the ETF is trading at a premium, this would result in a lower return for the investor as opposed to if the investor had bought the ETF when its prices were at or close to the NAV per share of the ETF or at a discount. As discussed above, the arbitrage mechanism inherent in the ETF structure keeps these differences small.

41. In this regard, the Commission finds it significant that market makers for Applicants expressed some skepticism during meetings with Commission staff that the IIV could be used as the primary pricing signal for ETFs with active management strategies that might involve high portfolio turnover or alternative asset classes.[60] They indicated that they would likely use the pieces of information provided by the Applicants (IIV, quarterly portfolio holdings disclosure and prospectus disclosure) to construct hedge portfolios using sophisticated algorithms.[61] Their ability to construct hedge portfolios that are generally predictive of the portfolio holdings of the ETF is critical to their management of their exposure to the ETF. If there is a break in the alignment between the market makers' hedge portfolios and the NAV per share of the ETF, the market makers' risk of loss increases. The greater the risk of loss, the more the market makers will seek to cover that risk by quoting wider price spreads of the proposed ETFs. This would result in market prices, at which investors would buy and sell the ETF shares, not being at or close to the NAV per share of the ETF, which would be contrary to the

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60 Commission staff met with market makers invited by the Applicants on January 23, 2014.

61 ETF market makers commonly use representative hedging portfolios instead of trading in basket securities because they may be easier to implement or more cost effective. They do this to offset market exposures as they build short or long positions in the ETFs intraday. The market maker will earn profits to the extent its hedge portfolio deviates from the NAV per share. *See* Gastineau March 2014 Letter, *supra* note 22, at 6.

foundational principle underlying section 22(d) and rule 22c-1 under the Act that shareholders be treated equitably.

42. The Commission preliminarily believes that, even under normal market conditions, market makers could be unable to deconstruct the portfolio holdings of a proposed ETF with sufficient accuracy in order to construct a hedge portfolio that is closely aligned to the NAV per share of the ETF. The proposed disclosures by the Applicants would likely be useful in narrowing down the pool of securities and other assets that may be held by the ETF, but only to a limited extent. For example, prospectus disclosures of general risks and investment objectives provide little quantitative precision about an ETF's assets and risk exposures. The proposed quarterly portfolio disclosures would provide little additional quantitative precision as a result of portfolio turnover, as discussed previously. Consequently, variability would inevitably be introduced into the proposed model. The Commission believes that this may lead to a break in alignment between a market maker's hedge portfolio and the NAV per share of the ETF; this could diminish the market maker's ability to manage its risks, which, in turn, could increase its risk of loss.[62] This greater risk of loss would be reflected in wider bid/ask spreads

62 *See* Examining the Exchange-Traded Nature of Exchange-Traded Funds, Morningstar ETF Research (Feb. 11, 2013) ("Morningstar ETF Report"), at 21 ("To consider conducting an arbitrage transaction, arbitrageurs must be fairly confident that they will receive a return commensurate with the level of risk they are assuming. Therefore, it is likely that intraday changes to volatility (that is, risk) cause arbitrageurs to become more or less confident when transacting in the equity market for purposes of arbitrage and thus cause premiums or discounts to occur in the short term.... From the perspective of an arbitrageur, increased equity market volatility implies that the value of purchased equities relative to the value of the ETF's shares is at greater risk to fall and thus increases the potential that arbitrage trade will be less profitable, if at all. Therefore, when equity market volatility rises, it is likely that an arbitrageur would wait longer before acting to exploit an ETF premium. As a result, the ETF market price would outperform the NAV price on days when equity market volatility is increasing.... Arbitrageurs knowingly leave profits on the table for a short amount of time because the risk or cost to trade and profit is too high at that time.").

and result in intraday market prices that deviate from the NAV per share of the ETF, which would be contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act that shareholders be treated equitably.

43. The Commission also preliminarily believes that this potential price disparity could be even worse under times of market stress or volatility. Market makers would likely be heavily reliant on sophisticated algorithms to deconstruct the portfolio holdings of the proposed ETF in order to construct the hedge portfolio. During times of market stress or volatility, the Commission believes that reliance on these algorithms would not be sufficient for market making purposes in the proposed ETFs and the correspondence between the hedge portfolio and the NAV per share of the ETF might be expected to lag. This is because the market makers' hedge portfolio may deviate significantly from the actual portfolio of the proposed ETF, resulting in greater intraday market risk to the market maker and a corresponding widening of the bid/ask spread.[63] This would result in market prices, at which investors would buy and sell the ETF shares, not being at or close to the NAV per share of the ETF, which would be contrary to the foundational principle underlying section 22(d) and rule 22c-1 under the Act that shareholders be treated equitably. Accordingly, although some market makers supporting Applicants noted that they should be able to construct hedge portfolios that were closely aligned (and would remain aligned) to the NAV per share of the ETF for the domestic equity ETFs proposed by Applicants, the Commission cannot fully agree with that conclusion.

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63 Ron Delegge, *ETF Bid/Ask Spreads* (Apr. 23, 2013), *available at* http://investius.com/2013/04/23/etf-bidask-spreads/.

44. Finally, although Applicants proposed a retail redemption option to address a significant and persistent deviation of market price to NAV, as discussed in detail above, the Commission preliminarily believes that this option is not sufficient to protect investors as required by the Act.

B. Potential Disruption of Orderly Trading and Damage to Market Confidence

45. In the absence of sufficient information for market makers to accurately assess the value of the underlying portfolio securities and to make markets in ETF shares at levels that are closely aligned to the NAV per share of the ETF, market makers are likely to trade in proposed ETFs with wide bid/ask spreads and variable premiums/discounts to the NAV per share of the ETF. This would be particularly the case during times of market stress and for active management strategies that might involve high portfolio turnover when there is a greater need for confidence in pricing signals.[64] Under particularly stressful or volatile market conditions, the inability to independently and accurately value an ETF's portfolio assets may cause market makers to withdraw from providing meaningful liquidity, which in turn can lead to the disruption of orderly trading in the ETF.[65] The Commission preliminarily believes that a structure that may lead market makers to make markets in the proposed ETFs at prices that are not closely aligned to the NAV per share of the ETF is not necessary or appropriate in the public interest, nor is it consistent with the protection of investors or with the foundational principle underlying section 22(d) and rule 22c-1 under the Act that shareholders be treated equitably.

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64 *See supra* note 50 and accompanying text.

65 *See* Flash Crash Report, *supra* note 51, at 4-6. *See also* Morningstar ETF Report, *supra* note 62.

46. Further, any breakdown in the pricing or the ability to price the proposed ETF may result in damage to market confidence in secondary trading of ETFs—not just in the proposed product, but in ETFs generally. Investors may exit the ETF market because of a loss of trust, particularly in actively managed ETFs, should the proposed ETFs fail to function in a manner similar to current ETFs.[66] For this additional reason, the Commission preliminarily believes that it is not necessary or appropriate, nor in the public interest or consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act, to grant the requested relief.

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66 *See* Tamar Frankel, *Regulation and Investors' Trust in the Securities Markets*, 68 BROOK. L. REV. 439 (2002), at 448 (arguing that once investors' trust is lost, they will flee the stock markets and turn to other types of investments that "they can see, evaluate and guard for themselves.").

47. In light of the foregoing, the Commission remains unconvinced that Applicants' proposed ETFs meet the standard for relief under section 6(c) of the Act. Accordingly, absent a request for a hearing that is granted by the Commission, the Commission intends to deny Applicants' request for an exemption under section 6(c) of the Act as not necessary or appropriate in the public interest and as not consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73402 / October 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16205

In the Matter of **Asura Development Group, Inc. (f/k/a IA Global, Inc.),** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Asura Development Group, Inc. (f/k/a IA Global, Inc.) ("Asura Development" 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 Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. Asura Development (CIK No. 1077634) is a delinquent Delaware corporation located in Scottsdale, Arizona with classes of securities registered with the Commission pursuant to Exchange Act Sections 12(b) and 12(g). As of March 20, 2014, the company's stock (symbol "IAGI") 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).

2. Asura Development has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder because it has not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2010.

IV.

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

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

Brent J. Fields
Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

HANGE ACT OF 1934
October 22, 2014

VE PROCEEDING

r of Solar, Inc., Respondent.	ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Entech Solar, Inc. ("Entech Solar" 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 Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. Entech Solar (CIK No. 811271) is a void Delaware corporation located in Grapevine, Texas with class of securities registered with the Commission pursuant to

Exchange Act Section 12(g). As of May 14, 2014, Entech Solar's stock (symbol "ENSL") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc., had twelve market makers, and was eligible for the "piggyback" exemption of Exchange Act Rule 15c2-11(f)(3).

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

IV.

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

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

Brent J. Fields
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. 73404 / October 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16207

In the Matter of **ORB Automotive Corp.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against ORB Automotive Corp. ("ORB Automotive" 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 Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. ORB Automotive (CIK No. 1381805) is a Cayman Islands corporation located in Shenzhen, China with class of securities registered with the Commission pursuant to Exchange Act Section 12(g).

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

IV.

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

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

Brent J. Fields
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. 73406 / October 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16208

In the Matter of **21st Century Telesis II, Inc.,** **Agemark Corp.,** **Alnilam Corp.,** **American Centrality Group, Inc.,** **China Feicui Guodian Group Ltd., and** **Icon Public Ltd. Co.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents 21st Century Telesis II, Inc., Agemark Corp., Alnilam Corp., American Centrality Group, Inc., China Feicui Guodian Group Ltd., and Icon Public Ltd. Co.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. 21st Century Telesis II, Inc. (CIK No. 947660) is a void Delaware corporation located in Costa Mesa, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 21st Century Telesis 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, 1998, which reported a net loss of over $1.5 million for the prior three months.

2. Agemark Corp. (CIK No. 1077641) is a dissolved Nevada corporation located in Berkeley, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Agemark is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2004.

3. Alnilam Corp. (CIK No. 1128288) is a revoked Nevada corporation located in Costa Mesa, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Alnilam 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, 2008, which reported a net loss of $91,989 from its May 10, 2000 inception to June 30, 2008.

4. American Centrality Group, Inc. (CIK No. 1413414) is a Nevada corporation located in San Jose, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Centrality is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on December 19, 2007.

5. China Feicui Guodian Group Ltd. (CIK No. 818806) is a revoked Nevada corporation located in Palm Desert, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). China Feicui 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 $418,929 from the company's February 24, 1987 inception to March 31, 2010.

6. Icon Public Ltd. Co. (CIK No. 1060373) is an Irish company located in Dublin, Ireland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Icon Public is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended May 31, 2002, which reported a net loss of $87,939 for the prior three months. As of October 16, 2014, the company's stock (symbol "ICLR") was quoted on Nasdaq, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration

is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

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

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73419; File No. 10-214)

October 23, 2014

Automated Matching Systems Exchange, LLC; Order Instituting Proceedings to Determine Whether to Grant or Deny an Application for an Exemption from Registration as a National Securities Exchange Under Section 5 of the Securities Exchange Act of 1934

I. Introduction

On July 7, 2014, Automated Matching Systems Exchange, LLC ("AMSE") filed with the Securities and Exchange Commission ("Commission") an application seeking a limited volume exemption under Section 5 of the Securities Exchange Act ("Exchange Act") from registration as a national securities exchange under Section 6 of the Exchange Act.[1] Notice of AMSE's exemption application was published for comment in the Federal Register on July 29, 2014.[2] Although Section 5 of the Exchange Act does not require the Commission to institute proceedings on whether to grant or deny AMSE's exemption application, the Commission has determined, in its discretion, to institute such proceedings in order to solicit further the views of interested persons on AMSE's exemption application. This order institutes proceedings to determine whether to grant or deny the exemption application.

II. Description of AMSE's System

AMSE proposes to conduct business in reliance upon an exemption from registration as a national securities exchange pursuant to Section 5 of the Exchange Act.[3] In general, AMSE

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1 15 U.S.C. 78e.

2 See Securities Exchange Act Release No. 72661 (July 23, 2014), 79 FR 44070 ("Notice). The Commission notes that Section 5 of the Exchange Act did not require publication of AMSE's exemption application. The Commission determined, in its discretion, to publish the Notice in order to solicit the views of interested persons on AMSE's exemption application.

3 15 U.S.C. 78e.

seeks to operate as an exchange for alternative trading systems.[4] AMSE proposes to operate solely on an "off-order-book" trading basis. AMSE does not intend to have a physical exchange trading floor, centralized order book, or specialists or market makers with affirmative and negative market making obligations. Each member of AMSE would maintain its own automated matching system or electronic order book. Each member of AMSE would adopt its own rules governing the execution and priority of orders on its system. Trades would occur when an order to buy and an order to sell match on a member's electronic order book. Each member would report its transactions to AMSE at such intervals as required by AMSE.

III. Proceedings to Determine Whether to Grant or Deny the Exemption Application and Grounds for Denial Under Consideration

The Commission is instituting proceedings to determine whether AMSE's exemption application should be granted or denied. Institution of such proceedings is appropriate at this time in view of the legal and policy issues raised by the exemption application. Institution of proceedings does not indicate that the Commission has reached any conclusions with respect to

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4 For more detail on AMSE's proposed system, see AMSE's full exemption application and Exhibits, which are published with the Notice on the Commission's website at http://www.sec.gov/rules/other.shtml. The Commission notes that alternative trading systems are securities markets that meet the definition of exchange under the Exchange Act. Regulation ATS established an alternative regulatory regime for securities markets by giving them the choice to register as exchanges, or to register as broker-dealers and comply with Regulation ATS. See Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70847 (December 22, 1998) ("Regulation ATS Adopting Release"). Rule 300 of Regulation ATS defines an alternative trading system to mean "any organization, association, person, group of persons, or system: (1) That constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange within the meaning of [Rule 3b-16]; and (2) That does not: (i) Set rules governing the conduct of subscribers other than the conduct of such subscribers trading on such organization, association, person, group of persons, or system; or (ii) Discipline subscribers other than by exclusion from trading." See 17 CFR 242.300(a).

any of the issues involved. Rather, as described in greater detail below, the Commission seeks and encourages interested persons to provide additional comment on the exemption application.

The Commission is providing notice of the grounds for denial under consideration. Section 5 of the Exchange Act allows the Commission to exempt an exchange from the requirements of exchange registration if "in the opinion of the Commission, by reason of the limited volume of transactions effected on such exchange, it is not practicable and not necessary or appropriate in the public interest or for the protection of investors to require such registration."[5] Section 3(a)(1) of the Exchange Act[6] defines an "exchange" to be "any organization, association, or group of persons, whether incorporated or incorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock market as that term is generally understood, and includes the market place and facilities maintained by such exchange." Rule 3b-16 under the Exchange Act[7] further provides that "[a]n organization, association, or group of persons shall be considered to constitute, maintain, or provide 'a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange,' as those terms are used in Section 3(a)(1) of the Act, (15 U.S.C. 78c(a)(1)), if such organization, association, or group of persons: (1) Brings together the orders of securities of multiple buyers and sellers; and (2) Uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders

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5 15 U.S.C. 78e.

6 15 U.S.C. 78c(a)(1).

7 17 CFR 240.3b-16.

interact with each other, and the buyers and sellers entering such orders agree to the terms of the trade."

As noted above, trades would occur on the separate systems of the individual members of AMSE. As described in the AMSE exemption application, it does not appear that the orders of the individual members of AMSE would interact with one another on any AMSE system, but rather on each distinct and separate system of AMSE's members. That is, it does not appear that any AMSE system would operate as an exchange by bringing together purchasers and sellers of securities. As a result, the Commission is concerned that AMSE's exemption application does not meet a key threshold requirement for being granted an exemption from exchange registration – namely, that the applicant actually be an "exchange" as defined under Section 3(a)(1) of the Exchange Act and Rule 3b-16 thereunder.[8]

Accordingly, the Commission believes that it is appropriate at this time to issue this order to institute proceedings to determine whether to grant or deny the exemption application on the grounds that the applicant does not meet the definition of an "exchange" under Section 3(a)(1) of the Exchange Act and Rule 3b-16 thereunder.

IV. Procedure: Request for Written Comments

The Commission requests written views, data, and arguments with respect to the concerns identified above as well as other relevant concerns. Such comments should be submitted by [insert 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from publication in the Federal Register]. Although there do not appear to be any issues relevant to a grant or denial of the exemption application which

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8 See Regulation ATS Adopting Release, 63 FR at 70898-70901 (discussing the Commission's revised interpretation of the "exchange" definition). Among other things, the Commission stated that "the first essential element of an exchange is the bringing together of orders of multiple buyers and sellers." Id. at 70900.

would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider any request for an opportunity to make an oral presentation.

Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number 10-214 on the subject line.

Paper comments:

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

All submissions should refer to File Number 10-214. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/other.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the exemptive application that are filed with the Commission, and all written communications relating to the exemptive application between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number 10-214 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. Rebuttal comments should be submitted by [insert date 35 days from the date of publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73420 / October 23, 2014

Admin. Proc. File No. 3-16100

In the Matter of ACCREDITED BUSINESS CONSOLIDATORS CORP.	ORDER DISMISSING NOTICE OF INTENTION TO PETITION FOR REVIEW

Accredited Business Consolidators Corp. ("ABCC") has filed a Notice of Intention to Petition for Review (the "Notice").[1] We dismiss the Notice.

ABCC's Notice is directed at an order (the "Temporary Suspension Order") issued on July 31, 2014 pursuant to Section 12(k) of the Securities Exchange Act of 1934,[2] which suspended trading in ABCC's securities for ten days on the ground that there was a lack of current and accurate information concerning the issuer.[3] The Temporary Suspension Order was published in the Federal Register on August 4, 2014 and by its terms expired on August 13.[4] On the same day that we issued the Temporary Suspension Order, we also instituted administrative proceedings pursuant to Section 12(j) of the Exchange Act to determine whether the registration of ABCC's securities should be suspended or permanently revoked.[5] ABCC entered an appearance and filed an answer in the Section 12(j) proceeding on August 18. Two weeks later, on September 2, 2014, ABCC filed the instant Notice seeking review of the expired Temporary Suspension Order.

As a threshold matter, ABCC's Notice, which invokes Rule of Practice 430, is procedurally defective in three separate respects and therefore is subject to dismissal. First, Rule 430 applies only to Commission review of actions made "pursuant to delegated authority."[6] The Temporary Suspension Order was issued "[b]y the Commission" itself,[7] not pursuant to

1 17 C.F.R. § 201.430(b)(1).

2 15 U.S.C. § 78*l*(k)(1)(A).

3 *Accredited Business Consolidators Corp.*, Securities Exchange Act Release No. 72725, 2014 WL 3749704 (July 31, 2014).

4 79 Fed. Reg. 45228 (Aug. 4, 2014).

5 *Accredited Business Consolidators Corp.*, Exchange Act Release No. 72726, 2014 WL 3749701 (July 31, 2014).

6 17 C.F.R. § 201.430(b)(1).

7 79 Fed. Reg. at 45228.

delegated authority, and thus is not reviewable under Rule 430. Second, even if Rule 430 otherwise applied, the Notice would be untimely, since it was not filed within "15 days after publication of the notice of action [*i.e.*, the Temporary Suspension Order] in the Federal Register."[8] Third, even if Rule 430 applied and the Notice was timely for purposes of that rule, ABCC has not perfected its Notice by filing the actual petition for review, a step that Rule 430(b)(2) requires to take place "[w]ithin five days" of the filing of the notice.[9]

We also note that Commission review of the Temporary Suspension Order is not available at this juncture for another reason. The means for Commission review of a Section 12(k)(1)(A) order set forth in our Rules of Practice is the filing of a petition pursuant to Rule 550(a) "requesting that the [summary] suspension be terminated" while the suspension order is still in effect.[10] Such a petition must "set forth the reasons why the petitioner believes that the suspension of trading should not *continue* and state with particularity the facts upon which the petitioner relies."[11] Once a temporary suspension order has expired, which typically happens after ten days, there is no suspension to be "terminated" or discontinued; the door to relief under Rule 550 is shut. ABCC did not file a timely petition to terminate the Temporary Suspension Order under Rule 550.

ABCC complains that the Temporary Suspension Order was "made *ex parte*" and "without any opportunity to be heard" and asserts that these circumstances should excuse its failure to timely seek relief.[12] We disagree. The accelerated timeframe for review mandated by Rule 550 is in harmony with the statutory scheme.[13] Section 12(k)(1)(A) authorizes the

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8 17 C.F.R. § 201.430(b)(1).

9 *Id.* § 201.430(b)(2).

10 *Id.* § 201.550(a). Rule 550 establishes "a special mechanism to allow persons adversely affected by a suspension to petition for relief." *Adopting Release*, *Rules of Practice*, 60 Fed. Reg. 32738, 32787 (June 23, 1995).

11 17 C.F.R. § 201.550 (emphasis added).

12 Although the Notice does not indicate the date upon which ABCC received actual notice of the Temporary Suspension Order, we find that ABCC was aware of the suspension by August 11, 2014, at the latest—two days before the suspension expired. That was the date that ABCC mailed its Answer in the Section 12(j) proceeding, which includes a statement that the Commission had "suspended the trading of [its] shares."

13 It accords also with due process. *E.g.*, *Catanzaro v. Weiden*, 188 F.3d 56, 61-62 (2d Cir. 1999) (explaining that the "necessity of quick action" can justify summary administrative action); *Talamantes-Penalver v. INS*, 51 F.3d 133, 135 (8th Cir. 1995) (rejecting claim that ten-day deadline for filing administrative appeal was violative of due process); *Spiegel v. Ryan*, 946 F.2d 1435, 1442 (9th Cir. 1991) (Rymer, J., joined by Hall, J., concurring) (holding that a "ten-day window" for seeking review of temporary order did not "deprive [the] respondent . . . of due process").

Commission "*summarily* to suspend trading in any security" if the Commission is of the opinion that the "public interest and the protection of investors so require."[14] Congress thus conferred upon the Commission the authority to impose time-limited trading restrictions "without any notice, opportunity to be heard, or findings based upon a record."[15] In imposing a trading suspension, the Commission aims to "alert the investing public that there is insufficient public information about the issuer upon which an informed investment judgment can be made, or that the market for the securities may be reacting to manipulative forces or deceptive practices."[16] In short, there are sound reasons that the Commission does not provide advance notice to a company that it is considering a trading suspension.[17]

Consistent with these policies and purposes, Rule 550 provides for a narrow, focused review of the Commission's "determin[ation] whether or not a 10-day suspension" is warranted following announcement of the suspension.[18] After the suspension's expiration, the issuer's opportunity under Rule 550 to present arguments why "suspension of trading should not continue" lapses, and review of the temporary suspension order itself is no longer available.[19] Furthermore, trading suspensions under Section 12(k)(1)(A) are statutorily limited in duration to a single, ten-day period based on any single set of circumstances.[20] For these reasons, although

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14 15 U.S.C. § 78*l*(k)(1) (emphasis added).

15 *SEC v. Sloan*, 436 U.S. 103, 112 (1978); *see also Sloan v. SEC*, 547 F.2d 152, 158 (2d Cir. 1976). The specific "factors cited by the Commission in its order as the basis for the [temporary] trading suspension . . . do not constitute an adjudication of fact or law with respect to those matters." *Proposed Rule: Initiation or Resumption of Quotations Without Specified Information*, 54 Fed. Reg. 39194, 39198 (Sept. 25, 1989).

16 *Adopting Release: Rules of Practice*, 60 Fed. Reg. at 32787.

17 *E.g.*, Securities and Exchange Commission, Office of Investor Education and Advocacy, *Investor Bulletin: Trading Suspensions* (May 2012), *available at* http://www.sec.gov/investor/alerts/tradingsuspensions.pdf (last visited October 23, 2014) ("The SEC cannot announce that it's working on a suspension. We conduct this work confidentially to maintain the effectiveness of any related investigation we may be conducting. Confidentiality also protects a company and its shareholders if the SEC ultimately decides not to issue a trading suspension.").

18 *Adopting Release*, *Rules of Practice*, 60 Fed. Reg. at 32787.

19 17 C.F.R. § 201.550(a). Because the issue has not been presented to us, we do not address whether or how relief might be sought with respect to any of the potentially continuing collateral consequences of an already expired temporary suspension order.

20 15 U.S.C. § 78*l*(k)(1)(A); *see also Sloan*, 436 U.S. at 111. To suspend for up to twelve months or revoke a security's registration, the Commission must institute a separate proceeding under Section 12(j) and provide an opportunity for an on-the-record hearing, which is occurring here. 15 U.S.C. § 78*l*(j); *see supra* note 5.

we retain jurisdiction over the Temporary Suspension Order in the same fashion that we retain jurisdiction over any other Commission determination,[21] we have determined not to review it.

Accordingly, it is ORDERED that ABCC's Notice of Intention to Petition for Review of the Temporary Suspension Order is DISMISSED.

By the Commission.

Brent Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

21 No statutory provision explicitly gives the Commission authority to reconsider temporary suspension orders, but an agency's power to revisit prior determinations is inherent in its jurisdiction over a controversy. *E.g.*, *West v. Standard Oil Co.*, 278 U.S. 200, 210 (1929) ("[S]o long as the Department retains jurisdiction of the [matter], administrative orders concerning it are subject to revision."); *Tokyo Kikai Seisakusho, Ltd. v. United States*, 529 F.3d 1352, 1360 (Fed. Cir. 2008) ("The power to reconsider is inherent in the power to decide."). Judicial review of Commission orders under Section 12 is governed by Section 25(a) of the Exchange Act; as such, jurisdiction vests in the Court of Appeals upon the filing of a petition for review with the court. *See* 15 U.S.C. §§ 78*l*(k)(5), 78y(a)(3).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73421 / October 23, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3591 / October 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16210

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

I.

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

II.

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

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

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

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. Hovanec, age 61, of Westlake Village, California, has been a certified public accountant licensed to practice in the State of New York since 1976; the status of his license is currently not registered. Hovanec served as Vice President of Finance and Chief Financial Officer at Vitesse from December 1993 through April 2005. In April 2005, after being promoted to Executive Vice President he relinquished his role as CFO. Hovanec served as Executive Vice President until May 17, 2006, when he was terminated by Vitesse's Board. Between 1994 and 2007, Hovanec served on the board of Interlink Electronics, Inc., a U.S. public company.

2. Vitesse Semiconductor Corporation ("Vitesse" or the "Company") is a major producer of high-performance integrated circuits for use primarily by systems manufacturers in the storage and communications industries. Vitesse was incorporated in Delaware in 1987, is headquartered in Camarillo, California, and maintains a September 30th fiscal year-end. During the relevant period, the Company's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the Nasdaq National Market under the symbol VTSS.

3. On December 10, 2010, the Commission filed a complaint against Hovanec in Securities and Exchange Commission v. Vitesse Semiconductor Corp. et al, No. 10 Civ. 9239 in the United States District Court for the Southern District of New York. On August 8, 2014, the court entered an order permanently enjoining Hovanec by consent from future violations of Sections 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b), 13(b)(5), and 16(a) of the Securities Exchange Act of 1934 ("Exchange Act"), and Exchange Act Rules 10b-5, 13a-14, 13b2-1, 13b2-2, and 16a-3, and from aiding and abetting Vitesse's violations of Section 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1, and 13a-13. The final judgment also ordered him to pay disgorgement of $781,280, which was deemed satisfied by his prior payment and transfer of, respectively, $250,000 and 458,014 shares of Vitesse stock, to the class action Settlement Fund in Louis Grasso, et.al. v. Vitesse Semiconductor, et.al., No. CV 06-02639 R (CTx) (C.D. Cal.), and a $50,000 civil penalty.

4. The Commission's complaint alleged, among other things, that starting from about September 2001 through April 2006, Hovanec participated in a channel stuffing scheme to improperly record revenue on product shipments. In furtherance of this scheme, Hovanec failed to timely record customer credits required by large returns of unwanted product, and he directed the misapplication of cash receipts to obscure aged accounts receivables that resulted from the failure to timely record credits. The complaint also alleged, that from 1995 to 2006, Hovanec participated in a scheme to backdate stock option grant dates for his personal benefit

and the benefit of other Vitesse executives and employees. Hovanec also failed to ensure that Vitesse properly recorded compensation expense for backdated stock option grants. The complaint alleges that as a result of these actions, between 1996 and early 2006, Hovanec, among other violations: engaged in fraudulent accounting practices that materially misstated the Company's quarterly and annual financial statements, and that Hovanec knowingly circumvented or failed to implement Vitesse's system of internal accounting controls and falsified Vitesse's books, records and accounts; and made material misrepresentations to Vitesse's independent auditor. The complaint also alleges that as part of his misconduct, between June 1996 and February 2005, Hovanec signed registration statements and annual and quarterly reports that contained false and misleading financial statements and disclosures.

IV.

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

Accordingly, it is hereby ORDERED effective immediately, that:

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

B. After ten years (or 120 months) from the date of the Order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

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

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

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

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

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

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

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating
Commissioner Piwowar
Disapproved

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73424; File No. SR-NYSEArca-2014-10)

October 24, 2014

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Disapproving a Proposed Rule Change to Adopt NYSE Arca Equities Rule 8.900, Which Permits the Listing and Trading of Managed Portfolio Shares, and to List and Trade Shares of the ActiveShares Large-Cap Fund, ActiveShares Mid-Cap Fund, and ActiveShares Multi-Cap Fund Pursuant to that Rule

On February 7, 2014, NYSE Arca, Inc. ("Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to adopt new NYSE Arca Equities Rule 8.900, which would govern the listing and trading of Managed Portfolio Shares, and to list and trade shares of the ActiveShares Large-Cap Fund, ActiveShares Mid-Cap Fund, and ActiveShares Multi-Cap Fund (each a "Fund" and, collectively, "Funds") under proposed NYSE Arca Equities Rule 8.900.[3] The proposed rule change was published for

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 The Commission notes that Precidian ETFs Trust, which would be the issuer of the Funds, filed an Application for an Order under Section 6(c) of the 1940 Act for exemptions from various provisions of the 1940 Act and rules thereunder (File No. 812–14116), dated July 18, 2013 ("Exemptive Application"). The Commission published notice of this application ("Notice of Application for Exemptive Relief") on October 21, 2014. See Investment Company Act Release No. 31300 (Oct. 21, 2014) (Precidian ETFs Trust, et al.; Notice of Application).

comment in the Federal Register on February 26, 2014.[4] The Commission received one comment letter on the proposed rule change during the initial comment period.[5]

On April 7, 2014, pursuant to Section 19(b)(2) of the Exchange Act,[6] the Commission designated a longer period within which to approve the proposed rule change, disapprove the proposed rule change, or institute proceedings to determine whether to approve or disapprove the proposed rule change.[7] The Commission received two additional comment letters on the proposed rule change, including a letter from the Exchange in support of its proposal.[8] On May 27, 2014, the Commission instituted proceedings under Section 19(b)(2)(B) of the Exchange Act[9] to determine whether to approve or disapprove the proposed rule change.[10] The

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4 See Securities Exchange Act Release No. 71588 (Feb. 20, 2014), 79 FR 10848 ("Notice"), available at http://www.sec.gov/rules/sro/nysearca/2014/34-71588.pdf.

5 See Letter from Gary L. Gastineau, President, ETF Consultants.com, Inc., to Elizabeth M. Murphy, Secretary, Commission (Mar. 18, 2014) ("Gastineau Letter"). All comments on this proposal (see also notes 8 and 11, infra) are available at http://www.sec.gov/comments/sr-nysearca-2014-10/nysearca201410.shtml.

6 15 U.S.C. 78s(b)(2).

7 See Securities Exchange Act Release No. 71895, 79 FR 20285 (Apr. 11, 2014). The Commission designated a longer period within which to take action on the proposed rule change and designated May 27, 2014, as the date by which it should approve, disapprove, or institute proceedings to determine whether to disapprove the proposed rule change.

8 See Letter from Dennis J. DeCore, Former Co-Head U.S. Index Arbitrage (1997-2007), Nomura Securities, to Elizabeth M. Murphy, Secretary, Commission (Apr. 8, 2014) ("DeCore Letter"); Letter from Martha Redding, Chief Counsel and Assistant Corporate Secretary, NYSE Euronext, to Secretary, Commission (May 14, 2014) ("Response Letter").

9 15 U.S.C. 78s(b)(2)(B).

10 See Securities Exchange Act Release No. 72255, 79 FR 31362 (June 2, 2014). Specifically, the Commission instituted proceedings to allow for additional analysis of the proposed rule change's consistency with Section 6(b)(5) of the Exchange Act, which

Commission received a second letter from one of the commenters.[11] On August 22, 2014, the Commission designated a longer period for Commission action on the proposed rule change.[12] The Commission subsequently received an additional comment letter regarding the proposed rule change.[13]

This Order disapproves the proposed rule change.

I. Description of the Proposal

The Exchange proposes: (1) to adopt new NYSE Arca Equities Rule 8.900 to permit the listing and trading, or trading pursuant to unlisted trading privileges ("UTP"), of Managed Portfolio Shares, which are securities issued by an actively managed open-end investment management company; and (2) to list and trade shares ("Shares") of the Funds under proposed

requires, among other things, that the rules of a national securities exchange be "designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade," and "to protect investors and the public interest." See id., 79 FR at 31368 (text accompanying n.86).

11 See Letter from Gary L. Gastineau, President, ETF Consultants.com, Inc., to Elizabeth M. Murphy, Secretary, Commission (June 23, 2014) ("Second Gastineau Letter").

12 See Securities Exchange Act Release No. 72901, 79 FR 51380 (Aug. 28, 2014) (designating October 24, 2014 as the date by which the Commission must either approve or disapprove the proposed rule change).

13 See Letter from Reginald M. Browne, Senior Managing Director – ETF Group, Cantor Fitzgerald & Co, to Mary Jo White, Chair, Commission (Oct. 20, 2014) ("Browne Letter").

NYSE Arca Equities Rule 8.900.[14] The discussion below summarizes the Exchange's proposal, details of which are described in the Notice.[15]

A. Proposed Listing Rules

The Exchange's proposal defines the term "Managed Portfolio Share" as a security that (a) is issued by a registered investment company ("Investment Company") organized as an open-end management investment company or similar entity that invests in a portfolio of securities selected by the Investment Company's investment adviser consistent with the Investment Company's investment objectives and policies; (b) is issued in any number of shares for a cash amount equal to the next determined net asset value ("NAV"); (c) may be redeemed for cash by any Retail Investor (as defined below) in any size less than a Redemption Unit (as defined below) for a cash amount equal to the next determined NAV; and (d) when aggregated in a number of shares equal to a Redemption Unit or multiples thereof, may be redeemed by or through an Authorized Participant,[16] with payment to be made, through a blind trust established

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14 The Exchange also proposes to amend NYSE Arca Equities Rule 7.34(a)(4)(A) (Trading Sessions) to include Managed Portfolio Shares in the trading halt provision for shares traded pursuant to UTP during the Exchange's Opening Session.

15 See Notice, supra note 4. Additional information regarding the Precidian ETFs Trust and the Shares, including investment strategies, risks, creation and redemption procedures, fees, portfolio holdings disclosure policies, distributions, and taxes is available in the registration statement filed by the Precidian ETFs Trust on January 22, 2014, on Form N–1A under the Securities Act of 1933 and under the Investment Company Act of 1940 ("1940 Act") relating to the Funds (File Nos. 333–171987 and 811–22524) ("Registration Statement").

16 Certain large market participants, typically broker-dealers, can become "Authorized Participants" with respect to the Funds. Each Authorized Participant would enter into a contractual relationship with a Fund or Funds, allowing it to engage in redemptions of Shares directly with the issuer.

for the Authorized Participant's benefit, in the form of securities, cash, or both with a value equal to the next determined NAV.

While funds issuing Managed Portfolio Shares would be actively managed and, to that extent, would be similar to Managed Fund Shares (which are actively managed funds listed and traded under NYSE Arca Equities Rule 8.600), Managed Portfolio Shares differ from Managed Fund Shares in the following significant respects.

- In contrast to Managed Fund Shares, for which a "Disclosed Portfolio" is required to be disseminated at least once daily,[17] the portfolio for an issue of Managed Portfolio Shares would be disclosed once quarterly in accordance with disclosure requirements otherwise applicable to open-end investment companies registered under the 1940 Act.[18]
- In connection with the redemption of shares in Redemption Unit[19] size, the in-kind delivery of any portfolio securities would generally be effected through a blind trust for the benefit of the redeeming Authorized Participant, and the blind trust would liquidate

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17 NYSE Arca Equities Rule 8.600(c)(2) defines the term "Disclosed Portfolio" as the "identities and quantities of the securities and other assets held by the Investment Company that will form the basis for the Investment Company's calculation of net asset value at the end of the business day." NYSE Arca Equities Rule 8.600(d)(2)(B)(i) requires that the Disclosed Portfolio be disseminated at least once daily and that it be made available to all market participants at the same time.

18 A mutual fund is required to file with the Commission its complete portfolio schedules for the second and fourth fiscal quarters on Form N-SAR under the 1940 Act, and to file its complete portfolio schedules for the first and third fiscal quarters on Form N-Q under the 1940 Act, within 60 days of the end of the quarter. Form N-Q requires funds to file the same schedules of investments that are required in annual and semi-annual reports to shareholders. These forms are available to the public on the Commission's website at http://www.sec.gov/.

19 A "Redemption Unit" is a specified number of Managed Portfolio Shares used for determining whether a retail investor may redeem for cash. According to the Notice, a Redemption Unit is currently 50,000 Shares.

the portfolio securities pursuant to standing instructions from the Authorized Participant without disclosing the identity of those securities to the Authorized Participant.

- Investors, including "Retail Investors,"[20] would be able to purchase shares either (a) in the secondary markets (e.g., the Exchange) at market prices or (b) for cash directly from a Fund in any amount on any day a fund determines its NAV, as described in more detail below.
- As with traditional open-end investment companies, Retail Investors would be able to redeem shares for cash directly from a fund on any day and in any size less than a Redemption Unit at the fund's NAV.[21]

For each series of Managed Portfolio Shares, an estimated value, defined in the proposed rules as the "Portfolio Indicative Value" ("PIV"), that reflects an estimated intraday value of a fund's portfolio, based on the last market price or last sale price, would be disseminated. The PIV would be based upon all of a Fund's holdings as of the close of the prior business day and would be widely disseminated by one or more major market data vendors at least every 15 seconds during the Exchange's Core Trading Session (normally, 9:30 a.m. to 4:00 p.m., Eastern Time).

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20 Under the proposal, a "Retail Investor" is defined as (i) a natural person; (ii) a trust established exclusively for the benefit of a natural person or a group of related family members; or (iii) a tax deferred retirement plan where investments are selected by a natural person purchasing for its own account.

21 With respect to the three Funds that are the subject of the proposal, the Exchange has represented that fees for creations and redemptions by Retail Investors would not exceed two percent, in accordance with the requirements of Rule 22c-2 under the 1940 Act.

The Exchange's proposal provides that the Exchange would file separate proposals under Section 19(b) of the Exchange Act before listing and trading any additional series of Managed Portfolio Shares.

B. Description of the Funds

The portfolio for each Fund would consist primarily of stocks in the Russell 3000 Index (which consists of stocks included in the Russell 1000 Index and the Russell 2000 Index) and shares issued by other exchange-traded funds ("ETFs) that invest primarily in shares of issuers in the Russell 3000 Index. The ActiveShares Large Cap Fund would invest primarily in securities included in the Russell 1000 Index and in ETFs that primarily invest in stocks in the Russell 1000 Index. The ActiveShares Mid-Cap Fund would invest primarily in securities that are included in the Russell 2000 Index and in ETFs that primarily invest in stocks in the Russell 2000 Index. And the ActiveShares Multi-Cap Fund would invest primarily in securities included in the Russell 3000 Index and in ETFs that primarily invest in stocks in the Russell 3000 Index. All exchange-listed equity securities in which the Funds would invest would be listed and traded on a U.S. national securities exchange.

Each Fund would target an overall net equity market exposure of between 70% and 130% of the Fund's assets. Each Fund would purchase securities that its portfolio managers believed to be undervalued and would sell short securities that the portfolio managers believed to be overvalued. Under normal market conditions,[22] each Fund's net long equity market exposure

22 The terms "normally" and "under normal market conditions" would include, but not be limited to, the absence of extreme volatility or trading halts in the equity markets or the financial markets generally; operational issues causing dissemination of inaccurate market information; or force majeure events such as systems failure, natural or man-made disaster, act of God, armed conflict, act of terrorism, riot or labor disruption, or any similar intervening circumstance.

would not exceed 130%, and its net short equity market exposure would not exceed 30%, but the portfolio managers might at times exceed these percentages.

Other Investments. While each Fund, under normal market conditions, would invest primarily in stocks included in the Russell 3000 Index and ETFs, as described above, each Fund would be able to invest its remaining assets in repurchase agreements and reverse repurchase agreements, high-quality money market instruments, and the securities of other investment companies to the extent allowed by law.

II. Summary of the Comments Received

As noted above, the Commission received two letters from the same commenter opposing the proposed rule change,[23] two letters from commenters supporting the proposal, and a letter from the Exchange responding to the opposing commenter's objections. Comments on the proposal raised two broad issues – (1) the effectiveness of arbitrage in the absence of daily portfolio disclosure, and (2) the benefits and drawbacks of the Funds' unique creation and redemption processes – as well as a number of other issues that are narrower in scope.

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23 This commenter notes that he has a retained economic interest in a product that may be competitive with Managed Portfolio Shares and states that his views on the Exchange's filing "may be considered subject to a conflict of interest." Gastineau Letter, supra note 5, at 1, n.1. The Exchange asserts that the concerns of the opposing commenter are driven by competitive motives and that these concerns should not affect the Commission's decision to approve or disapprove the proposed rule change. See Response Letter, supra note 8, at 5. Instead, according to the Exchange, different proposals to list and trade actively managed EFTs without daily portfolio disclosure should be assessed on their individual merits and risks. See id. The opposing commenter asserts that the Commission should not ignore his comments just because they are raised by a competitor. See Second Gastineau Letter, supra note 11, at 7. The opposing commenter argues that the Commission should consider legitimate issues raised by any credible source, and he asserts that his comments are made in the public interest and, to the best of his ability, are not influenced by any conflict. See id.

A. The Effectiveness of Arbitrage in the Absence of Daily Portfolio Disclosure

The opposing commenter predicts that, compared to most existing ETFs, the Shares would probably trade with significantly wider bid-ask spreads, with more variable premiums and discounts, or with both, because of what the opposing commenter characterizes as the unreliability of the Funds' proposed method for ensuring secondary market trading efficiency.[24] The opposing commenter states that the Funds' market makers would have only indirect, and likely imperfect, information about Fund holdings.[25] As a result, according to the opposing commenter, effectively arbitraging the Funds would be significantly more difficult than the arbitrage for most existing foreign ETFs.[26]

The opposing commenter argues that there is no support for the Exchange's contention that existing ETFs holding portfolios of foreign securities, such as index-based ETFs holding Asian stocks, have demonstrated efficient pricing characteristics even though they do not provide opportunities for riskless arbitrage transactions during much of the trading day.[27] The opposing commenter also cites a draft academic working paper for the propositions that market trading efficiency varies significantly by type and size of ETF; that funds with high share trading volumes, liquid underlying holdings, and efficient arbitrage mechanisms trade with relatively

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24 See Gastineau Letter, supra note 5, at 6.

25 See id. at 8.

26 See id.

27 See id.

tight bid-ask spreads and more stable premiums and discounts; and that funds lacking these characteristics generally trade with wider spreads and more variable premiums and discounts.[28]

Another commenter predicts that trading spreads in Managed Portfolio Shares would not be as "tight" as trading spreads in the SPY or QQQ (where futures, options, and equity portfolios can be used as a pure hedge), but that a frequent update of the intraday indicative value would allow market maker spreads to be reasonable.[29] A third commenter, who is a market maker in ETFs, states that, in his professional opinion and after significant analysis, "given a clearly defined investment objective within a known universe of securities, efficient markets can and will be made in ETFs utilizing Precidian's Blind Trust Structure."[30]

The Exchange responds to the opposing commenter that, as set forth in the Notice, market makers have indicated that the available information regarding the Shares would be sufficient for arbitrage and hedging purposes.[31] Additionally, the Exchange states that, based on discussions with market makers, it expects that market makers would agree to act as lead market makers ("LMMs") in the Shares and believes that no market maker would accept an LMM assignment if it were not entirely comfortable in its ability to hedge its positions.[32] The Exchange argues that the opposing commenter offers no direct support for his doubts regarding efficient

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28 See id. (citing Antti Petajisto, Inefficiencies in the Pricing of Exchange-Traded Funds (Working Paper Sept. 20, 2013 ("Petajisto Study")).

29 See DeCore Letter, supra note 8, at 1.

30 See Browne Letter, supra note 13, at 2.

31 See Response Letter, supra note 8, at 2.

32 See id.

secondary market trading, and the Exchange asserts that these LMMs are uniquely suited to prospectively assess the effectiveness of arbitrage in the shares.[33]

Regarding the Exchange's assertion that market makers will be able to make efficient and liquid markets priced near the PIV as long as an accurate PIV is disseminated every 15 seconds and market makers have knowledge of a fund's means of achieving its investment objective, the opposing commenter states that, for a number of reasons, the dissemination of a PIV by the Funds is likely to prove ineffective in ensuring alignment of secondary market prices for the Shares with the values of the underlying portfolios.[34] The opposing commenter asserts that, during periods of rapid market movement, the use of last-sale prices to calculate a PIV, coupled with the dissemination of the PIV only every 15 seconds, would mean that the PIV would be a lagging indicator of actual portfolio values.[35] Additionally, the opposing commenter asserts that the PIV may reflect clearly erroneous values for securities that have not yet opened for trading on a particular business day or that are subject to an intraday interruption in trading.[36] The opposing commenter also criticizes the Exchange's representation that the adviser and calculation agent would use "commercially reasonable efforts" to calculate the PIV, arguing that this is a substantially lower standard of care than that applying to NAV calculations for ETFs and

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33 See id.

34 See Gastineau Letter, supra note 5, at 2-3.

35 See id. at 10.

36 See id.

mutual funds.[37] The opposing commenter further asserts that the proposal does not provide that any entity would stand behind a Fund's PIV to ensure timeliness and accuracy.[38]

The opposing commenter predicts that frequent PIV errors would cause "erroneous share trades" to be executed.[39] The opposing commenter states that the proposal does not address whether PIV errors and related erroneous trades would be detected by the Exchange, whether such trades would be cancelled, or whether the Exchange would apply a materiality standard for cancellations.[40] The opposing commenter argues that, as a condition of approval, the Exchange should be required to monitor the timeliness and accuracy of PIV dissemination and to implement procedures to address trades when an erroneous PIV has been disseminated.[41]

The Exchange agrees with the opposing commenter that an accurate PIV would be essential for trading in the Shares, but asserts that the opposing commenter offers no support for the assertion that the PIV would be unreliable.[42] The Exchange reiterates that market makers have indicated that, after the first few days of trading, there would be sufficient data to run a statistical analysis that would lead to differences between the Share price of the ETF and the PIV being tightened substantially.[43] The Exchange states that it has no reason to believe that the PIV, which would be calculated using methodology substantially similar to that used in the calculation

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37 See id. at 10-11.

38 See id. at 11.

39 See id. at 13.

40 See id.

41 See id.

42 See Response Letter, supra note 8, at 2.

43 See id.

of all other ETF intraday indicative values, would be inherently unreliable.[44] The Exchange asserts that market participants would accept the PIV as a reliable, indicative real-time value because (a) the PIV would be calculated and disseminated based on a Fund's actual portfolio holdings; (b) the securities in which the Funds plan to invest are generally highly liquid and actively traded and therefore generally have accurate real-time pricing available; and (c) market participants would have a daily opportunity to evaluate whether the PIV at or near the close of trading was indeed predictive of the actual NAV.[45]

The Exchange states that, because it has no reason to believe that the PIVs would be inherently unreliable, it does not propose to institute any additional monitoring programs.[46] Instead, the Exchange states that it would rely on its existing surveillance systems to monitor trading in the Shares and that these procedures are adequate to properly deter and detect violations of Exchange rules and federal securities laws applicable to trading on the Exchange.[47] The Exchange also states that its existing rule applicable to trade cancellations (NYSE Arca Equities Rule 7.10) neither addresses trade cancellations in the event erroneous PIVs are disseminated nor provides the Exchange with the discretion to cancel trades.[48]

In his second comment letter,[49] which addresses the Exchange's Response Letter,[50] the opposing commenter states that he does not question the veracity of LMMs who have discussed

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44 See id.

45 See id.

46 See id.

47 See id. at 3.

48 See id.

49 See Second Gastineau Letter, supra note 11.

with the Exchange their ability to make efficient and liquid markets in the Shares, but that he questions whether the important caveat – that accurate PIVs are available – would reliably be met.[51] He offers the following reasons why dissemination of PIVs at 15-second intervals throughout the Exchange's Core Trading Session would not provide a reliable and sufficient basis for ensuring that market trading prices of Shares maintain a close correspondence to each Share's underlying value: (a) PIVs may not be calculated in the same manner as NAV; (b) PIVs would be based on consolidated last sale information and may reflect clearly erroneous values for securities that have not opened for trading on a particular business day or that are subject to an intraday interruption in trading; (c) PIVs would be calculated based on a "commercially reasonable" standard of care, not the higher standards that apply to a Fund's daily NAV calculations; (d) there would be no time or scope for checking calculated PIV values before they are released in real time 1,560 times each trading day; and (e) the calculation of PIVs would require the coordinated actions of multiple parties, none of which would guarantee the accuracy of disseminated PIVs or assume liability for damages resulting from PIV errors.[52]

The opposing commenter asserts that disseminated PIVs for ETFs with transparent portfolios have essentially no relevance to secondary market trading efficiency and limited overall utility for investors.[53] In contrast, according to the opposing commenter, the officially disseminated PIVs would be the foundation supporting market trading of the Shares, because Fund holdings would not be disclosed, and market makers in the Shares would not be able to

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50 See Response Letter, supra note 8.

51 See Second Gastineau Letter, supra note 11, at 3.

52 See id.

53 See id.

calculate their own independent estimates of intraday Fund values or to verify the accuracy of the Fund-disseminated PIVs.[54] The opposing commenter states that he is unaware of any studies that demonstrate the reliability of the intraday values disseminated for existing ETFs based on substantially the same calculation methodology and standards as proposed for the Shares.[55] He recommends that, if the Exchange is unwilling to undertake a surveillance program to detect erroneous PIVs and to establish procedures for cancelling trades based on erroneous trades, the Commission should condition any approval of the proposed rule change on a demonstration of the prospective reliability of Fund PIVs through a comprehensive study of the historical accuracy of the disseminated intraday values of existing ETFs with investment profiles similar to the Funds.[56]

The opposing commenter also questions whether the terms "efficient and liquid markets" and "priced near the PIV" (used by the cited LMMs) are properly defined or are suitable standards for open-end funds issuing redeemable securities.[57] The opposing commenter asserts that the Petajisto Study[58] demonstrates that the trading efficiency of existing ETFs varies across a broad range and that many existing ETFs trade with wide bid-ask spreads and highly variable

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54 See id. at 4-5.

55 See id. at 5.

56 See id.

57 See id. at 3.

58 See supra note 28.

premiums/discounts,[59] and he posits that some of the LMMs supporting trading in those ETFs would nonetheless represent that they trade "efficiently" and "near" underlying value.[60]

The opposing commenter recommends that the Commission ask the Exchange to quantify the range of expected bid-ask spreads and premiums/discounts at which LMMs have indicated they expect the Shares to trade and to compare these expectations to accurate measures of benchmark index ETF trading performance.[61] Additionally, the opposing commenter argues that the Exchange's statement that it "expects that a market maker will act as [LMM] in the Shares and believes no market maker would accept [an LMM] assignment if they were not entirely comfortable in their ability to hedge their positions" does not support the Exchange's assertion that the Shares can be expected to trade at consistently tight bid-ask spreads and stable premiums/discounts.[62] He asserts that: (1) every closed-end fund listed on the Exchange also has an LMM, including the many closed-end funds that routinely trade at double-digit discounts or premiums to NAV; and therefore (2) the mere presence of a market maker willing to serve as LMM is not evidence that a particular fund would trade with bid-ask spreads and premiums/discounts consistent with the marketplace's expectations for how ETFs should trade or the legal standard applicable to open-end investment companies issuing redeemable securities.[63]

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59 See Second Gastineau Letter, supra note 11, at 3.

60 See id.

61 See id.

62 See id. at 4.

63 See id.

B. Creation and Redemption Process

1. Redemptions by Authorized Participants

The opposing commenter raises a number of objections to the Funds' proposed use of a blind trust to effect redemption transactions by Authorized Participants. He predicts that the proposed redemption arrangements would introduce additional costs and uncertainties for Authorized Participants for the following reasons:

- the Funds' custodian would have a monopoly position as the sole eligible provider of trustee services for the blind trust;
- the Funds' adviser, rather than the Authorized Participant, would negotiate the fees paid to the trustee;
- in contrast to existing ETFs, no Authorized Participant would have the potential ability to use its market knowledge and market position to enhance arbitrage profits (or offset arbitrage costs) by managing sales of the distributed securities to minimize market impact or to realize prices above the market close; and
- the Funds' custodian, who acts for the Authorized Participant in the sale of distributed securities, would have no apparent incentive to sell distributed securities with low market impact or at prices above the close and would experience little or no downside from doing the opposite.[64]

The opposing commenter also asserts that redeeming Authorized Participants would be exposed to potential costs and risks associated with not being able to control disposition of significantly more concentrated redemption proceeds, and the opposing commenter argues that these extra costs and risks associated with the blind trust arrangement would be passed through

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64 See Gastineau Letter, supra note 5, at 12.

to shareholders transacting in the secondary market, reflected as wider bid-ask spreads, more volatile premiums and discounts for the Shares, or both.[65]

In addition, the opposing commenter argues that the Commission should not grant the issuer's pending request for exemptive relief under the 1940 Act to maintain early Order Cut-Off Times for Fund redemptions, which are intended to facilitate the timely sale of distributed securities by the blind trusts that receive the proceeds of Authorized Participant redemptions and to facilitate the efficient processing of redemptions by retail investors through the Retail Redemption Facility.[66]

In response, the Exchange argues that the opposing commenter's arguments regarding cost considerations are irrelevant under the Exchange Act[67] and that limiting broker-dealer processing fees on direct purchases and redemptions of Shares would require Commission rulemaking.[68] The Exchange also argues that the opposing commenter's arguments regarding early Order Cut-Off Times for redemption is not relevant under the Exchange Act.[69]

The opposing commenter argues, in response, that mandatory early Order Cut-Off Times for direct purchases and redemptions of Shares, while raising issues under the 1940 Act, also raise Exchange Act issues due to the potential impact on secondary market trading. Specifically, the opposing commenter asks: (1) if Authorized Participants cannot enter orders to purchase and redeem Shares after a designated cut-off time, how would this affect market trading later in the

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65 See id.

66 See id. at 16.

67 See Response Letter, supra note 8, at 4-5.

68 See id. at 4.

69 See id. at 4-5.

session; and (2) if market makers cannot transact with the Fund to offload long and short positions in Shares accumulated after the cut off time, how could the Funds' proposed arbitrage mechanism function effectively?[70]

In connection with the unique redemption features of the Funds, the opposing commenter further asserts that there is a "significant risk" that the Internal Revenue Service ("IRS") would deny the purported tax benefits of the Funds' distinctive in-kind redemption program.[71] Therefore, the opposing commenter recommends that approval of the proposal be conditioned on the issuer obtaining a favorable IRS determination of the tax treatment through a Private Letter Ruling.[72]

In response, the Exchange argues that the opposing commenter's arguments regarding the tax treatment of in-kind distributions through the blind trust are not relevant under the Exchange Act.[73]

The opposing commenter's second letter restates his belief that the tax treatment of the Funds' in-kind redemptions is relevant and again urges the Commission to condition any approval of the proposed rule change on the issuer receiving a Private Letter Ruling from the IRS affirming the claimed tax treatment of the Funds' in-kind redemptions.[74]

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70 See Second Gastineau Letter, supra note 11, at 2.

71 See Gastineau Letter, supra note 5, at 5.

72 See id.; Second Gastineau Letter, supra note 11, at 2.

73 See Response Letter, supra note 8, at 4-5.

74 See Gastineau Letter, supra note 5, at 5. More generally, the opposing commenter asserts that none of the arguments he made are irrelevant because Section 6(b)(5) of the Exchange Act states, in relevant part, that the "rules of the exchange must be designed … to promote just and equitable principles of trade, … to remove impediments to and perfect the mechanism of a free and open market … and, in general, to protect investors

2. The Retail Redemption Facility

The opposing commenter posits that a principal purpose of including direct Share purchases and the Retail Redemption Facility in the proposal is to provide comfort to the Commission and market participants that investors would be able to transact with the Fund at or near NAV whenever secondary market trading prices of shares vary significantly from NAV.[75] The opposing commenter argues that these provisions, as proposed, are inadequate for this purpose because: (a) the Retail Redemption Facility would be available only to a limited set of shareholders and would be restricted to redemptions of less than a Redemption Unit of shares; (b) the expected early Order Cut-Off Time for direct share purchases and the Retail Redemption Facility means that an investor's ability to directly purchase or redeem shares for cash would exist for only a portion of each business day; (c) investors who directly purchase and redeem shares would be subject to transaction fees imposed by the Fund of up to 2% and may also be subject to broker-dealer processing fees; (d) self-directed investors may not have adequate information about the available liquidity options to make intelligent choices about how best to buy and sell shares; (e) broker-dealers may not have adequate information to ensure that their customers consistently receive best execution on transactions in shares, given the two distinct liquidity pathways; and (f) broker-dealers may not have or may not develop the systems capabilities necessary to support customer transactions in Funds offering both secondary market trading in shares and direct share purchases and redemptions.[76]

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and the public interest; and are not designed to permit unfair discrimination" among market participants. See Second Gastineau Letter, supra note 11, at 2 (omissions in original).

75 See Gastineau Letter, supra note 5, at 17.

76 See id. at 17-18.

The opposing commenter asserts that the Exchange's statements that "investors may choose to purchase Shares directly from a Fund if they want to assure that they would not purchase Shares at a premium" and that "Retail Investors may decide to redeem their Shares for cash if they want to make sure they receive the NAV and do not want to risk selling their Shares in the secondary market at a discount" are valid only to the extent that a Fund's direct purchase and redemption options apply to a particular investor, are available at the particular time of day when the investor seeks to buy or sell Shares, are not negated by disproportionate fees, and are backed by investor information and broker-dealer systems adequate to support informed decision-making and effective execution of direct transactions in Shares.[77] The opposing commenter expresses concern that, because of the challenges to broker-dealer trade management and order processing systems introduced by the Funds' unique dual-liquidity features, broker-dealers (if left unregulated) would charge significantly higher fees on direct purchases and redemptions than the commissions they charge on comparably sized secondary market trades in Shares.[78] He argues that, if broker-dealer fees on direct transactions in Shares are too high, then shareholders would, in a practical sense, lose access to the Funds' intended mechanism for ensuring continued access to liquidity at or near NAV during periods when market trading prices of Shares vary significantly from NAV.[79] To the extent that the Commission values the Funds' direct purchase and redemption facilities, he recommends that the Commission place appropriate

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77 See Second Gastineau Letter, supra note 11, at 6.

78 See id.

79 See id.

limits on associated broker-dealer fees and Fund Transactions Fees.[80] The opposing commenter also repeats his views that the Funds' proposed direct purchase and redemptions options should apply equally to all investors and should be available throughout each business day's Regular Trading Session, arguing that disparate redemption rights for different groups of shareholders are inherently discriminatory and inconsistent with the Requirements of Section 6(b)(5) of the Exchange Act.[81]

The opposing commenter recommends that the Funds should be required to extend eligibility for the Retail Redemption Facility to all shareholders and that the Order Cut-Off Times for direct purchases of shares and redemptions under the Retail Redemption Facility be established as of the close of the Exchange's regular trading session.[82] The opposing commenter recommends that the Exchange be required to limit trading in shares to broker-dealers that have represented to the Exchange that they have systems in place (a) to accommodate direct purchases and redemptions of Shares on terms no less favorable than secondary market transactions and (b) to ensure best execution of transactions in shares, considering both secondary market trading and direct purchase and redemption options.[83] The opposing commenter also recommends that the broker-dealers trading shares on the Exchange should not be permitted to charge their customers processing fees on direct purchases and redemptions of shares that exceed what they charge the same customers for secondary market trades.[84] Further, the opposing commenter

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80 See id.

81 See id.

82 See Gastineau Letter, supra note 5, at 20.

83 See id.

84 See id.

recommends that the Funds should not be permitted to charge transaction fees on direct purchases and redemptions of shares that exceed the associated Fund expenses incurred, taking into account the size of a specific transaction.[85]

In response, the Exchange does not address the individual objections raised by the opposing commenter, but instead asserts that the process proposed in the Notice is consistent with the applicable provisions of the Exchange Act.[86]

C. Other Issues

1. Disclosures

The opposing commenter alleges that the prospectus contains a number of material misstatements and omissions relating to in-kind redemptions and direct purchases and redemptions.[87] In response, the Exchange argues that the opposing commenter's arguments regarding prospectus disclosures are irrelevant under the Exchange Act.[88] The opposing commenter, in his second comment letter, argues that adequacy of Fund disclosures is critically important to evaluation of the proposal under both the 1940 Act and the Exchange Act because efficient, informed, and non-discriminatory trading in the Shares requires market participants to have access to timely and accurate information regarding the Funds, including risks and special considerations in buying and selling Shares.[89]

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85 See id. at 20-21.

86 See Response Letter, supra note 8, at 4.

87 See Gastineau Letter, supra note 5, at 27-28.

88 See Response Letter, supra note 8, at 4-5.

89 See Second Gastineau Letter, supra note 11, at 3.

With respect to improved disclosures and availability of information, the opposing commenter states that, given the importance of the PIV to the decision-making process of current and prospective Fund investors, all Fund investors should have ongoing access to current PIV values.[90] The opposing commenter suggests that each Fund's current PIV be provided at no charge on a public website and made available to the public no later than it is made available to any other market participant.[91] The opposing commenter also suggests that the following be published on the Funds' website: real-time PIVs and historical PIV information; statistics regarding closing-price premiums and discounts, statistics regarding intraday estimated premiums and discounts; statistics regarding bid-ask spreads; statistics regarding long or short equity market exposure and the amount of investment leverage employed; and statistics regarding transaction fees applicable to direct purchases of shares, redemptions through the Retail Redemption Facility, and Redemption Unit redemptions by Authorized Participants.[92]

Further, the opposing commenter asserts that, given the fundamental differences in how the Shares may be bought or sold, compared to other ETFs, it is not appropriate for the Funds to be advertised or marketed as ETFs.[93] Therefore, the opposing commenter recommends that the Commission take appropriate steps to ensure that the Exchange, broker-dealers, and market data providers do not describe the Funds as ETFs.[94]

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90 See Gastineau Letter, supra note 5, at 25.

91 See id.

92 See id. at 26-27.

93 See id. at 28.

94 See id.

In response, the Exchange states that such real-time website disclosure of an indicative value is not required of other ETFs.[95] The Exchange states that the PIV is designed to provide guidance regarding variances between the prior day's closing prices and intraday changes in the value of the underlying portfolio.[96] The pricing of the Shares themselves would be disseminated in real time through the Consolidated Quotation System, according to the Exchange.[97]

Responding to the Exchange's assertion that the Funds should not be required to provide investors with free public access to real-time PIVs and other Fund trading information because these requirements do not apply to existing ETFs, the opposing commenter asserts that the Funds would differ from all existing ETFs in three respects for which the suggested requirements for additional PIV and other Fund trading information disclosures are highly relevant: (a) the Funds would offer shareholders two distinct pathways for buying and selling Shares (i.e., direct transactions and secondary market trades) and therefore should be obligated to give investors sufficient information about Share trading conditions to help them determine how best to buy and sell Shares; (b) the arbitrage mechanism intended to support efficient secondary market trading in Shares is untested and is likely to be less reliable than the mechanism supporting efficient trading in existing ETFs, meaning that investors in the Funds should appropriately pay more attention to Share trading costs and must have access to enhanced trading information to make that possible; and (c) the arbitrage mechanism underlying trading in Shares is uniquely

95 See Response Letter, supra note 8, at 4.

96 See id.

97 See id.

reliant upon PIVs, with the result that a level playing field among market participants can only be achieved if all Fund investors have equal access to this critical Fund data.[98]

2. Proposed Limits on Fund Holdings

The opposing commenter asserts that the Funds should: (a) be required to limit their equity investments to U.S.-exchange-listed stocks with market caps of $5 billion or greater (consistent with the general understanding of large- and medium-cap stocks, a universe of about 700 stocks currently); (b) not be permitted to invest in illiquid assets or debt instruments of non-U.S. issuers; and (c) not be permitted to employ investment leverage or hold short positions.[99]

In response, the Exchange argues that the opposing commenter's recommendation to curtail the permitted investments of the Funds is not relevant under the Exchange Act.[100]

In his second letter, the opposing commenter argues that the nature of the Funds' holdings is highly relevant because the reliability of a Fund's PIVs would depend on the availability, timeliness, and accuracy of intraday valuations for the Fund's underlying holdings, which in turn would vary significantly by holdings type.[101] He asserts that, if intraday valuation information for a Fund's holdings does not support the dissemination of timely and accurate PIVs throughout the Regular Trading Session, the Fund cannot be expected to trade efficiently.[102]

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98 See Second Gastineau Letter, supra note 11, at 7.

99 See Gastineau Letter, supra note 5, at 24.

100 See Response Letter, supra note 8, at 4.

101 See Second Gastineau Letter, supra note 11, at 3.

102 See Second Gastineau Letter, supra note 11, at 3.

3. Trading Hours

The opposing commenter notes that the Exchange would permit trading in the Shares between 4:00 a.m. and 8:00 p.m., but that the PIV would only be disseminated during the Core Trading Session of 9:30 a.m. to 4:00 p.m.[103] The opposing commenter asserts that the proposal does not adequately address the significant risk that the prices of shares bought or sold in the Opening Session (4:00 a.m. to 9:30 a.m.) and Late Trading Session (4:00 p.m. to 8:00 p.m.) would vary widely from underlying portfolio values because an updated PIVs would not be available.[104] Therefore, the opposing commenter suggests that trading in shares should be limited to the Exchange's Core Trading Session.[105]

In response, the Exchange states that: (a) its surveillance procedures are operative during all trading sessions and are adequate to monitor trading in the Shares; (b) that it has no reason to discount the assertions of market makers regarding their ability to make efficient markets during all trading sessions; and (c) it would ensure that the information bulletin required by the Exchange's listing standards would adequately address the special characteristics and risks associated with trading in the Shares.[106]

In response, the opposing commenter questions: (a) how a market maker would have any idea whether Shares were trading at a premium or a discount during the Opening and Late Trading Sessions, if PIVs are not being disseminated; and (b) how a market maker would have a

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103 See Gastineau Letter, supra note 5, at 24.

104 See id.

105 See id.

106 See Response Letter, supra note 8, at 3.

basis to construct hedge positions against Share inventory accumulated during these sessions.[107] He asserts again that the Shares should not trade during periods when neither the contents nor any estimates of current values of Fund holdings are known in the marketplace.[108]

4. Potential Informational Advantages for Certain Market Participants

The opposing commenter argues that the lack of portfolio transparency would favor market makers and other professional traders over other market participants, such as investors, and the opposing commenter concludes that this disparate treatment is contrary to the principle that all participants should be on an equal footing with respect to knowledge of a fund's holdings.[109] Notwithstanding the public dissemination of the PIV, the opposing commenter argues that market makers and other professional traders would have a significant indirect informational advantage over other participants because of their ability to glean information about a Fund's holdings through sophisticated data analysis of changes in the PIV.[110] In particular, the opposing commenter asserts that market makers and professional traders could uncover a Fund's holdings and trading activity and front-run the Fund.[111] The opposing commenter asserts that, prior to approval, the proposal should be amended to include: (1) a discussion of the steps to be taken to minimize reverse-engineering risk; (2) a discussion of how the Funds propose to resolve the conflict between providing market makers with adequate information to support efficient Share trading and protecting against reverse engineering; and (3)

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107 See Second Gastineau Letter, supra note 11, at 7.

108 See id.

109 See Gastineau Letter, supra note 5, at 14-15.

110 See id. at 14.

111 See id. at 15.

representations that the Funds would adequately disclose reverse-engineering risk and the conflicts the Funds face in seeking to provide for efficient market trading and protection against reverse engineering.[112]

The Exchange states that the following information would be publicly available to market professionals and retail investors alike: a PIV, disseminated every 15 seconds; an NAV, disseminated daily after the close; and the national best bid and offer and last trade for the Shares, disseminated in real-time through the Consolidated Quotation System and the Consolidated Tape.[113] The Exchange also states that, as with other ETFs, any independent view that market participants might have about the composition of the fund holdings and the value of those holdings would be included in the prices at which those participants would be willing to trade the product.[114]

The opposing commenter counters that all investors would not have equal access to Share trading information unless, as he recommends, the Commission conditions approval of the proposal on the Funds providing free access to PIVs on a public website and PIVs being available to the general public as soon as they are available to any party.[115] Otherwise, the opposing commenter argues, market makers would be able to generate an informational advantage regarding a Fund's holdings through sophisticated time-series analysis of intraday changes in the Fund's PIVs.[116] He asserts that the dissemination of market information in a

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112 See id.

113 See Response Letter, supra note 8, at 3.

114 See id.

115 See Second Gastineau Letter, supra note 11, at 6.

116 See id.

manner that facilitates unfair discrimination among market participants is inconsistent with equitable principles of trade and, therefore, with the requirements of Section 6(b)(5) of the Exchange Act.[117]

5. Potential Benefits

One commenter supports the proposed rule change, asserting that investors would have access for the first time to many different types of active management strategies.[118] This commenter also asserts that Managed Portfolio Shares would have the benefit of intraday trading and of creation and redemption at closing NAV and that they would, unlike other ETFs, offer the additional advantage of allowing investors to create or redeem directly for cash in amounts less than a creation unit.[119] Another commenter states that the Funds would permit investors to "avail themselves of the alpha-generating capabilities of professional managers and potentially greater returns, while enjoying greater access and information than a mutual fund can provide."[120] This commenter also notes that money managers, too, would enjoy benefits in the form of "lower infrastructure costs, greater efficiency and the associated flexibility to make portfolio changes, and the ability to maintain portfolio confidentiality while avoiding professional front running."[121]

The Exchange asserts that, assuming investor protection concerns are adequately addressed, investors and the marketplace can only benefit from listing and trading of a variety of

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117 See id.

118 See DeCore Letter, supra note 8, at 1.

119 See id. at 1-2.

120 See Browne Letter, supra note 13, at 1.

121 See Browne Letter, supra note 13, at 2.

products with different structures, positing that competitive forces would ultimately decide the success or failure of such initiatives.[122]

III. Discussion and Commission Findings

Under Section 19(b)(2)(C) of the Exchange Act, the Commission shall approve a proposed rule change of a self-regulatory organization if the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder that are applicable to that organization.[123] The Commission shall disapprove a proposed rule change if it does not make such a finding.[124] Commission Rule of Practice 700(d)(3) provides that, when the Commission has instituted proceedings to determine whether to approve or disapprove a rule filing, the Commission shall makes its determination on the basis of the record, which "shall consist of the proposed rule change filed on Form 19b-4 by the self-regulatory organization, including all attachments and exhibits thereto, and all written materials received from any interested parties on the proposed rule change, including the self-regulatory organization that filed the proposed rule change … as well as any written materials that reflect communications between the Commission and any interested parties."[125]

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122 See Response Letter, supra note 8, at 5.

123 15 U.S.C 78s(b)(2)(C)(i).

124 15 U.S.C. 78s(b)(2)(C)(i); see also 17 CFR 201.700(b)(3).

125 17 CFR 201.700(d)(3). The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding. See id. Any failure of a self-regulatory organization to provide the information solicited by Form 19b-4 may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder that are applicable to the self-regulatory organization. Id.

After careful consideration, the Commission does not find that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Commission does not find that the proposed rule change is consistent with Section 6(b)(5) of the Exchange Act, which requires that the rules of a national securities exchange be designed, among other things, to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest.[126]

Before an ETF can list and trade on a national securities exchange, the ETF must have exemptive relief under the 1940 Act, and a national securities exchange must have effective rules in place to list and trade the ETF.[127] As noted above, the Precidian ETFs Trust has filed an Exemptive Application under the 1940 Act.[128] As stated in the Notice of an Application for Exemptive Relief, however, "the Commission preliminarily believes that [Precidian's] proposed

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126 15 U.S.C. 78f(b)(5). In disapproving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

127 Neither an ETF that has obtained 1940 Act exemptive relief but does not fall within Commission-approved exchange listing standards, nor an ETF that falls within Commission-approved listing standards but has been denied 1940 Act exemptive relief, can legally be listed and traded on a national securities exchange.

128 See note 3, supra. The Precidian ETFs Trust submitted an application for an order under section 6(c) of the 1940 Act for an exemption from sections 2(a)(32), 5(a)(1), 22(d) and 22(e) of the 1940 Act and rule 22c-1 under the 1940 Act; under sections 6(c) and 17(b) of the 1940 Act for an exemption from sections 17(a)(1) and 17(a)(2) of the 1940 Act; and under section 12(d)(1)(J) of the 1940 Act for an exemption from sections 12(d)(1)(A) and 12(d)(1)(B) of the 1940 Act.

ETFs do not meet the standard for exemptive relief under section 6(c) of the [1940] Act,"[129] and accordingly, "absent a request for a hearing that is granted by the Commission, the Commission intends to deny [Precidian's] request for an exemption under section 6(c) of the [1940] Act as not necessary or appropriate in the public interest and as not consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the [1940] Act."[130]

The purpose of the Exchange's proposed rule change is to allow the listing and trading of the proposed Funds and future Funds of the same type. The Commission does not believe that approving this proposed rule change would be consistent with the requirement under the Exchange Act that an exchange's rules be consistent with the protection of investors and the public interest, because the Commission has stated its intention to deny the Funds exemptive relief under the 1940 Act and because denying this exemptive relief would mean that the Funds could not legally operate.[131]

IV. Conclusion

For the reasons set forth above, the Commission does not find that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations

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129 Notice of Application for Exemptive Relief, supra note 3, at 3.

130 Id. at 29.

131 The Commission's determinations under Section 6(c) of the 1940 Act with respect to the Funds are preliminary and could change if a hearing were requested, the Commission were to grant the request, and persuasive new information were presented. Under Section 19(b)(2) of the Exchange Act, however, the last date on which the Commission can take final action to approve or disapprove the Exchange's proposed rule change is no later than 240 days after notice of the proposed rule change was published in the Federal Register. As a result, the Commission must either approve or disapprove the proposed rule change by October 24, 2014, and it must do so on the basis of the facts as they currently exist, irrespective of any information that might be presented to or considered by the Commission at a later date in the context of its final determination under Section 6(c) of the 1940 Act.

thereunder applicable to a national securities exchange, and in particular, with Section 6(b)(5) of the Exchange Act.[132]

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act, that the proposed rule change (SR-NYSEArca-2014-10) be, and it hereby is, disapproved.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

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132 Having found for the reasons explained above that the Exchange's proposed rule change is not consistent with the requirements of the Exchange Act, the Commission does not believe it is necessary to address each of the particular objections raised by the commenter who opposes the proposed rule change.

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73427 / October 24, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3592 / October 24, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16212

In the Matter of **BERMAN & COMPANY, P.A., and ELLIOT BERMAN CPA** **Respondents.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Elliot Berman ("Elliot") and Berman & Company, P.A. ("Berman & Co.") (collectively, "Respondents") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) and 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

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1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

II.

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

III.

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

A. SUMMARY

Berman & Co. audited the financial statements of Issuer A for the year ended December 31, 2011, as it had done for the prior five years. Berman & Co.'s owner, Elliot Berman ("Elliot") had been the lead partner for the Issuer A audit for the previous five years. Accordingly, Elliot could no longer serve as the lead partner for the fiscal year ("FY") 2011 audit.

Elliot appointed an employee at Berman & Co. ("Employee A") as the nominal lead partner of the FY 2011 audit of Issuer A. Employee A was not a certified public accountant ("CPA"). Employee A was not otherwise qualified to be the lead partner. While Berman & Co. was registered in the State of Florida and with the Public Company Accounting Oversight Board

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> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

Rule 102(e)(1)(iii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found...to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

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

("PCAOB") to issue audits, relevant Florida statutes governing the practice of accounting in that state did not permit Employee A to issue an audit opinion and Employee A was not qualified under the standards of the PCAOB to express an opinion on the financial statements of a public company in an audit report.

In addition, despite the Commission's rule that he rotate off the engagement, Elliot performed certain services of a lead partner on the audit. Performing these duties violated the rotation requirements of the Federal securities laws and the rules and regulations thereunder.

By appointing Employee A as nominal lead partner and by Elliot's continued performance of certain lead partner duties, Berman & Co. and Elliot Berman engaged in improper professional conduct and willfully violated and aided and abetted violations of the Federal securities laws and the rules and regulations thereunder.

B. RESPONDENTS

Berman & Company, P.A. ("Berman & Co.") is an accounting and auditing firm based in Boca Raton, Florida. Berman & Co. is registered with the PCAOB. The firm reported having 14 issuer audit clients on its PCAOB Form 2 filed on June 19, 2013. The firm listed six accountants, two of which are CPAs, and stated two partners have the ability to sign audit reports. Berman & Co. served as the auditor for Issuer A since 2006.

Elliot Berman is a CPA licensed to practice in Florida. He has been a CPA in Florida since 2005 and a CPA since 1998, and has no disciplinary history. Elliot served as the lead partner on Issuer A's audits and reviews for the years ended 2006 through 2010. During the relevant period, Elliot generally served as the lead partner for all of the firm's issuer clients. Elliot is the founder and managing director of Berman & Co.

C. OTHER RELEVANT PARTIES

Employee A is an accountant in the firm Berman & Co. Employee A served as the nominal lead partner on the audit of Issuer A for the year ended December 31, 2011.

Issuer A, a Delaware corporation, is a biotech company. Issuer A's stock is registered pursuant to Section 12(b) of the Exchange Act.

D. FACT SUMMARY

1. Berman & Co. audited Issuer A for the years ended December 31, 2006 through December 31, 2011.

2. Elliot served as the lead partner for the FY2006 through FY2010 audits. After the audit for the year ended December 31, 2010, Elliot was required to rotate off as lead partner for the Issuer A engagement for FYs 2011 through 2015. Elliot was also required not to serve

as the lead partner for any Form 10-Q reviews during this time. *See* Rule 2-01(c)(6) of Regulation S-X [17 C.F.R. 210.2-01(c)(6)].

3. Elliot, as the managing director of Berman & Co., appointed Employee A as the nominal lead partner on the Issuer A audit engagement and quarterly reviews for the year ended December 31, 2011.

4. Employee A was not licensed to practice as a CPA and had never been a CPA. Nor was Employee A qualified to perform the functions of a lead partner for the audit of a public company. Employee A had no experience auditing public companies and very little experience auditing private companies. Nor did Employee A have the requisite understanding of PCAOB audit standards necessary to perform a public company audit.

5. Through the course of the Issuer A quarterly reviews and audit for the year ended December 31, 2011, Elliot performed some of the functions of a lead partner.

6. In particular, Elliot continued to serve as the primary contact with Issuer A's management, board of directors, and the board's audit committee. Elliot made the presentation of certain matters related to the conduct of the audit to Issuer A's audit committee (via phone). He also communicated with Issuer A's management on substantive audit issues.

7. Elliot was the sole contact with the engagement quality review partner for the 2011 Issuer A audit.

8. Elliot also reviewed and commented on the company's 2011 Form 10-K, reviewed the audit work papers for some of the 2011 quarterly reviews and left comments for the audit team, made staffing decisions concerning the engagement, directed staff regarding audit documentation, and performed the audit work regarding the company's discontinued operations.

9. On March 30, 2012, Berman & Co. issued an audit report in connection with its audit of the financial statements of Issuer A for the year ended December 31, 2011. In the audit report, Berman & Co. incorrectly represented that it conducted its audit in accordance with PCAOB standards. Berman & Co did not, however, conduct its audit of the financial statements of Issuer A for the year ended December 31, 2011 in accordance with PCAOB standards, which require Berman & Co. to be independent and require the lead audit partner to be qualified. *See* PCAOB Rule 3520.

E. BERMAN & CO. AND ELLIOT BERMAN'S PERFORMANCE OF LEAD PARTNER SERVICES VIOLATED FEDERAL SECURITIES LAWS AND CONSTITUTED IMPROPER PROFESSIONAL CONDUCT

Exchange Act Section 10A(j), *Audit Partner Rotation*,
<u>and Rule 2-01(c) of Regulation S-X, *Partner Rotation*</u>

10. Section 10A(j) of the Exchange Act, *Audit Partner Rotation*, states:

It shall be unlawful for a registered public accounting firm to provide audit services to an issuer if the lead (or coordinating) audit partner (having primary responsibility for the audit), or the audit partner responsible for reviewing the audit, has performed audit services for that issuer in each of the 5 previous fiscal years of that issuer.

11. Rule 2-01(c)(6) of Regulation S-X, *Partner Rotation*, states:

... an accountant is not independent of an audit client when:

(A) Any audit partner ... performs:

(1) The services of a lead partner .... or concurring partner ... for more than five consecutive years;

....

(B) Any audit partner:

(1) Within the five consecutive year period following the performance of services for the maximum period permitted under paragraph (c)(6)(A)(1) of this rule, performs for that audit client the services of a lead partner ... or concurring partner ... or a combination of those services.

12. As detailed above, Elliot provided certain services of a lead partner for more than the five consecutive years permitted.

13. As a result, Berman & Co. was not independent with respect to the audit services provided in connection with Berman & Co.'s audit and reviews of Issuer A's financial statements for the year ended December 31, 2011.

F. BERMAN & CO. AND ELLIOT BERMAN'S APPOINTMENT OF EMPLOYEE A AS LEAD PARTNER CONSTITUTED IMPROPER PROFESSIONAL CONDUCT

Florida Statutes Governing the Practice of Accounting

14. The State of Florida defines the practice of public accounting to include the following:

(8) "Practice of," "practicing public accountancy," or "public accounting" means:

(a) Offering to perform or performing for the public one or more types of services involving the expression of an opinion on financial statements, the attestation as an expert in accountancy to the reliability or fairness of presentation of financial information, the utilization of any form of opinion or financial statements that provide a level of assurance, the utilization of any form of disclaimer of opinion which conveys an assurance of reliability as to matters not specifically disclaimed, or the expression of an opinion on the reliability of an assertion by one party for the use by a third party;

Fla. Stat. §§ 473.302(8)(a).

15. The State of Florida states that a person may not knowingly

(1) A person may not knowingly:

(a) Practice public accounting unless the person is a certified public accountant or a public accountant;

....

(c) Perform or offer to perform any services described in s. 473.302(8)(a) unless such person holds an active license under this chapter and is a licensed audit firm, provides such services through a licensed audit firm, or complies with ss. 473.3101 and 473.3141. This paragraph does not prohibit the performance by persons other than certified public accountants of other services involving the use of accounting skills, including the preparation of tax returns and the preparation of financial statements without expression of opinion thereon;

....

(g) Employ unlicensed persons to practice public accounting....

Fla. Stat. § 473.322(1).

16. Accordingly, Employee A was not permitted to serve as lead audit partner for the Issuer A audit under the laws of the State of Florida.

17. Nor were Berman & Co. and its principal Elliot permitted to employ Employee A as the lead partner for that audit.

18. Accordingly, Berman & Co. and Elliot's employment of Employee A as the nominal lead partner of that audit constituted a violation of applicable professional standards.

PCAOB Interim Standards, AU Section 210:
Training and Proficiency of the Independent Auditor

19. PCAOB Interim Standards, AU Section 210.01 requires that an audit "be performed by a person or persons having adequate technical training and proficiency as an auditor.

20. AU Section 210.02 makes clear that "however capable a person may be in other fields, including business and finance, he cannot meet the requirements of the auditing standards without proper education and experience in the field of auditing."

21. AU Section 210.03 states, "In the performance of the audit which leads to an opinion, the independent auditor holds himself out as one who is proficient in accounting and auditing. The attainment of that proficiency begins with the auditor's formal education and extends into his subsequent experience. The independent auditor must undergo training adequate to meet the requirements of a professional. This training must be adequate in technical scope and should include a commensurate measure of general education.... The engagement partner must exercise seasoned judgment in the varying degrees of his supervision and review of the work done and judgments exercised by his subordinates...."

22. Berman and Co. and Elliot appointed a lead audit partner who did not meet the requirements of PCAOB AU Section 210.

PCAOB Interim Standards, AU Section 230:
<u>Due Professional Care in the Performance of Work</u>

23. PCAOB Interim Standards, AU Section 230 .06 states, "Auditors should be assigned to tasks and supervised commensurate with their level of knowledge, skill and ability so that they can evaluate the audit evidence they are examining. The engagement partner should know, at a minimum, the relevant professional accounting and auditing standards and should be knowledgeable about the client."

24. AU Section 230.03 makes clear that an auditor "assumes the duty to exercise in the employment such skill as he possesses with reasonable care and diligence. In all these employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretentions are unfounded, he commits a species of fraud upon every man who employs him in reliance on his public profession."

25. Berman and Co. and Elliot Berman knowingly appointed a lead audit partner who did not meet the requirements of PCAOB AU Section 230.

PCAOB Interim Standards, QC Section 40:
The Personnel Management Element of a Firm's System of Quality Control <u>Competencies Required by a Practitioner-in-Charge of an Attest Engagement</u>

26. PCAOB Interim Standards, PCAOB QC Section 40.07 states that the "practitioner-in-charge of an engagement to audit the financial statements of a public company would be expected to have certain technical proficiency in SEC reporting requirements.... This would include, for example, experience in the industry and appropriate knowledge of SEC ... rules and regulations, including accounting and independence standards."

27. Berman and Co. and Elliot Berman appointed a lead audit partner who did not meet the requirements of PCAOB QC Section 40.

G. BERMAN & CO.'S AUDIT REPORT DID NOT COMPLY WITH PCAOB STANDARDS AND THUS VIOLATED RULE 2-02 OF REGULATION S-X

Rule 2-02 of Regulation S-X, *Accountants' Reports and Attestation Reports*

28. Rule 2-02(b)(1) of Regulation S-X (*Representations as to the Audit included in Accountants' Reports*) requires an accountant's report to state "whether the audit was made in accordance with generally accepted auditing standards. ("GAAS")." These standards include the standards of the PCAOB. "[R]eferences in Commission rules and staff guidance and in the federal securities laws to GAAS or to specific standards under GAAS, as they related to issuers, should be understood to mean the standards of the PCAOB plus any applicable rules of the Commission." SEC Release No. 34-49708.

29. Berman & Co. issued an audit report on Issuer A's 2011 financial statements stating that it had conducted its audits in accordance with PCAOB standards.

30. Berman & Co.'s audit, however, was not conducted in accordance with PCAOB auditing standards and interim standards as described above, and, moreover, was not conducted by an independent auditor. *See* PCAOB Rule 3520, *Auditor Independence*.

31. Accordingly, Berman & Co. violated and Elliot Berman aided and abetted and caused a violation of Rule 2-02 of Regulation S-X.

H. BERMAN & CO. AND ELLIOT BERMAN'S CONDUCT CAUSED VIOLATIONS OF EXCHANGE ACT SECTION 13(a) AND RULE 13a-1 THEREUNDER

32. Exchange Act Section 13(a) and Rule 13a-1 require an issuer to file accurate annual reports on Form 10-K.

33. Berman & Co. issued an audit report improperly indicating that its audit of Issuer A's 2011 financial statements had been conducted in accordance with PCAOB standards, despite the facts that Employee A lacked the requisite technical competence as required by PCAOB auditing standards. In addition, Berman & Co. was not independent because Elliot continued to provide lead partner services.

34. The above-described actions by Berman & Co. and Elliot caused Issuer A to violate Section 13(a) and Rule13a-1 thereunder. Berman & Co. and Elliot caused Issuer A to file a Form 10-K for the year ended December 31, 2011 that included an audit report that incorrectly stated it had been conducted by an independent public accounting firm in accordance with the standards of the PCAOB. To the contrary, Berman & Co. was not independent and its audit was not conducted pursuant to PCAOB standards.

I. VIOLATIONS

35. As a result of the conduct described above, Berman & Co. and Elliot Berman willfully[4] violated Section 10A(j) of the Exchange Act;

36. As a result of the conduct described above, Berman & Co. willfully violated and Elliot Berman willfully aided and abetted and caused a violation of Rule 2-02 of Regulation S-X.

37. As a result of the conduct described above, Berman & Co. and Elliot Berman caused Issuer A to violate Section 13(a) of the Exchange Act and Rule 13a-1 thereunder.

38. As a result of the conduct described above, Berman & Co. and Elliot Berman engaged in improper professional conduct as defined in Rule 102(e)(1)(ii) in that their conduct constituted a single instance of highly unreasonable conduct resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission.

J. FINDINGS

39. Based on the foregoing, the Commission finds that Elliot Berman and Berman & Co. engaged in improper professional conduct pursuant to Section 4C(a)(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

40. Based on the foregoing, the Commission finds that Elliot Berman (a) willfully violated Section 10A(j) of the Exchange Act and, (b) willfully aided and abetted and caused a violation of Rule 2-02 of Regulation S-X, and (c) caused Issuer A's violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder.

41. Based on the foregoing, the Commission finds that Berman & Co. (a) willfully violated Section 10A(j) of the Exchange Act, Rule 2-02 of Regulation S-X, and (b) caused Issuer A's violations of Section 13(a) of the Exchange Act and Rule 13a-1 thereunder.

K. RESPONDENTS' REMEDIAL EFFORTS

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

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[4] A finding of willfulness does not require intent to violate, but merely intent to do the act which constitutes a violation. *SEC v. K.W. Brown & Co.*, 555 F. Supp. 2d 1275, 1309 (S.D. Fla.2007), citing *Wonsover* v. *SEC*, 205 F.3d 408, 413-15 (D.C. Cir. 2000); *SEC v. Steadman*, 603 F.2d 1126, 1135 (5th Cir. 1979); *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976).

IV.

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

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

A. Elliot Berman and Berman & Co. shall cease and desist from committing or causing any violations and any future violations of Section 10A(j) and 13(a) of the Exchange Act, Rule 13a-1 promulgated thereunder, and Rule 2-02 of Regulation S-X.

B. Berman & Co. is censured.

C. Elliot Berman is denied the privilege of appearing or practicing before the Commission as an accountant.

D. After 1 year from the date of this order, Elliot Berman may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

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

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

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

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

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

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

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

F. Elliot Berman and Berman & Co. shall jointly and severally pay civil penalties of $15,000, to the Securities and Exchange Commission. Payment shall be made in the following installments:

Within 14 days of the issuance of this Order	$3,750
Within 90 days of the issuance of this Order	$3,750
Within 180 days of the issuance of this Order	$3,750
Within 210 days of the issuance of this Order	$3,750

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 make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(2) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341

6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Elliot Berman and Berman & Co. as a 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 John T. Dugan, Associate Regional Director, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Boston, MA 02110.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9669 / October 24, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73428 / October 24, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16213

In the Matter of **DAVID G. DERRICK, Sr.,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against David G. Derrick, Sr. ("Respondent" or "Derrick").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. David G. Derrick, Sr. ("Derrick") was a founder of SecureAlert, Inc. and served as Chairman of the Board and Chief Executive Officer ("CEO") from February 2001 until June 30, 2011. Derrick, 61 years old, is a resident of Farmington, Utah.

B. OTHER RELEVANT ENTITY AND INDIVIDUAL

2. SecureAlert, Inc. ("SecureAlert"), formerly known as RemoteMDx, Inc., incorporated in Utah in 1995, markets and sells tracking technology devices in the area

of adult probation and parole. SecureAlert's principal place of business is in Sandy, Utah. SecureAlert's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act and trades on the OTC Bulletin Board. SecureAlert 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.

3. James J. Dalton, Jr. ("Dalton") was a founder of SecureAlert and served as a Director from 2001 to November 2, 2009 and was President from August 2003 to June 19, 2008. Dalton, 72 years old, is a resident of Park City, Utah.

C. BACKGROUND

4. In 2007, SecureAlert sold its product through a distributorship system, whereby distributors were given specific territories in which to market SecureAlert product. SecureAlert had been struggling for years and was making a substantial effort to boost sales and revenues.

Undisclosed Personal Guarantees by Derrick and Dalton

5. On September 20, 2007, just prior to the end of the fiscal year on September 30, 2007, SecureAlert entered into an Exclusive Distribution Agreement ("Distribution Agreement") with a large investor ("Distributor"). The Distribution Agreement called for Distributor to purchase 2,000 devices at $500 each for a total of $1 million, with payment due in six months.

6. Derrick negotiated the Distribution Agreement on behalf of SecureAlert. Prior to executing the agreement, Distributor informed Derrick and Dalton that he would not pay for any product and would not subject himself to liability for purchasing product if he was unable to sell it. Dalton does not recall that either Derrick or Distributor told him whether Distributor had sold any SecureAlert product to end user customers but Distributor told Derrick or Dalton that Distibutor was engaging in significant efforts to leverage his business and personal connections to, among other things, establish a sales infrastructure to sell SecureAlert product. Derrick, Dalton and Distributor knew this was a new technology application and that the possibility of product failure existed.

7. Distributor further informed Derrick that he did not need any product at the time because he did not yet have customers. Derrick insisted that Distributor accept shipment of the 2,000 units from SecureAlert, and Derrick and Dalton agreed that Distributor would not have to pay for product that Distributor was not able to sell. To document this, the Distribution Agreement gave Distributor a right of return and reimbursement for any unused units in the event the contract was terminated for any reason.

8. To further protect himself from liability, Distributor also required Derrick and Dalton to personally guarantee that they would pay for any unused units under the Distribution Agreement if Distributor was not satisfied with the devices or the business

arrangement for any reason. Derrick and Dalton signed a letter dated September 20, 2007 to that effect. Derrick and Dalton did not disclose the personal guarantee to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel. Distributor accepted the 2,000 units but did not pay for any product at the time.

9. On December 13, 2007, near the end of the following quarter, Derrick and Dalton requested a purchase order from Distributor to purchase an additional 2,000 devices from SecureAlert at $500 each for a total of $1 million, with payment due in six months. Dalton does not recall Derrick or Distributor at the time of the second purchase order, telling Dalton that Distributor had not yet sold any of the first 2,000 units or any additional devices that would be requested by a purchase order. Distributor informed Derrick he did not need any more devices, but Derrick insisted on the purchase order and that Distributor accept shipment of the devices. Derrick and Dalton again agreed to provide a personal guarantee that they would pay for any unused units. Derrick and Dalton did not disclose this agreement to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel. Distributor accepted the second 2,000 units but did not pay for any product at the time.

10. Derrick and Dalton knew or should have known that the personal guarantees were material related-party agreements that should have been disclosed and should have been considered in SecureAlert's financial statements.

11. SecureAlert filed its Form 10-KSB for the fiscal year ended September 30, 2007 ("2007 Form 10-KSB") on January 15, 2008. The financial statements reported $1 million in revenue for the September 20, 2007 transaction with Distributor. The $1 million was also recorded as an accounts receivable due in six months, on or around March 20, 2007. Derrick signed certifications for the 2007 Form 10-KSB as CEO. The 2007 Form 10-KSB did not disclose the personal guarantee and did not consider the personal guarantee in its accounting treatment of the $1 million purported sale in September 2007.

12. The $1 million in reported revenue for the September 2007 transaction represented 29% of product revenues and 12% of total revenues for fiscal year 2007 and represented a gross profit of $254,000. SecureAlert reported a gross loss of $404,000 for the year. Without gross profits from the $1 million "sale" to Distributor at year-end, the gross loss would have been 63% greater.

13. SecureAlert filed its Form 10-QSB for the period ended December 31, 2007 ("December 31, 2007 Form 10-QSB") on February 14, 2008. The December 31, 2007 Form 10-QSB reported $1 million in revenue for the December 2007 transaction with Distributor. The $1 million was also recorded as an accounts receivable due in six months, on or around June 13, 2008. Derrick signed certifications for the December 31, 2007 Form 10-QSB. The December 31, 2007 Form 10-QSB did not disclose the personal guarantee that Distributor would not be liable for unsold product and did not consider this personal guarantee in its accounting treatment of the $1 million purported sale in December 2007.

14. On March 13, 2008, staff in the Commission's Division of Corporation Finance ("Corp Fin Staff") issued a comment letter ("March 13 Comment Letter") with regard to SecureAlert's 2007 Form 10-KSB and its December 31, 2007 Form 10-QSB. The March 13 Comment Letter included a question as to why the year-end accounts receivable balance was more than half of SecureAlert's revenue for the year.

Undisclosed Personal Financing of Transactions by Derrick and Dalton

15. Soon after receiving Corp Fin Staff's comment letter, payment for the first $1 million purported sale to Distributor became due, on or around March 20, 2008. In the meantime, Distributor had learned that many of the devices shipped to him were defective or damaged. Distributor had not sold any devices at that point, and he refused to pay for defective devices or devices he had not sold. Derrick attempted to arrange financing to pay the accounts receivable due, in an apparent attempt to conceal the fact that revenue should not have been recognized in the transaction. In this way, SecureAlert's accounting records would reflect the $1 million accounts receivable as fully paid at or around the due date.

16. Derrick reached out to a third party financing entity ("Third Party"), with which he had previously done business. Third Party agreed to make the payment for the accounts receivable to SecureAlert. However, Third Party would not provide funding because of the risk, so Derrick and Dalton provided their own personal funds, through their entity, to finance the transaction.

17. The Third Party transaction was documented with a promissory note dated March 26, 2008, in which Distributor promised to pay Third Party $1 million plus interest by March 31, 2009. Distributor signed the promissory note, but Derrick and Distributor agreed that the transaction was executed on paper only and that Distributor had no obligation to pay $1 million to Third Party. Derrick and Distributor also agreed that Distributor would not be liable for any interest due under the note. Dalton was made aware of the agreement between Derrick and Distributor. Derrick and Dalton did not disclose to Distributor that they provided the $1 million in funds to Third Party.

18. Derrick and Dalton sent $1 million of their personal funds to Third Party on March 31, 2008. Third Party, in turn, sent the funds to SecureAlert to satisfy the $1 million accounts receivable due in March 2008.

19. The accounts receivable for the December 2007 $1 million purported sale to Distributor became due on or around June 13, 2008. Again, Distributor had not yet sold any devices, so he refused to pay for devices that were defective or unsold. Derrick again approached Third Party, which agreed to make the second payment for the accounts receivable to SecureAlert if Derrick and Dalton again provided the funds.

20. The second Third Party transaction was documented with a promissory note dated September 16, 2008, in which Distributor promised to pay Third

Party $1 million plus interest by September 16, 2009. Distributor signed the promissory note, but again Derrick and Distributor agreed that this transaction was executed on paper only and that Distributor had no obligation to pay the $1 million to Third Party. Derrick and Distributor also agreed that Distributor would not be liable for any interest due under the note. Dalton was made aware of the agreements. Derrick and Dalton did not disclose to Distributor that they provided the second $1 million in funds to Third Party.

21. Derrick and Dalton sent $1 million of their personal funds to Third Party on September 12, 2008. This time, Third Party wired the money to Distributor, who in turn forwarded $1 million to SecureAlert on September 25, 2008, just prior to the end of fiscal year 2008. The $1 million was used to pay the $1 million accounts receivable due in June 2008.

22. Derrick and Dalton did not disclose their personal financing of the Third Party transactions to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel.

Comment Process with Corp Fin Staff

23. From March to June 2008, SecureAlert engaged in the comment process with Corp Fin Staff. On April 28, 2008, SecureAlert filed a response to the staff's March 13, 2008 comment letter, and discussed SecureAlert's revenue recognition policies. The letter was signed by Derrick and represented that SecureAlert only recognized revenue if the following conditions were met: persuasive evidence of an arrangement exists, ***title passes to the customer and the customer cannot return the devices,*** prices are fixed or determinable, and collection is reasonably assured.

24. SecureAlert also made the following separate representations about revenue recognition in its April 28, 2008 response: (1) "Distributors do not have general rights of return;" (2) "Generally, title and risk of loss pass to the buyer upon delivery of the devices;" (3) "The distributors do not have general rights of return for these devices."

25. The statements related to revenue recognition were false in the case of Distributor because Derrick and Dalton had made assurances to Distributor that he would not be liable for any unsold devices and that Distributor could return devices at any time for any reason.

26. In the April 28, 2008 response and a response to additional staff comments filed on May 14, 2008, SecureAlert represented that it had collected 100% of the accounts receivable due from Distributor for the first $1 million purported sale. The responses did not disclose that Distributor did not pay the receivable. The responses did not disclose that Derrick and Dalton actually paid the receivable with their own personal funds through a third party. The responses did not disclose that Derrick and Dalton had agreements with Distributor that he was not liable to pay for any devices he did not sell.

27. During the comment process, SecureAlert reviewed the Distribution Agreement. SecureAlert, in consultation with its independent auditor and outside securities counsel, determined that the provision in the Distribution Agreement allowing Distributor a right to return product did not allow for revenue to be recognized. Therefore, SecureAlert informed Corp Fin Staff that it would restate the $1 million initially recorded as revenue from the purported sale in September 2007 to "deferred revenue."

28. On May 6, 2008, SecureAlert filed a Form 8-K announcing a restatement of the financial statements, including the deferral of the $1 million in revenue from the September 2007 contract with Gonzalez. The Form 8-K contained no disclosure of the personal guarantees or the personal financing of the $1 million "sale."

29. To avoid future issues with revenue recognition, SecureAlert amended the Distribution Agreement in April 2008 ("Amended Distribution Agreement") to remove Distributor's unilateral right to return product. SecureAlert determined that under the Amended Distribution Agreement, revenue from sales to Distributor could be recognized immediately if they met the required revenue recognition conditions, including that title passes to the customer and the customer cannot return devices. Based on this determination, SecureAlert concluded it did not need to restate revenue from the December 2007 purported sale to Distributor. Derrick and Dalton did not disclose their side agreement that Distributor could return unused or unsold product for any reason and that Distributor would not be liable for any product it did not use.

<u>SecureAlert Files Materially Misstated Periodic Reports with the Commission</u>

30. On June 18, 2008, SecureAlert filed an amended Form 10-QSB/A for the period ended December 31, 2007 ("December 2007 Form 10-QSB/A"). The $1 million in revenue for the second purported sale to Distributor in December 2007 was not restated and remained in the financials as revenue. Derrick signed certifications as CEO for the December 2007 Form 10-QSB/A.

31. On June 19, 2008, SecureAlert filed an amended Form 10-KSB/A ("2007 Form 10-KSB/A"). The 2007 Form 10-KSB/A restated the $1 million revenue from the first purported sale in September 2007 as "deferred revenue." The Distribution Agreement was attached as an exhibit to the filing; however, the personal guarantee and the personal financing arrangements were not disclosed. Derrick signed certifications as CEO for the 2007 Forms 10-KSB/A and 10-QSB/A.

32. On August 15, 2008, SecureAlert filed its Form 10-Q for the period ended June 30, 2008 ("June 2008 Form 10-Q"). Because of the Amended Distribution Agreement, SecureAlert determined it could now recognize revenue from the September 2007 $1 million purported sale to Distributor. Derrick signed certifications as CEO for the June 2008 Form 10-Q.

33. On December 26, 2008, SecureAlert filed its Form 10-K for the fiscal year ended September 30, 2008 ("2008 Form 10-K). The entire $2 million for the September and December 2007 purported sales was reported as revenue in the year-end

financial statements. The $2 million in reported revenue made up 78% of SecureAlert's product revenues and 16% of all revenues for fiscal year 2008. Derrick signed certifications as CEO for the 2008 Form 10-K.

34. The materially misstated financial statements continued to be reported in SecureAlert's filings through the end of fiscal year 2009. The filings included Forms 10-Q for the periods ended December 31, 2008, March 31, 2009, and June 30, 2009. The Form 10-K for the fiscal year ended September 30, 2009 ("2009 Form 10-K") was the last report to contain the misstated financial statements and was filed on January 13, 2010. Derrick signed certifications as CEO for each of the quarterly reports filed during fiscal year 2009 and the 2009 Form 10-K.

35. Derrick made misrepresentations to SecureAlert's independent auditor during the yearly audit and quarterly review periods for each of the relevant periods. For each period, he signed a management representation letter to the auditor, representing, among other things, that: financial statements were fairly presented in conformity with GAAP along with all related disclosures, that he had no knowledge of any fraud or suspected fraud, and that all related party transactions had been properly recorded or disclosed. These representations were false in light of the undisclosed personal guarantees and personal related-party financing of transactions.

Assignment of Third Party Promissory Notes to Derrick and Dalton Entity

36. By June 2009, SecureAlert and its distributors continued to struggle. There were still problems with technology and defective units and Distributor had sold little, if any, of the $2 million in product purportedly sold to him in September and December 2007. The $2 million owed to Third Party had not been paid. The first $1 million was three months overdue, and Derrick knew that Distributor would not pay. Although Third Party had not provided any funds for the transactions, Third Party desired to remove the large, stale accounts receivables from Third Party's balance sheet. Therefore, Derrick devised a plan to arrange additional transactions, which served to cover up the personal financing arrangements and the personal guarantees.

37. In June 2009, Derrick formed an entity called JBD Management, LLC ("JBD"). JBD was owned by Derrick (47.5%), Dalton (47.5%) and Third Party (5%). Derrick arranged for Third Party to assign its interest in the March 2008 $1 million promissory note and the September 2008 $1 million promissory note to JBD. The assignment involved a series of transactions and documents executed in July 2009. Interest due on the notes had previously been paid to Third Party by Derrick and Dalton.

38. The end result was that, on paper, Distributor appeared to owe $2 million to JBD. Derrick and Dalton did not disclose that Distributor was not obligated to pay the $2 million to JBD, nor did they disclose that funds for the Third Party transactions had been personally provided by Derrick and Dalton.

39. In addition, Derrick and Dalton executed and signed a second undisclosed side agreement, dated July 13, 2009, to personally guarantee the re-purchase of

any unused product in Distributor's possession by December 31, 2010. This personal guarantee apparently documented the agreement that Distributor would not be liable for the 2,000 units purportedly sold to him in December 2007, and he would not have to make payments on the financing arrangement, which were to come due in September 2009, if Distributor did not need or sell devices. Derrick and Dalton did not disclose this personal guarantee to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel.

40. During the relevant period, Derrick and Dalton solicited investments in SecureAlert and obtained money or property, including money for the sale of SecureAlert stock, by means of the material misstatements and omissions contained in the company's financial statements and the non-disclosure of their personal guarantees and material related-party transactions. During that time period, SecureAlert was engaged in offering and selling its securities in private offerings and via Forms S-8. SecureAlert issued 23,927,219 shares of common stock to a number of private parties for prices ranging from $0.20 to $1.00 and a total of $8,307,914.00. In addition, on August 26, 2008 and March 9, 2009, SecureAlert filed Forms S-8 to register shares for sales or awards of stock to employees. The August 26, 2008 Form S-8 incorporated by reference SecureAlert's materially false financial statements found in SecureAlert's 2007 Form 10-KSB. The March 9, 2009 Form S-8 incorporated by reference SecureAlert's materially false financial statements found in SecureAlert's 2008 Form 10-K. Derrick's and Dalton's actions also constituted a transaction, practice, or course of business which operated as a fraud or deceit in the offer or sale of SecureAlert securities.

<u>Internal Control Deficiencies</u>

41. During the relevant period, Derrick and Dalton knowingly failed to implement a system of internal accounting controls for SecureAlert and directly or indirectly caused to be falsified SecureAlert's books, records, and accounts.

42. Through their conduct, Derrick and Dalton caused SecureAlert's books and records to be inaccurate and caused SecureAlert to fail to devise or maintain a system of sufficient internal accounting controls.

<u>Discovery of Undisclosed Personal Guarantees and Personal Financing</u>

43. In or around spring of 2011, Distributor and Derrick discussed the issue of obligation under the Third Party transactions. For the first time, Derrick admitted to Distributor that he and Dalton had provided the financing for the Third Party transactions. Over the next several months, Distributor had discussions with the Board regarding the situation. The Board ultimately asked for Derrick's resignation, which he provided on June 30, 2011.

44. After Derrick left SecureAlert, the Board authorized an internal investigation into Derrick's business dealings, including transactions with Distributor and Third Party. SecureAlert self-reported the possible violations and, later, the results of the internal investigation to Commission Enforcement Staff. After initiation of the internal

investigation, SecureAlert implemented a number of internal control procedures to prevent future violations of the federal securities laws.

Reclassification of Revenues

45. After learning of the personal guarantees and personal financing arrangements by Derrick and Dalton, SecureAlert, with the help of its independent auditor, concluded it should reclassify the $2 million for the Distributor transactions as capital contributions. SecureAlert determined that the transactions should be treated as capital contributions because JBD was ultimately issued stock for the $2 million that Derrick and Dalton paid to finance the transactions. This was pursuant to the assignment of the Third Party notes to JBD and subsequent transactions involving SecureAlert and Distributor.

46. The reclassification was made in the second quarter of fiscal year 2012 and reported in SecureAlert's Form 10-Q for the period ended March 31, 2012, which was filed on May 17, 2012. For that period, SecureAlert's 2008 statement of operations was no longer presented in its filings. As a result, the reclassification was made directly between SecureAlert's accumulated deficit and additional paid-in capital. At the time, SecureAlert's balance sheet reflected $249 million in additional paid-in capital and an accumulated deficit of $234 million.

D. VIOLATIONS

1. As a result of the conduct described above, Derrick violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

2. As a result of the conduct described above, Derrick violated Exchange Act Rule 13a-14, which requires the principal executive officer to sign and certify annual and quarterly reports.

3. As a result of the conduct described above, Derrick violated Section 13(b)(5) of the Exchange Act, which prohibits any person from knowingly circumventing or failing to implement a system of internal accounting controls and Rule 13b2-1 thereunder, which prohibits the direct or indirect falsification of an issuer's books, records, or accounts.

4. As a result of the conduct described above, Derrick violated Exchange Act Rule 13b2-2, which prohibits directors or officers of an issuer to make or cause to be made materially false or misleading statements or omissions to an accountant in connection with any audit, review, or examination of the financial statements of the issuer.

5. As a result of the conduct described above, Derrick caused violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, which require the filing of annual and quarterly reports that do not contain material misstatements or omissions.

6. As a result of the conduct described above, Derrick caused violations of Section 13(b)(2)(A) of the Exchange Act, which requires Section 12 registrants to make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer and Section 13(b)(2)(B) of the Exchange Act, which requires Section 12 registrants to devise and maintain a system of sufficient internal accounting controls.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that 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. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and (B), and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13b2-1, and 13b2-2 thereunder, whether Respondent should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act and Section 21B(a) of the Exchange, and whether Respondent should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act and Sections 21B(e) and 21C(e) of the Exchange Act.

IV.

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

IT IS FURTHER ORDERED that 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 as provided for in the Commission's Rules of Practice.

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.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9670 / October 24, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73429 / October 24, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16214

In the Matter of **JAMES J. DALTON, JR.** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against James J. Dalton, Jr. ("Dalton" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of the non-disclosure of personal guarantees and material related-party transactions by Dalton and another officer of SecureAlert, Inc. ("SecureAlert"), a public company. The non-disclosures resulted in material misstatements of $2 million in overstated revenue in SecureAlert's financial statements for fiscal years 2007 and 2008. The misstatements and omissions were in Forms 10-KSB, 10-KSB/A, 10-QSB, and 10-QSB/A filed from September 2007 through January 2010.

Respondent

1. James J. Dalton, Jr. ("Dalton") was a founder of SecureAlert and served as a Director from 2001 to November 2, 2009 and was President from August 2003 to June 19, 2008. Dalton, 72 years old, is a resident of Park City, Utah.

Other Relevant Entity and Individual

2. SecureAlert (formerly known as RemoteMDx, Inc.), incorporated in Utah in 1995, markets and sells tracking technology devices in the area of adult probation and parole. SecureAlert's principal place of business is in Sandy, Utah. SecureAlert's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act and trades on the OTC Bulletin Board. SecureAlert 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.

3. David G. Derrick, Sr. ("Derrick") was a founder of SecureAlert and served as Chairman of the Board and Chief Executive Officer ("CEO") from February 2001 until June 30, 2011. Derrick, 61 years old, is a resident of Farmington, Utah.

Background

4. In 2007, SecureAlert sold its product through a distributorship system, whereby distributors were given specific territories in which to market SecureAlert product. SecureAlert had been struggling for years and was making a substantial effort to boost sales and revenues.

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

Undisclosed Personal Guarantees by Derrick and Dalton

5. On September 20, 2007, just prior to the end of the fiscal year on September 30, 2007, SecureAlert entered into an Exclusive Distribution Agreement ("Distribution Agreement") with a large investor ("Distributor"). The Distribution Agreement called for Distributor to purchase 2,000 devices at $500 each for a total of $1 million, with payment due in six months.

6. Derrick negotiated the Distribution Agreement on behalf of SecureAlert. Prior to executing the agreement, Distributor informed Derrick and Dalton that he would not pay for any product and would not subject himself to liability for purchasing product if he was unable to sell it. Dalton understood that Distibutor was engaging in significant efforts to leverage his business and personal connections to, among other things, establish a sales infrastructure to sell SecureAlert product, but that Distributor had not yet sold any SecureAlert product to end user customers at the time of the Distribution Agreement in September 2007. Dalton does not recall any conversations with Derrick, Distributor, or anyone else at that time, in which Dalton was informed of any sales to end user customers. Derrick, Dalton and Distributor knew this was a new technology application and that the possibility of product failure existed.

7. Distributor further informed Derrick that he did not need any product at the time because he did not yet have customers. Derrick insisted that Distributor accept shipment of the 2,000 units from SecureAlert, and Derrick and Dalton agreed that Distributor would not have to pay for product that Distributor was not able to sell. To document this, the Distribution Agreement gave Distributor a right of return and reimbursement for any unused units in the event the contract was terminated for any reason.

8. To further protect himself from liability, Distributor also required Derrick and Dalton to personally guarantee that they would pay for any unused units under the Distribution Agreement if Distributor was not satisfied with the devices or the business arrangement for any reason. Derrick and Dalton signed a letter dated September 20, 2007 to that effect. Derrick and Dalton did not disclose the personal guarantee to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel. Distributor accepted the 2,000 units but did not pay for any product at the time.

9. On December 13, 2007, near the end of the following quarter, Derrick requested a purchase order from Distributor to purchase an additional 2,000 devices from SecureAlert at $500 each for a total of $1 million, with payment due in six months. Dalton does not recall any conversations with Derrick, Distributor, or anyone else at the time of the December 2007 purchase order, in which Dalton was informed that Distributor had sold any of the first 2,000 units or any additional devices that would be requested by a purchase order. Distributor informed Derrick he did not need any more devices, but Derrick insisted on the purchase order and that Distributor accept shipment of the devices. Derrick and Dalton again agreed to provide a personal guarantee that they would pay for any unused units. Derrick and Dalton did not disclose this agreement to other Board members or employees of SecureAlert, nor did they disclose it to

SecureAlert's independent auditor or outside securities counsel. Distributor accepted the second 2,000 units but did not pay for any product at the time.

10. Derrick and Dalton knew or should have known that the personal guarantees were material related-party agreements that should have been disclosed and should have been considered in SecureAlert's financial statements.

11. SecureAlert filed its Form 10-KSB for the fiscal year ended September 30, 2007 ("2007 Form 10-KSB") on January 15, 2008. The financial statements reported $1 million in revenue for the September 20, 2007 transaction with Distributor. The $1 million was also recorded as an accounts receivable due in six months, on or around March 20, 2007. Derrick signed certifications for the 2007 Form 10-KSB as CEO. The 2007 Form 10-KSB did not disclose the personal guarantee and did not consider the personal guarantee in its accounting treatment of the $1 million purported sale in September 2007.

12. The $1 million in reported revenue for the September 2007 transaction represented 29% of product revenues and 12% of total revenues for fiscal year 2007 and represented a gross profit of $254,000. SecureAlert reported a gross loss of $404,000 for the year. Without gross profits from the $1 million "sale" to Distributor at year-end, the gross loss would have been 63% greater.

13. SecureAlert filed its Form 10-QSB for the period ended December 31, 2007 ("December 31, 2007 Form 10-QSB") on February 14, 2008. The December 31, 2007 Form 10-QSB reported $1 million in revenue for the December 2007 transaction with Distributor. The $1 million was also recorded as an accounts receivable due in six months, on or around June 13, 2008. Derrick signed certifications for the December 31, 2007 Form 10-QSB. The December 31, 2007 Form 10-QSB did not disclose the personal guarantee that Distributor would not be liable for unsold product and did not consider this personal guarantee in its accounting treatment of the $1 million purported sale in December 2007.

14. On March 13, 2008, staff in the Commission's Division of Corporation Finance ("Corp Fin Staff") issued a comment letter ("March 13 Comment Letter") with regard to SecureAlert's 2007 Form 10-KSB and its December 31, 2007 Form 10-QSB. The March 13 Comment Letter included a question as to why the year-end accounts receivable balance was more than half of SecureAlert's revenue for the year.

Undisclosed Personal Financing of Transactions by Derrick and Dalton

15. Soon after receiving Corp Fin Staff's comment letter, payment for the first $1 million purported sale to Distributor became due, on or around March 20, 2008. In the meantime, Distributor had learned that many of the devices shipped to him were defective or damaged. Distributor had not sold any devices at that point, and he refused to pay for defective devices or devices he had not sold. Derrick attempted to arrange financing to pay the accounts receivable due, in an apparent attempt to conceal the fact that revenue should not have been

recognized in the transaction. In this way, SecureAlert's accounting records would reflect the $1 million accounts receivable as fully paid at or around the due date.

16. Derrick reached out to a third party financing entity ("Third Party"), with which he had previously done business. Third Party agreed to make the payment for the accounts receivable to SecureAlert. However, Third Party would not provide funding because of the risk, so Derrick and Dalton provided their own personal funds, through their entity, to finance the transaction.

17. The Third Party transaction was documented with a promissory note dated March 26, 2008, in which Distributor promised to pay Third Party $1 million plus interest by March 31, 2009. Distributor signed the promissory note, but Derrick and Distributor agreed that the transaction was executed on paper only and that Distributor had no obligation to pay $1 million to Third Party. Derrick and Distributor also agreed that Distributor would not be liable for any interest due under the note. Dalton was made aware of the agreement between Derrick and Distributor. Derrick and Dalton did not disclose to Distributor that they provided the $1 million in funds to Third Party.

18. Derrick and Dalton sent $1 million of their personal funds to Third Party on March 31, 2008. Third Party, in turn, sent the funds to SecureAlert to satisfy the $1 million accounts receivable due in March 2008.

19. The accounts receivable for the December 2007 $1 million purported sale to Distributor became due on or around June 13, 2008. Again, Distributor had not yet sold any devices, so he refused to pay for devices that were defective or unsold. Derrick again approached Third Party, which agreed to make the second payment for the accounts receivable to SecureAlert if Derrick and Dalton again provided the funds.

20. The second Third Party transaction was documented with a promissory note dated September 16, 2008, in which Distributor promised to pay Third Party $1 million plus interest by September 16, 2009. Distributor signed the promissory note, but again Derrick and Distributor agreed that this transaction was executed on paper only and that Distributor had no obligation to pay the $1 million to Third Party. Derrick and Distributor also agreed that Distributor would not be liable for any interest due under the note. Dalton was made aware of the agreements. Derrick and Dalton did not disclose to Distributor that they provided the second $1 million in funds to Third Party.

21. Derrick and Dalton sent $1 million of their personal funds to Third Party on September 12, 2008. This time, Third Party wired the money to Distributor, who in turn forwarded $1 million to SecureAlert on September 25, 2008, just prior to the end of fiscal year 2008. The $1 million was used to pay the $1 million accounts receivable due in June 2008.

22. Derrick and Dalton did not disclose their personal financing of the Third Party transactions to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel.

Comment Process with Corp Fin Staff

23. From March to June 2008, SecureAlert engaged in the comment process with Corp Fin Staff. On April 28, 2008, SecureAlert filed a response to the staff's March 13, 2008 comment letter, and discussed SecureAlert's revenue recognition policies. The letter was signed by Derrick and represented that SecureAlert only recognized revenue if the following conditions were met: persuasive evidence of an arrangement exists, ***title passes to the customer and the customer cannot return the devices,*** prices are fixed or determinable, and collection is reasonably assured.

24. SecureAlert also made the following separate representations about revenue recognition in its April 28, 2008 response: (1) "Distributors do not have general rights of return;" (2) "Generally, title and risk of loss pass to the buyer upon delivery of the devices;" (3) "The distributors do not have general rights of return for these devices."

25. The statements related to revenue recognition were false in the case of Distributor because Derrick and Dalton had made assurances to Distributor that he would not be liable for any unsold devices and that Distributor could return devices at any time for any reason.

26. In the April 28, 2008 response and a response to additional staff comments filed on May 14, 2008, SecureAlert represented that it had collected 100% of the accounts receivable due from Distributor for the first $1 million purported sale. The responses did not disclose that Distributor did not pay the receivable. The responses did not disclose that Derrick and Dalton actually paid the receivable with their own personal funds through a third party. The responses did not disclose that Derrick and Dalton had agreements with Distributor that he was not liable to pay for any devices he did not sell.

27. During the comment process, SecureAlert reviewed the Distribution Agreement. SecureAlert, in consultation with its independent auditor and outside securities counsel, determined that the provision in the Distribution Agreement allowing Distributor a right to return product did not allow for revenue to be recognized. Therefore, SecureAlert informed Corp Fin Staff that it would restate the $1 million initially recorded as revenue from the purported sale in September 2007 to "deferred revenue."

28. On May 6, 2008, SecureAlert filed a Form 8-K announcing a restatement of the financial statements, including the deferral of the $1 million in revenue from the September 2007 contract with Gonzalez. The Form 8-K contained no disclosure of the personal guarantees or the personal financing of the $1 million "sale."

29. To avoid future issues with revenue recognition, SecureAlert amended the Distribution Agreement in April 2008 ("Amended Distribution Agreement") to remove Distributor's unilateral right to return product. SecureAlert determined that under the Amended Distribution Agreement, revenue from sales to Distributor could be recognized immediately if they met the required revenue recognition conditions, including that title passes to the customer and the customer cannot return devices. Based on this determination, SecureAlert concluded it did not

need to restate revenue from the December 2007 purported sale to Distributor. Derrick and Dalton did not disclose their side agreement that Distributor could return unused or unsold product for any reason and that Distributor would not be liable for any product it did not use.

SecureAlert Files Materially Misstated Periodic Reports with the Commission

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32. On August 15, 2008, SecureAlert filed its Form 10-Q for the period ended June 30, 2008 ("June 2008 Form 10-Q"). Because of the Amended Distribution Agreement, SecureAlert determined it could now recognize revenue from the September 2007 $1 million purported sale to Distributor.

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34. The materially misstated financial statements continued to be reported in SecureAlert's filings through the end of fiscal year 2009. The filings included Forms 10-Q for the periods ended December 31, 2008, March 31, 2009, and June 30, 2009. The Form 10-K for the fiscal year ended September 30, 2009 ("2009 Form 10-K") was the last report to contain the misstated financial statements and was filed on January 13, 2010.

Assignment of Third Party Promissory Notes to Derrick and Dalton Entity

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37. The end result was that, on paper, Distributor appeared to owe $2 million to JBD. Derrick and Dalton did not disclose that Distributor was not obligated to pay the $2 million to JBD, nor did they disclose that funds for the Third Party transactions had been personally provided by Derrick and Dalton.

38. In addition, Derrick and Dalton executed and signed a second undisclosed side agreement, dated July 13, 2009, to personally guarantee the re-purchase of any unused product in Distributor's possession by December 31, 2010. This personal guarantee apparently documented the agreement that Distributor would not be liable for the 2,000 units purportedly sold to him in December 2007, and he would not have to make payments on the financing arrangement, which were to come due in September 2009, if Distributor did not need or sell devices. Derrick and Dalton did not disclose this personal guarantee to other Board members or employees of SecureAlert, nor did they disclose it to SecureAlert's independent auditor or outside securities counsel.

39. During the relevant period, Derrick and Dalton solicited investments in SecureAlert and obtained money or property, including money for the sale of SecureAlert stock, by means of the material misstatements and omissions contained in the company's financial statements and the non-disclosure of their personal guarantees and material related-party transactions. During that time period, SecureAlert was engaged in offering and selling its securities in private offerings and via Forms S-8. SecureAlert issued 23,927,219 shares of common stock to a number of private parties for prices ranging from $0.20 to $1.00 and a total of $8,307,914.00. In addition, on August 26, 2008 and March 9, 2009, SecureAlert filed Forms S-8 to register shares for sales or awards of stock to employees. The August 26, 2008 Form S-8 incorporated by reference SecureAlert's materially false financial statements found in SecureAlert's 2007 Form 10-KSB. The March 9, 2009 Form S-8 incorporated by reference SecureAlert's materially false financial statements found in SecureAlert's 2008 Form 10-K. Derrick's and Dalton's actions also constituted a transaction, practice, or course of business which operated as a fraud or deceit in the offer or sale of SecureAlert securities.

Internal Control Deficiencies

40. During the relevant period, Derrick and Dalton knowingly failed to implement a system of internal accounting controls for SecureAlert and directly or indirectly caused to be falsified SecureAlert's books, records, and accounts.

41. Through their conduct, Derrick and Dalton caused SecureAlert's books and records to be inaccurate and caused SecureAlert to fail to devise or maintain a system of sufficient internal accounting controls.

Discovery of Undisclosed Personal Guarantees and Personal Financing

42. In or around spring of 2011, Distributor and Derrick discussed the issue of obligation under the Third Party transactions. For the first time, Derrick admitted to Distributor that he and Dalton had provided the financing for the Third Party transactions. Over the next several months, Distributor had discussions with the Board regarding the situation. The Board ultimately asked for Derrick's resignation, which he provided on June 30, 2011.

43. After Derrick left SecureAlert, the Board authorized an internal investigation into Derrick's business dealings, including transactions with Distributor and Third Party. SecureAlert self-reported the possible violations and, later, the results of the internal investigation to Commission Enforcement Staff. After initiation of the internal investigation, SecureAlert implemented a number of internal control procedures to prevent future violations of the federal securities laws.

Reclassification of Revenues

44. After learning of the personal guarantees and personal financing arrangements by Derrick and Dalton, SecureAlert, with the help of its independent auditor, concluded it should reclassify the $2 million for the Distributor transactions as capital contributions. SecureAlert determined that the transactions should be treated as capital contributions because JBD was ultimately issued stock for the $2 million that Derrick and Dalton paid to finance the transactions. This was pursuant to the assignment of the Third Party notes to JBD and subsequent transactions involving SecureAlert and Distributor.

45. The reclassification was made in the second quarter of fiscal year 2012 and reported in SecureAlert's Form 10-Q for the period ended March 31, 2012, which was filed on May 17, 2012. For that period, SecureAlert's 2008 statement of operations was no longer presented in its filings. As a result, the reclassification was made directly between SecureAlert's accumulated deficit and additional paid-in capital. At the time, SecureAlert's balance sheet reflected $249 million in additional paid-in capital and an accumulated deficit of $234 million.

Violations

46. As a result of the conduct described above, Dalton violated Sections 17(a)(2) and (3) of the Securities Act, which prohibit a person from obtaining money or property by means of a material misrepresentation or omission or to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit in the offer or sale of securities.

47. As a result of the conduct described above, Dalton knowingly violated Section 13(b)(5) of the Exchange Act, which prohibits any person from knowingly circumventing or failing to implement a system of internal accounting controls and Rule 13b2-1 thereunder, which prohibits the direct or indirect falsification of an issuer's books, records, or accounts.

48. As a result of the conduct described above, Dalton caused violations of Section 13(b)(2)(A) of the Exchange Act, which requires Section 12 registrants to make and keep books, records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer and Section 12(b)(2)(B), which requires Section 12 registrants to devise and maintain a system of sufficient internal accounting controls.

49. Respondent will pay a second-tier civil penalty of $65,000.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondent Dalton cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act and Sections , 13(b)(2)(A) and (B), and 13(b)(5) of the Exchange Act and Rule 13b2-1 thereunder.

B. Respondent shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $$65,000 to the Securities and Exchange Commission. 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 James J. Dalton, Jr. 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, Regional Director, Division of Enforcement, Securities and Exchange Commission, 351 So. West Temple, Suite 6.100, Salt Lake City, UT 84101.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73434 / October 27, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3593 / October 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16215

In the Matter of	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND A CIVIL PENALTY
GREAT LAKES DREDGE & DOCK CORPORATION	
Respondent.	

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 Great Lakes Dredge & Dock Corporation ("Great Lakes" or "the company" or "Respondent").

II.

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

III.

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

Summary

1. During the second and third quarters of 2012, Great Lakes overstated revenue in its demolition segment. Specifically, the demolition segment recorded revenue for pending change orders even though it did not have sufficient proof of customer acceptance of the pending change orders. The company's inadequate internal controls over revenue recognition with respect to pending change orders on its demolition projects failed to prevent or detect these misstatements.

2. The revenue overstatements were discovered during the year-end 2012 audit process. A material weakness in the company's system of internal control over financial reporting failed to prevent or detect misstatements of the company's financial statements for the quarterly and year-to-date periods ended June 30, 2012, and September 30, 2012. Specifically, the company's controls failed to capture and analyze timely and consistently pending change orders in its demolition segment, largely as a result of inadequate accounting policies and procedures, inadequate training of segment personnel, and insufficient monitoring by corporate accounting staff.

3. In addition, by recognizing certain pending change order revenue in its demolition segment without sufficient proof of customer acceptance, the company did not comply with its accounting policies set forth in its annual Commission filings. Moreover, by overstating revenue in its demolition segment, Great Lakes also materially overstated its net income for the second and third quarters of 2012. Accordingly, Great Lakes violated Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder, the reporting, books-and-records, and internal controls provisions of the federal securities laws.

Respondent

4. Great Lakes Dredge & Dock Corporation is a Delaware corporation, headquartered in Oak Brook, Illinois, that in 2012 operated in two reportable segments: a dredging segment with both U.S. and foreign operations, which was responsible for 85% of the company's revenues; and a demolition segment with only U.S. operations, which was responsible for the remaining 15% of revenues.[2] Great Lakes's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on NASDAQ (Ticker: GLDD). Great Lakes files periodic

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

[2] On April 23, 2014, Great Lakes sold its demolition subsidiary.

reports, including Forms 10-K and 10-Q, with the Commission pursuant to Section 13(a) of the Exchange Act and related rules thereunder.

Facts

Great Lakes's Restatement

5. On March 14, 2013, Great Lakes filed with the Commission a Form 8-K announcing that it would restate its demolition segment revenues for the second and third quarters of 2012. In addition, Great Lakes announced that it had identified a material weakness in its internal control over financial reporting that failed to prevent or detect accounting errors in its financial statements. The Form 8-K further stated that Great Lakes would file amended Forms 10-Q for the quarters ended June 30 and September 30, 2012 and that the filing of its Form 10-K for the year-ended December 31, 2012 would be delayed. According to the Form 8-K and the amended filings, the company had recorded revenues from certain pending change orders in the demolition segment where client acceptance had not been finalized. The revenue recognition was inconsistent with Great Lakes's accounting policy and also inconsistent with Generally Accepted Accounting Principles (GAAP). Great Lakes filed its Forms 10-Q/A for the restated quarters, as well as its 2012 Form 10-K, on March 29, 2013.

Great Lakes's External Auditor Advised the Company in Prior Periods of Concerns Regarding Its Accounting for Pending Change Orders

6. During 2012 and earlier periods, a "pending change order" occurred when Great Lakes's demolition subsidiary performed additional work on a project outside the provisions of the original contract and had not yet received a final written contract amendment approving the scope and price of the work from the customer. Sometimes, the demolition subsidiary did not yet have customer acceptance as to the amounts to be paid for the additional work. Great Lakes's policy for pending change orders was to immediately recognize the costs, but recognize the related revenue (up to cost) when the recovery was probable and collectability was reasonably assured. Once the scope and amount were formally documented in a written contract amendment, it became a "change order," and Great Lakes then recognized profit margin for the additional work. Pending change orders in dispute or unapproved as to both scope and price left Great Lakes with a "claim" for payment. Under Great Lakes's accounting policy, revenue associated with a "claim" was not recognized until such claim was settled.[3]

[3] Under GAAP, accounting for unpriced change orders "depends on their characteristics and the circumstances in which they occur. For all unpriced change orders, recovery should be deemed probable if the future event or events necessary for recovery are likely to occur. Some of the factors to consider in evaluating whether recovery is probable are the customer's written approval of the scope of the change order, separate documentation for change order costs that are identifiable and reasonable, and the entity's favorable experience in negotiating change orders, especially as it relates to the specific type of contract and change order being evaluated." (ASC 605-35-25-28.) Under GAAP, "change orders in dispute or unapproved as to both scope and price" are treated as claims (ASC 605-35-25-30). Recognition of revenue relating to claims is permitted under GAAP only if certain specific conditions are met. However a company may elect, as Great Lakes did, "a practice such as

7. During the 2010 year-end audit, Great Lakes's external auditor advised the Audit Committee and management that it disagreed with the company's accounting for certain pending change orders in one demolition project because the pending change orders had not been prepared, submitted to the customer, or approved. Although the revenue amounts were not material to the company's financial statements, the auditor determined that the issue represented a "significant deficiency" in the company's internal controls.[4] During the 2011 year-end audit, Great Lakes's auditor advised the company that it disagreed with the company's accounting for certain pending change orders for a different demolition project, because the pending change orders had not been submitted to the customer and there was inadequate documentation of customer acceptance. These revenue amounts were not material to the company's 2011 financial statements. The auditor also determined that, as a result of improved internal controls by the company during 2011, the company had "partially remediated" the "significant deficiency" to a "deficiency" and notified the Audit Committee and management.

8. During the 2011 year-end audit, members of the audit team, including the audit partner, met with Great Lakes's CFO, the demolition subsidiary president, and one other employee to discuss the appropriate level of documentation of pending change orders. At the end of the first quarter of 2012, the audit firm again advised the company about adequate documentation of its pending change orders. The audit firm further advised, and the company understood, that for purposes of the year-end audit it would need to have documentation persuasively supporting the pending change orders. The company's corporate controller also advised in an e-mail at the conclusion of the first quarter of 2012 to demolition subsidiary management and the assistant corporate controller that "we need to continue improving on the quality of evidence" regarding pending change orders.[5] During the second and third quarters of 2012, demolition subsidiary personnel gathered evidence supporting pending change orders and provided the evidence to the audit firm as part of the auditor's quarterly reviews of Great Lakes's interim financial statements.

Discovery of the Misstatements

9. During the year-end 2012 audit process, an audit confirmation letter was sent to the customer for the large demolition project that related to the auditor's 2011 finding of a deficiency in the company's internal controls. The confirmation letter response from the customer showed an

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recording revenues from claims only when the amounts have been received or awarded" (ASC 605-35-25-31). The company's policy regarding claims, as stated in its Form 10-K for the year ended December 31, 2011, was that, "Claims for additional compensation due to the Company are not recognized in contract revenues until such claims are settled."

4 Rule 1-02(a)(4) of Regulation S-X defines a "significant deficiency" as a deficiency or combination of deficiencies in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the company's financial reporting.

5 The corporate controller left the company in the second quarter of 2012, however, and was not replaced until December 2012.

approved contract value materially smaller than the amount of revenue Great Lakes had recorded for the project.

10. Most of the difference in the contract value was due to several pending change orders recorded as revenue by Great Lakes during fiscal year 2012. Given the circumstances, including the existence of certain disputes between the demolition subsidiary and the customer, Great Lakes did not have sufficient proof of customer acceptance of the specific pending change orders at issue to support the conclusion that recovery was probable and collectability was reasonably assured. Therefore, Great Lakes had improperly recorded revenues for those pending change orders.

Great Lakes's Inadequate Internal Controls

11. A material weakness in Great Lakes's internal control over financial reporting failed to prevent or detect the material misstatements. Great Lakes did not have a written accounting policies and procedures manual during 2012. Moreover, there was inadequate training of demolition personnel as to the evaluation of pending change orders. In practice, Great Lakes's accounting for demolition projects relied heavily on the judgments of a small group of people at the demolition subsidiary. Finally, formal review of these judgments by accountants at Great Lakes was insufficient.

12. At each quarter end during 2012, the determination as to whether revenue should be recognized on a demolition subsidiary pending change order was made by the subsidiary's controller, in consultation with the project manager and the subsidiary's president and with some involvement by corporate accounting staff. One of the main factors considered was whether, in the project manager's opinion, the revenue was reasonably assured of collection. During the second and third quarters of 2012, the conclusion to recognize revenue on the pending change orders at issue was based in part on the project manager's assurance of customer acceptance of the scope and of collectability of the pending change order without adequate confirming written documentation from the customer.

13. The company had no written policies on how to handle negative change orders at the demolition subsidiary.[6] On the large demolition project, the project manager received numerous negative change orders from the customer. The project manager made the determination, without consulting with any senior manager or accounting personnel, that certain of the negative change orders from the customer were without merit and should not be recognized in the accounting records or in the overall project estimate. Neither Great Lakes management nor the

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6 Negative change orders are not uncommon in the construction industry and represent circumstances where the general contractor may perform work or provide equipment originally included in the scope of the subcontractor's contract or where the general contractor believes it is necessary to correct sub-quality work performed by the subcontractor. In such circumstances, the general contractor would issue negative change orders which would reduce the contract value and, thereby, the expected revenue to the subcontractor.

auditor was aware of the existence of certain negative change orders until the year-end 2012 audit process.

Great Lakes's Restated Q2 and Q3 2012 Financial Statements

14. As a result of these errors, Great Lakes restated its second and third quarter 2012 financial statements. For the second quarter 2012, the company had overstated net income by approximately \$3.2 million or 266% (reducing net income from \$4.4 million to \$1.2 million), and had overstated revenue in its demolition segment by approximately \$3.9 million or 2.1% (reported company revenue decreased from \$166.5 million to \$163.1 million).[7] For the third quarter, the company had understated net loss by \$3.2 million or 60% (increasing its net loss for the quarter from -\$2.1 million to -\$5.3 million), and overstated revenue in its demolition segment by \$4.3 million or 2.6% (reported company revenue decreased from \$166.8 million to \$162.5 million). For the Q2 and Q3 restatements, \$3.3 million and \$2.8 million, respectively, of overstated revenues in the demolition segment was from the single, large project, including more than \$468,000 for unrecorded negative change orders. The remainder of the restated revenue came from three other projects in Q2 and six other projects in Q3, the largest of which was an error of a little over \$500,000.

Great Lakes's Remediation Plan

15. Upon discovering the accounting errors, the company began investigating the causes. As a result of its investigations, Great Lakes presented, in its year-end 2012 Form 10-K, a proposed remediation plan to address the material weakness in its internal control over financial reporting. The remediation plan had five elements: 1) review of the demolition subsidiary management and resources; 2) direct reporting of the demolition subsidiary finance team to corporate finance, instead of demolition subsidiary management; 3) more accounting resources at corporate level; 4) evaluation of information technology resources; and 5) additional accounting training for the demolition subsidiary and corporate finance personnel. The auditor concurred with the remediation plan. Among the specific changes made were: 1) hiring a new demolition subsidiary controller; 2) providing additional IT resources for the accounting function; and 3) hiring additional accounting staff at the corporate level. In its audit report on the internal control over financial reporting of Great Lakes as of December 31, 2013, the auditor concluded that the company maintained, in all material respects, effective internal control over financial reporting. Ultimately, Great Lakes sold the demolition subsidiary in April 2014.

Violations

16. Under Section 21C 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

[7] A portion of the revenue changes came from other adjustments made by Great Lakes for the two quarters.

the Act and upon any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation.

17. Section 13(a) of the Exchange Act requires issuers to file such periodic and other reports as the Commission may prescribe and in conformity with such rules as the Commission may promulgate. Exchange Act Rule 13a-13 requires the filing of quarterly reports. In addition to the information expressly required to be included in such reports, Rule 12b-20 of the Exchange Act requires issuers to add such further material information, if any, as may be necessary to make the required statements, in light of the circumstances under which they are made, not misleading. "The reporting provisions of the Exchange Act are clear and unequivocal, and they are satisfied only by the filing of complete, accurate, and timely reports." *SEC v. Savoy Industries, Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978) (citing *SEC v. IMC Int'l, Inc.*, 384 F. Supp. 889, 893 (N.D. Tex. 1974)). A violation of the reporting provisions is established if a report is shown to contain materially false or misleading information. *SEC v. Kalvex, Inc.*, 425 F. Supp. 310, 316 (S.D.N.Y. 1975).

18. Section 13(b)(2)(A) of the Exchange Act requires issuers to "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

19. By engaging in the conduct above, Great Lakes violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-13 thereunder, and Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

Cooperation and Remediation

20. In determining to accept the Offer, the Commission considered remedial acts undertaken by Great Lakes and the substantial cooperation provided by the company in connection with the Commission's investigation.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Great Lakes 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. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $150,000 to the Securities and Exchange Commission. 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 Great Lakes 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 Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5720.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73437 / October 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16216

In the Matter of **LAYNE CHRISTENSEN COMPANY,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Layne Christensen Company ("Layne Christensen" 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 ("Order"), as set forth below.

III.

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

SUMMARY

1. These proceedings arise out of violations of the anti-bribery, recordkeeping, and internal controls provisions of the Foreign Corrupt Practices Act (the "FCPA") by Layne Christensen. Between 2005 and 2010, Layne Christensen, through its wholly-owned subsidiaries in Africa and Australia, made a total of more than $1,000,000 in improper payments to foreign government officials in the Republic of Mali, the Republic of Guinea, Burkina Faso, the United Republic of Tanzania, and the Democratic Republic of the Congo. With the knowledge and approval of one of its officers, Layne Christensen made these improper payments in order to obtain favorable tax treatment, customs clearance for drilling equipment, work permits for expatriates, and relief from inspection by immigration and labor officials, as well as, to avoid penalties for the delinquent payment of taxes and customs duties and the failure to register immigrant workers. Layne Christensen funded some of these payments through cash transfers from its U.S. bank accounts to its Australian and African subsidiaries.

2. Layne Christensen falsely recorded these improper payments as legitimate expenses and failed to maintain a system of internal accounting controls sufficient to provide reasonable assurances over its operations.

3. As a result of making improper payments to foreign officials in Africa, Layne Christensen (1) realized improper tax benefits; (2) secured customs clearance of a drilling rig and other equipment; (3) avoided assessed customs duties and associated penalties; and (4) secured work permits for its employees and avoided the possible deportation of its undocumented workers and penalties for the failure to register these workers. Overall, Layne Christensen realized benefits of approximately $3.9 million by making improper payments to foreign officials in Africa between 2005 and 2010.

RESPONDENT

4. Layne Christensen is a Delaware corporation headquartered in The Woodlands, TX. Layne Christensen is a global water management, construction, and drilling company with more than 100 offices in Africa, Australia, Europe, South America, and North America. Layne Christensen's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and its securities are listed on the NASDAQ Global Select market under the ticker symbol LAYN.

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

OTHER RELEVANT ENTITIES

5. Layne Christensen Australia Pty Limited. ("Layne Australia") is an Australian shell corporation and wholly-owned subsidiary of Layne Christensen based in Perth, Australia. Through Layne Australia, Layne Christensen holds a 100% interest in holding company Stanley Mining Services ("SMS"). SMS, in turn, owns all of the equity interests of the following wholly-owned subsidiaries: International Mining Services Pty Limited, West African Drilling Services Sarl in Mauritania and Guinea ("WADS"), and Layne Drilling in Mali, Tanzania, and Burkina Faso ("Layne Drilling"). Layne Australia provides management and financial accounting services to Layne Christensen's companies operating in these African countries. Layne Christensen exercised direct operational control over these wholly-owned subsidiaries and consolidated their results in its financial statements.

6. Layne Drilling (DRC) SPRL ("Layne Drilling DRC") is a wholly-owned subsidiary of Layne Christensen held through a Delaware corporation and operates in the Democratic Republic of Congo.

FACTS

Knowledge of Improper Payments

7. The Mineral Exploration Division ("MinEx") is Layne Christensen's second-largest business division and is primarily responsible for the Company's mineral exploration drilling operations worldwide. Between 2005 and 2010, the president of MinEx (the "MinEx President") was a corporate officer of Layne Christensen and reported directly to Layne Christensen's Chief Executive Officer. Based in Salt Lake City, UT, the MinEx President supervised all of Layne Christensen's mineral exploration drilling operations, including operations in Australia and Africa.

8. The MinEx President had knowledge of and, in some instances, authorized the direct and indirect payment of bribes to foreign officials in Africa to obtain or retain business. Specifically, he was aware of payments made to third-party agents retained by Layne Christensen's African subsidiaries in order to obtain favorable tax treatment and to customs officials to obtain clearance for equipment and reduced customs duties.

Payments to Achieve Favorable Tax Treatment

9. Between 2005 and 2009, Layne Christensen paid approximately $768,000 in bribes to foreign officials in Mali, Guinea, and the Democratic Republic of the Congo, through its wholly-owned subsidiaries WADS and Layne Drilling, in order to reduce its tax liability and to avoid associated penalties for delinquent payment. By making these improper payments, Layne Christensen realized more than $3.2 million in improper tax savings.

REPUBLIC OF MALI

10. In connection with a 2005 tax audit, the WADS subsidiary made two improper payments totaling $93,000 to Malian tax officials through its local agent. The purpose of these payments was to reduce its liability for unpaid taxes and associated penalties.

11. The payments were made on September 5, 2005 and October 19, 2005. WADS falsely recorded the payments, respectively, as an "Advance of Audit" in its prepaid taxes account and as the "take up cost" of the agent's freight invoice (no freight services were provided).

12. The MinEx President was aware that WADS had engaged the agent in order to reduce its tax liability, and that as a result WADS had reduced its tax liability to less than half the original assessment. The MinEx President did not question how these tax savings were achieved.

13. In order to fund the payments, the chief financial officer of MinEx (the "MinEx CFO") directed another Layne Christensen subsidiary to transfer funds to WADS and WADS's financial controller to execute a cash call to Layne Christensen's corporate office. Layne Christensen wired funds from one of its U.S. banks accounts to WADS on the same day.

14. In 2007, WADS again made two improper payments to Malian tax officials through the same agent that it used in 2005. As a result of the payments, Layne avoided taxes and penalties of more than $1.2 million.

15. The check requisition used to make a payment to the agent listed the purpose of this payment as "Fret fees for container" and it was accompanied by an invoice from an unrelated company. The payment of $168,000 was falsely recorded as freight fees in Layne's books and records.

16. Following this payment, WADS received an official notice reflecting a substantial reduction in its tax assessment and indicating that WADS was entitled to a credit of approximately $280,000 that could be used to offset its tax liability. Internal emails show that the Malian tax inspectors had requested a payment of about $67,000 to ensure that WADS would receive this tax credit. WADS's financial controller wrote, "We have already paid the equivalent of US168K to [tax agent]. I was under the impression that this took care of all of 'their' payments." Nevertheless, one day later, WADS issued another check to the tax agent in the amount of approximately $68,000. The accompanying check requisition identified the payment as related to "Fiscal Audit 2005/2006" and WADS falsely recorded it as "Property Rates and Taxes" in its books and records.

17. The MinEx CFO provided the MinEx President with a memo summarizing the history of the tax assessments and the subsequent reductions. As in 2005, the MinEx President did not question how the tax savings were achieved.

REPUBLIC OF GUINEA

18. In 2006, WADS reduced its tax liability by paying bribes through two lawyers retained at the suggestion of the tax authorities but who provided no services.

19. WADS received an official tax assessment for the tax years 2002-2004 on February 15, 2006. However, prior to this date, WADS's Finance Manager and tax consultants from a local affiliate of a large multinational accounting firm ("International Tax Consultants") had been negotiating the amount of the assessment with Guinean tax officials. The WADS Finance Manager told the MinEx CFO that the official assessment was substantially lower than the amount that the Guinean tax authority had initially proposed but acceptance of this lower amount was conditioned on WADS making the payment within two days of the assessment. Without providing any supporting documentation, the MinEx CFO sent an email to Layne Christensen's corporate office seeking an urgent transfer of funds. Despite the lack of documentation or a justification for the transfer, Layne Christensen wired more than $200,000 from a U.S. bank account to WADS's local bank account on the same day.

20. On February 17, 2006, WADS made a single payment of approximately $97,648 to the tax authority and payments of $24,000 and $101,000 to the two lawyers, respectively. In comparison, WADS paid the International Tax Consultants only $8,400 for their services.

21. WADS falsely recorded the payments made to the lawyers as legal expense although internal communications show that the lawyers provided no services. In a March 14, 2006 memorandum to the MinEx CFO, the MinEx Tax Manager acknowledged that "The [C]ompany has never engaged any lawyers or other accountants in Guinea and [is] never likely to." However, he reasoned that although the payments to the lawyers could not be considered legal expense because although the lawyers did not perform any work and were "merely a conduit for the money," WADS could record them as tax expense because WADS would have faced a larger tax assessment if it had not made these payments.

22. In 2008, WADS obtained over a 90% reduction in its assessed taxes and penalties by funneling an improper payment of $273,000 to Guinean tax officials through the same lawyers that it used in connection with the 2006 audit.

23. On June 26 and 27, 2008, the lawyers submitted invoices to WADS totaling approximately $273,000 purportedly for rendering assistance with the tax audit. Neither lawyer participated in negotiating the settlement of the tax audit. WADS paid the lawyers' invoices on July 22, 2008.

24. Layne Christensen funded the payments to the lawyers through wire transfers from a U.S. bank account. On July 2, 2008, the MinEx CFO sought a cash call from Layne Christensen's corporate office. The stated purpose of the request was to pay WADS's outstanding taxes but the amount requested exceeded the assessed tax amount. Without

supporting documentation or further justification, Layne Christensen wired the funds on July 2 and 21, 2008, and falsely recorded the payments as tax expense.

25. In an internal memorandum dated July 23, 2008 that was provided to officers of Layne Christensen, the MinEx Tax Manager explained that on June 17, 2008, following the issuance of the original tax assessment in May, the tax authorities suggested WADS retain the same lawyers that it had used in 2006 to represent it in negotiating the tax assessment. Shortly thereafter, without engagement letters or the approval of Layne Christensen's management, WADS retained both lawyers on a success-fee basis that tied their compensation to the amount by which the assessment was reduced.

26. The MinEx Tax Manager also noted that a portion of the fees paid to the lawyers could have been used to fund illegal payments to tax officials and that the lawyers and the International Tax Consultants pressured WADS to make the payments to the lawyers in order to obtain a settlement of the audit.

27. A few days later, the MinEx President learned that WADS had achieved a substantial reduction in its tax assessment. On July 25, 2008, the Vice President of Operations for Africa and Australia informed the MinEx President that the amount of the settled tax assessment was materially different from the MinEx Division's forecasted amount, could have a material impact on Layne Christensen's reported earnings, and could be scrutinized by Layne Christensen's auditors. The MinEx President also learned that WADS had retained the lawyers without engagement letters. As with the Malian tax audits in 2005 and 2007, the MinEx President did not question how the tax savings were achieved.

DEMOCRATIC REPUBLIC OF THE CONGO

28. In July 2009, Layne Drilling DRC made an improper payment of more than $50,000 to tax officials in the Democratic Republic of the Congo ("DRC") through an agent in order to reduce its liability for unpaid taxes and penalties.

29. After receiving a multi-million dollar tax assessment in June 2009, Layne Drilling DRC's local tax agent recommended that it engage a specialized lawyer to negotiate a reduction in the assessment. On June 19, 2009, the MinEx CFO sought the approval of the MinEx President to retain the lawyer as Layne Drilling DRC's agent. Emphasizing that there was "a lot at stake, potentially $millions," the MinEx CFO explained that he had spoken to the country manager and knew "more than can be written down." However, he wrote that the transaction would entail paying $30,000 in taxes and $50,000 in legal commissions in an arrangement similar to the arrangement made with the lawyers in Guinea the previous year. The MinEx CFO also stated that all payments to the tax authorities would be made through the lawyer. Without questioning either the need to retain an agent or the suspicious proposed arrangement, the MinEx President approved Layne Drilling DRC's retention of the lawyer.

30. On July 9, 2009, Layne Drilling DRC paid the lawyer $57,200 and falsely recorded the payment as legal expense.

31. The next day, the DRC tax authority issued a revised final tax assessment to Layne Drilling DRC. The amount of the revised tax assessment was substantially lower than the assessment issued to Layne Drilling DRC in June 2009.

Payments to Reduce Customs Duties and Obtain Customs Clearance

32. Layne Christensen made multiple improper payments to customs officials in Burkina Faso and the DRC between 2007 and 2010 in order to avoid paying customs duties and to obtain clearance for the import and export of its equipment in these countries. Layne Christensen made these improper payments through its customs clearing agents and falsely recorded the payments as legal fees and agent commissions in its books and records.

BURKINA FASO

33. Burkina Faso's customs authority conducted an audit of WADS in June 2010. The auditors found that WADS had failed to comply with customs regulations relating to the importation of certain goods and to pay sufficient customs duties on these items. As a result, the customs authority assessed WADS nearly $2 million in unpaid duties and penalties.

34. Although WADS had retained a new customs clearing agent prior to receiving this assessment, it engaged its former customs agent purportedly to negotiate a reduction in the assessment. The former agent had cleared the disputed items but WADS terminated it in or about May 2009 due, in part, to poor performance. Nevertheless, WADS reengaged its former agent in June 2010 because the agent's owner was well-connected with customs authorities in Burkina Faso. In an email to the MinEx CFO, the WADS Finance Manager described the agent as someone who is "well known in the game." In addition, he informed the MinEx CFO that WADS retained the agent on a success fee basis and would pay the agent 10% of the difference between the original assessment and the final assessment.

35. On August 1, 2009, the MinEx CFO also told the MinEx President and another senior employee that WADS had retained a third-party agent to negotiate a settlement of the customs audit and the assessed customs duties were reduced from nearly $2 million to less than $300,000. The MinEx CFO recommended that WADS accept this settlement and he sought the approval of the MinEx President to send $300,000 to pay the customs fees and penalties as well as $100,000 for the agent's commission. Without questioning the identity of the agent, the nature of the services provided, or the size of the commission, the MinEx President approved the payments.

36. The MinEx CFO initiated cash calls to fund the payments and Layne transferred funds from a U.S. bank account to WADS on August 4 and August 28, 2010. Between August 4 and 20, 2010, WADS paid the agent a total of approximately $138,000, including one cash payment. WADS falsely recorded the payments to the agent as legitimate consultant fees in its books and records.

DEMOCRATIC REPUBLIC OF THE CONGO

a. Importation of Drilling Rigs and Equipment

37. In 2007, Layne Drilling DRC made improper payments to customs officials to obtain the initial importation of its drilling rigs and other equipment into the DRC.

38. In 2006 and 2007, Layne Drilling DRC encountered significant delays in obtaining customs clearance for the importation of its equipment, which resulted in the WADS Finance Manager terminating Layne Drilling DRC's then-customs clearing agent and hiring a new agent ("Customs Clearance Agent") in March 2007. The new Customs Clearance Agent was managed by the brother of a national government official in the DRC ("DRC Official"). In an email to the MinEx President, the WADS Finance Manager said that he had found someone who is "more connected" and "can get things moving for us." As an example, he noted that the Customs Clearance Agent had obtained clearance for two trucks in only two days whereas the former agent had been unable to clear three trucks through customs for more than five weeks.

39. Between March and September 2007, Layne Drilling DRC paid a total of approximately $124,000 to the Customs Clearance Agent for irregular expenses, described as things such as "per diem," "intervention expenses," and "honoraires," that were not related to specific invoices. Layne Drilling DRC paid the Customs Clearance Agent upon request and in amounts dictated by the agent. In addition, on two occasions, Layne Drilling DRC made payments to an unrelated third party in the U.S. at the direction of the Customs Clearance Agent.

40. As a result of these payments, Layne Christensen was able to import equipment necessary to perform on its existing contracts and derived more than $300,000 in benefits in 2007.

41. Layne Drilling DRC inaccurately recorded these payments as legitimate expenses relating to customs and clearance in its books and records.

b. Customs Clearance for Exports

42. Soon after beginning operations in the DRC in 2007, Layne Drilling DRC hired the nephew of the DRC Official as an office manager. Internal documents describe the DRC Official as Layne Drilling DRC's "protector" and show that Layne Drilling DRC hired the DRC Official's nephew in order to facilitate a good relationship.

43. Between November 2007 and August 2008, the office manager approved and made $18,000 in cash payments from Layne Drilling DRC's account. These payments were purportedly made based on invoices submitted by a local firm that had allegedly provided customs clearance services but with whom Layne Drilling DRC had no written contract. Many of the payments were made outside of Layne Drilling DRC's vendor system. In addition, the firm's invoices were undated and included undefined "per diem" and "honoraire" expenses,

similar to the invoices submitted by the Customs Clearance Agent. Layne improperly recorded these payments as legitimate customs and clearance expenses.

c. *Exportation of Equipment*

44. In 2009 and 2010, Layne Drilling DRC made payments through its agents to customs officials in order to secure the exportation of goods and equipment from the DRC to Zambia.

45. In June 2009, Layne Drilling DRC retained a customs clearing agent to facilitate the export of a drilling rig to Zambia on an expedited basis. However, when the customs clearing agent indicated that the exportation would be delayed due to the lack of documentation relating to the original importation of the drilling rig Layne Drilling DRC replaced the agent.

46. Between July 10 and July 17, 2009, Layne Drilling DRC paid $7,186 to the second agent who, in turn, made payments to customs officials and on July 20, 2009, the drilling rig was successfully exported to Zambia and placed it into operations. Layne Drilling DRC inaccurately recorded payments made to the agent as "governor office release rig" and "release documents for rig44."

47. By making improper payments to customs officials to secure the export of this drilling rig, Layne Drilling DRC realized benefits of approximately $145,000.

48. Similarly, between April and November 2010, Layne Drilling DRC made nearly $15,000 in improper payments, through its agent, to DRC officials in order to again obtain clearance of goods for export to Zambia that lacked the proper import documentation. As before, the agent provided invoices that included "honoraires" and "per diems" and the payments were falsely recorded as legitimate customs and clearance expenses in Layne's books and records.

OTHER PAYMENTS

49. Between 2007 and 2010, Layne Christensen made more than $10,000 in small payments to foreign officials through various customs and clearing agents that it used in the Republic of Tanzania, Burkina Faso, the Republic of Mali, Mauritania, and the DRC. These payments ranged from $4 to $1,700 and were characterized in invoices submitted by the agents as, among other things, "intervention," "honoraires," "commissions," and "service fees."

50. Between 2006 and 2010, Layne Christensen made more than $23,000 in cash payments, through its subsidiaries, to police, border patrol, immigration officials, and labor inspectors in Burkina Faso, Guinea, Tanzania, and the DRC to obtain border entry for its equipment and employees, to secure work permits for its expatriate employees, and to avoid penalties for noncompliance with local immigration and labor regulations.

LEGAL STANDARDS

C. 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 or any other person that is, was, or would be a cause of the violation due to an act or omission the person knew or should have known would contribute to such violation.

Violations of the Recordkeeping and Internal Controls Provisions of the FCPA

D. Section 13(b)(2)(A) of the Exchange Act requires issuers 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).

E. Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (i) transactions are executed in accordance with management's general or specific authorization; (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets; (iii) access to assets is permitted only in accordance with management's general or specific authorization; and (iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences. 15 U.S.C. § 78m(b)(2)(B).

F. As described above, Layne Christensen violated Section 13(b)(2)(A) of the Exchange Act by falsely recording improper payments that its wholly-owned subsidiaries made to foreign officials in Africa as legitimate expenses, including commissions, consulting fees, customs and clearing expenses, border assistance, and freight fees. Layne Christensen also violated Section 13(b)(2)(B) by failing to devise and maintain sufficient accounting controls to detect and prevent the making of these improper payments to foreign officials.

Violations of the Anti-Bribery Provision of the FCPA

G. Section 30A of the Exchange Act makes it unlawful for any issuer, officer, director, employee, or agent of such issuer or any stockholder thereof acting on behalf of the issuer, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to any foreign official or any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official for the purposes of (i) influencing any act or decision of such foreign official in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person. 15 U.S.C. § 78dd-1.

H. Layne Christensen violated Section 30A of the Exchange Act by paying bribes, through its wholly-owned subsidiaries and their agents, to foreign officials in multiple African countries in order to obtain or retain business. From 2005 through 2010, with the knowledge and approval of one of its corporate officers, Layne Christensen paid over $1 million in bribes to foreign officials in order to, among other things, obtain favorable tax treatment, customs clearance for its equipment, and a reduction in its customs duties. Layne Christensen funded many of these improper payments by transferring money from its U.S. bank accounts to its wholly-owned subsidiaries who, in turn, funneled cash to foreign officials through agents that the subsidiaries retained.

REMEDIAL MEASURES AND COOPERATION

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

J. Since 2010, Layne Christensen has implemented a number of remedial measures designed to identify and mitigate bribery risks and to prevent FCPA violations in the future. Upon learning of possible improper payments made to foreign officials by its staff in Africa, Layne Christensen's senior management and Audit Committee responded quickly by initiating an investigation conducted by an outside law firm and forensic accounting experts, self-reporting its preliminary findings to the Commission, and publicly disclosing its potential FCPA violations. During the course of the investigation, Layne Christensen terminated four employees, including the MinEx President, the MinEx CFO, and the WADS Finance Manager for their roles in the misconduct, and reduced the compensation of the MinEx President for failing to establish a strong compliance tone at the top. In addition, the Company conducted a comprehensive risk assessment of its worldwide operations and implemented measures to address its most significant corruption risks.

K. Layne Christensen also took affirmative steps to strengthen its internal compliance policies, procedures, and controls. Layne Christensen issued a standalone anti-bribery policy and procedures, improved its accounting policies relating to cash disbursements, implemented an integrated accounting system worldwide, revamped its anti-corruption training, and conducted extensive due diligence of third parties with which it does business. In addition, Layne Christensen hired a dedicated chief compliance officer and three full-time compliance personnel and retained a consulting firm to conduct an assessment of its anti-corruption program and make recommendations.

L. Layne Christensen exhibited a high level of cooperation throughout the Commission's investigation. In addition to self-reporting to the Commission shortly after it discovered potential FCPA violations, Layne Christensen voluntarily provided the Commission with real-time reports of its investigative findings, produced English language translations of documents, made foreign witnesses available for interviews in the United States, shared summaries of witness interviews and reports prepared by forensic consultants retained in connection with the Company's internal investigation, and responded to the Commission's requests for documents and information in a timely manner. These actions assisted the

Commission in efficiently collecting valuable evidence, including information that may not have been otherwise available to the staff. Based on these factors, the Commission considered Layne Christensen's significant cooperation in determining to accept the Respondent's Offer.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Layne Christensen cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A), 13(b)(2)(B), and 30A of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B), and 78dd-1].

B. Respondent shall, within fourteen (14) days of the entry of this Order, pay disgorgement of $3,893,472.42 which represents profits gained and losses avoided as a result of the conduct described herein, prejudgment interest of $858,720.68, and a civil money penalty of $375,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment 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 Layne Christensen 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 Kara N. Brockmeyer, Chief, Foreign Corrupt Practices Act Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5646.

C. Respondent undertakes to:

(1) Report to the Commission periodically, at no less than nine-month intervals during a two-year term, the status of its FCPA and anti-corruption related remediation and implementation of compliance measures. During this two-year period, should the Respondent discover credible evidence, not already reported to the Commission, that questionable or corrupt payments or questionable or corrupt transfers of property or interests may have been offered, promised, paid, or authorized by any Respondent entity or person, or any entity or person acting on behalf of Respondent, or that related false books and records have been maintained, Respondent shall promptly report such conduct to the Commission staff. During this two-year period, Respondent shall (1) conduct an initial review and submit an initial report, and (2) conduct and prepare two follow-up reviews and reports, as described below:

a. Respondent shall submit to the Commission staff a written report within one 180 calendar days of the entry of this Order setting forth a complete description of its remediation efforts to date, its proposals reasonably designed to improve the policies and procedures of Respondent for ensuring compliance with the FCPA and other applicable anti-corruption laws, and the parameters of the subsequent reviews ("the "Initial Report"). The Initial Report shall be transmitted to Charles E. Cain, Deputy Chief, FCPA Unit, Division of Enforcement, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5030. Respondent may extend the time period for issuance of the Initial Report with prior written approval of the Commission staff.

b. Respondent shall undertake two follow-up reviews, incorporating comments provided by the Commission on the previous report, to further monitor and assess whether the policies and procedures of the Respondent are reasonably designed to detect and prevent violations of the FCPA and other applicable anti-corruption laws (the "Follow-up Report").

c. The Follow-up Report shall be completed by no later than 270 days after the Initial Report. The second Follow-Up Report shall be completed by no later than 270 days after the completion of the first Follow-Up Report. Respondent may extend the time period for issuance of the Follow-up Report with prior written approval of the Commission staff.

d. The periodic reviews and reports submitted by Respondent will likely include proprietary, financial, confidential, and competitive business information. Public disclosure of the reports could discourage cooperation, impede pending or potential government investigations or undermine the objectives of the reporting requirement. For these reasons, among others, the reports and the contents thereof are intended to remain and shall remain non-public, except (a) pursuant to court order, (b) as agreed by the parties in writing, (c) to the extent that the Commission staff determines in its sole discretion that disclosure would be in furtherance of the Commission's discharge of its duties, or (d) is otherwise required by law.

(2) Certify, in writing, compliance with the undertaking(s) set forth above. The certification shall identify the undertaking(s), provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Respondent agrees to provide such evidence. The certification and supporting material shall be submitted to Charles E. Cain, Deputy Chief, FCPA Unit, 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.

D. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of $375,000 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 with prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (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.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73442 / October 27, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3958 / October 27, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16217

In the Matter of THRASOS TOMMY PETROU, Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, IMPOSING A CEASE-AND DESIST ORDER AND REMEDIAL SANCTIONS, AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Thrasos Tommy Petrou ("Respondent" or "Petrou").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to 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 Securities Exchange Act of 1934, and

Section 203(f) of the Investment Advisers Act of 1940, Making Findings and Imposing a Cease-and Desist Order and Remedial Sanctions, and Notice of Hearing, as set forth below.

III.

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

Summary

1. These proceedings arise out of multiple violations of Rule 105 of Regulation M of the Exchange Act ("Rule 105") by Petrou. Rule 105 prohibits buying any equity security that is the subject of a covered public offering from an underwriter or broker or dealer participating in the offering after having sold short the same security during the restricted period as defined therein. From December 16, 2009 through January 12, 2012 ("Relevant Period"), while trading for himself and two unregistered entities, in connection with twenty covered public offerings, Petrou bought offering shares from an underwriter or broker or dealer participating in a follow-on or secondary public offering after having sold short the same security during the restricted period.

Respondent

2. Petrou, age 40, is a resident of Brooklyn, New York. From approximately April 2008 to January 2012, Petrou traded securities for Worldwide Capital, Inc., and from approximately September 2010 to February 2013, he traded securities for an unregistered investment fund managed by War Chest Capital Partners LLC. Since March 2013, Petrou has been trading securities for another unregistered entity that is controlled by another individual who previously traded for Worldwide and War Chest. Petrou has never been associated with a registered broker-dealer or registered investment adviser.

Other Relevant Persons

3. At all relevant times, Worldwide was a Delaware corporation with its principal place of business in Nassau County, New York, and the *alter ego* of Jeffrey W. Lynn, who formed it for the purpose of trading his own capital. Worldwide and Lynn were the subjects of a recent Commission action against them for their violations of Rule 105. *Worldwide Capital, Inc., and Jeffrey W. Lynn*, Exchange Act Release No. 71653 (Mar. 5, 2014). (Worldwide and Lynn are collectively referred to hereafter as Worldwide.) Worldwide has never been registered with the Commission in any capacity.

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

4. At all relevant times, War Chest was a Delaware limited liability company with its principal place of business in New York, New York. At all relevant times, War Chest provided investment advisory services to one unregistered domestic investment fund with total assets under management of approximately $8 million ('the War Chest fund"). War Chest was the subject of a Commission enforcement action for its violations of Rule 105, *War Chest Capital Partners LLC*, Exchange Act Release No. 70411 (Sept. 16, 2013). War Chest has never been registered with the Commission in any capacity.

Legal Framework

5. Rule 105 makes it unlawful for a person to purchase equity securities in a covered public offering from an underwriter or broker or dealer participating in the offering if that person sold short the security that is the subject of the offering during the restricted period defined in the rule, absent an exception. 17 C.F.R. § 242.105; *see Short Selling in Connection with a Public Offering*, Exchange Act Release No. 56206, 72 Fed. Reg. 45094 (Aug. 10, 2007). The Rule 105 restricted period is the shorter of the period: (1) beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) beginning with the initial filing of a registration statement or notification on Exchange Act Form 1-A or Form 1-E and ending with pricing.

6. Rule 105 applies irrespective of the short seller's intent in effecting the short sale. "The prohibition on purchasing offered securities . . . provides a bright line demarcation of prohibited conduct consistent with the prophylactic nature of Regulation M." *Short Selling in Connection with a Public Offering,* 72 Fed. Reg. at 45096. The Commission adopted Rule 105 in an effort to prevent manipulative short selling prior to a public offering and, therefore, "to foster secondary and follow-on offering prices that are determined by independent market dynamics and not by potentially manipulative activity." *Id.* at 45094.

Petrou Violated Rule 105

7. From approximately April 2008 to January 2012, Petrou was one of a number of individuals who traded for Worldwide.[2] Under the terms of his arrangement with Worldwide, Worldwide funded Petrou's trading and the two shared equally in the profits and were equally liable for the losses generated by that trading.

8. At all relevant times, Petrou's and Worldwide's principal investment strategy was to obtain the maximum allocations possible for short-term trading in initial public offerings, as well as follow-on and secondary offerings. Accordingly, Petrou opened numerous accounts at large broker-dealers in the name of a corporate entity he created, owned and controlled, and used those accounts to purchase offered shares. By contrast, many of Petrou's sales of equity securities, including short sales, were executed through an account in Worldwide's name at one of several smaller broker-dealers that catered to small institutional customers and professional

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2 Five of those individuals were the subjects of recent Commission enforcement actions for violations of Rule 105 committed while trading for Worldwide. Exchange Act Release Nos. 72517 through 72521 (July 2, 2014).

traders. Regardless of the account in which the purchase or sale was executed, all of Petrou's trades for Worldwide were funded by Lynn, and cxecuted, cleared and settled in a Worldwide master account at Worldwide's prime broker.

9. From September 2010 to February 2013, Petrou was one of a number of individuals who traded for the War Chest fund. He did so through War Chest, which managed the War Chest fund's portfolio, and retained him as a trader through a pass-through entity created, owned, and controlled by another War Chest (and Worldwide) trader. The War Chest fund financed Petrou's trading and the two shared equally in the profits and were equally liable for the losses generated by that trading.

10. At all relevant times, one of the trading strategies employed by War Chest and Petrou was to buy and sell short publicly traded equity and debt securities. Petrou opened multiple accounts at large broker-dealers in the names of multiple corporate entities he created, owned and controlled, and in the names of several of his relatives. It was through those accounts that Petrou purchased shares in covered offerings, after having sold short the offered securities during the restricted period through one master account in the name of the War Chest fund at one of several smaller broker-dealers.

11. As reflected in the Appendix, from December 2009 to January 2012, in connection with twenty offerings, Petrou committed twenty-eight violations of Rule 105 by purchasing offering shares from an underwriter or broker or dealer participating in a covered offering after having sold short the same security during the restricted period. With respect to eight of the offerings, the violations occurred in connection with his trading for both Worldwide and the War Chest fund, with respect to eleven of the offerings, the violations occurred solely in connection with his trading for Worldwide, and with respect to one offering, the violations occurred solely in connection with his trading for the War Chest fund.

12. As a result of these violations, Petrou received ill-gotten gains produced by the violative trades.

Petrou Acted as an Investment Adviser and was An Associated Person of an Investment Adviser

13. With certain exceptions, an investment adviser is defined under the Advisers Act as "any person who, for compensation, engages in the business of advising others, directly or through publications or other writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities. . . ." Advisers Act Section 202(a)(11). By virtue of his trading for Worldwide, Petrou acted as an investment adviser to Worldwide and Lynn. By virtue of his trading for the War Chest fund, Petrou acted as an investment adviser to the fund and was an associated person of War Chest, which was also an investment adviser to the War Chest fund.

Violations

14. As a result of the conduct described above, Petrou willfully violated Rule 105 of Regulation M under the Exchange Act.

IV.

Pursuant to this Order, Respondent agrees to additional proceedings in this proceeding to determine what, if any, disgorgement, prejudgment interest and civil penalties pursuant to Sections 21B and 21C of the Exchange Act and Section 203 of the Advisers Act are in the public interest. In connection with such additional proceedings: (a) Respondent agrees that he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

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 the Offer, and to institute proceedings to determine what, if any, disgorgement and civil penalties are appropriate.

Accordingly, pursuant to Section 21C of the Exchange Act and Sections 203(f) of the Advisers Act, it is hereby ORDERED that:

A. Respondent Petrou shall cease and desist from committing or causing any violations and any future violations of Rule 105 of Regulation M of the Exchange Act; and

B. Respondent Petrou is censured.

VI.

IT IS FURTHER ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section IV hereof shall be convened not earlier than thirty (30) days and not later than sixty (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.

VII.

If Petrou fails to appear at a hearing after being duly notified, Petrou 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 Petrou 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.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9671 / October 28, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73447 / October 28, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3959 / October 28, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31320 / October 28, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16218

In the Matter of

ELI D. OKMAN,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTION 15(b)(6) 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 8A of the Securities Act of 1933 ("Securities Act"), Section 15(b)(6) 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 Eli D. Okman ("Okman" or "Respondent").

II.

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

III.

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

Summary

These proceedings involve churning violations by Okman, a recently-retired registered representative with Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"). Between January 2010 and September 2011, Okman churned the account of an elderly customer ("Customer") in violation of Section 17(a) of the Securities Act.

Respondent

1. Okman was employed by and registered with Merrill Lynch from 1972 through 2013. Okman worked at all relevant times at Merrll Lynch's branch office in Northbrook, Illinois. Okman, age 67, resides in Highland Park, Illinois.

Relevant Entity And Person

2. Merrill Lynch is a broker-dealer and investment adviser registered with the Commission pursuant to Section 15(b) of the Exchange Act and Section 203 of the Advisers Act. Merrill Lynch engages in a nationwide securities business.

3. Customer was an approximately 70 year old retiree with little investment experience. Customer inherited an account with Merrill Lynch valued at approximately $430,000 upon her father's death in April 2009. The Merrill Lynch account represented the majority of Customer's net worth.

Churning

4. Between January 2010 and September 2011, Okman churned Customer's account by engaging in excessive trading in disregard for her investment objectives.

5. Okman exercised *de facto* control over Customer's account. Customer was financially unsophisticated, trusted her broker, relied upon his recommendations and conducted little, if any, independent investment research.

6. Turnover ratio is the total purchases divided by the average account equity further divided by the number of years. The annualized turnover ratio in Customer's account was 6.1.

7. Cost-to-equity ratio is the total trading costs divided by the average account equity further divided by the number of years. The annualized cost-to-equity ratio in Customer's account was 15.65%.

8. A significant portion of the excessive trading involved the sale of one exchange traded fund coupled with the purchase of another.

9. Okman's misconduct generated commissions and fees of $110,085. Okman's personal profits were approximately $31,964.

10. As a result of the conduct described above, Okman willfully violated Section 17(a) of the Securities Act.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Section 15(b)(6) 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. Okman cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act.

B. Okman be and hereby is:

> suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and
>
> prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter;
>
> For a period of twelve (12) months, effective on the second Monday following the entry of this Order.

C. Okman shall, within ten (10) days of the entry of this Order, pay disgorgement of $31,964 and prejudgment interest of $2,910 and a civil money penalty in the amount of $31,964 to and for the benefit of Customer pursuant to the Fair Funds provisions of Section 308(a) of the

Sarbanes-Oxley Act of 2002. Payment must be accompanied by a cover letter identifying Okman 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 Reid A. Muoio, Deputy Director, Complex Financial Instruments Unit, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

D. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended, a Fair Fund is created for the disgorgement, interest and penalties referenced in paragraphs D above. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Okman 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 Okman's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Okman 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 Securities and Exchange Commission. 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 Okman 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.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73456 / October 28, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16222

In the Matter of **8 By 8, Inc.,** **8 Corp.,** **Ackeeox Corp.,** **Advanced Incubator, Inc.,** **Ameri First Financial Group, Inc.,** **American Capital Holdings, Inc.,** **Dynamic Health Products, Inc., and** **Spa-E,** **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 8 By 8, Inc., 8 Corp., Ackeeox Corp., Advanced Incubator, Inc., Ameri First Financial Group, Inc., American Capital Holdings, Inc., Dynamic Health Products, Inc., and Spa-E.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. 8 By 8, Inc. (CIK No. 1427420) is a void Delaware corporation located in Miami, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 8 By 8 is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the

period ended September 30, 2008, which reported a net loss of $13,250 for the prior three months.

2. 8 Corp. (CIK No. 1444288) is a Delaware corporation located in North Miami, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 8 Corp. is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on October 24, 2008, which reported a net loss of $5,000 from the company's May 16, 2008 inception to September 30, 2008.

3. Ackeeox Corp. (CIK No. 1129641) is a dissolved Florida corporation located in West Palm Beach, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ackeeox is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 8-A registration statement on July 25, 2001.

4. Advanced Incubator, Inc. (CIK No. 1165397) is a dissolved Florida corporation located in Boca Raton, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Advanced Incubator is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of $1,329 from the company's July 23, 2001 inception to September 30, 2002.

5. Ameri First Financial Group, Inc. (CIK No. 1105949) is a merged Delaware corporation located in Midland, Texas with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ameri First Financial is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on February 11, 2000, which reported a net loss of over $8 million for the year ended June 30, 1999.

6. American Capital Holdings, Inc. (CIK No. 1288012) is a Florida corporation located in Jupiter, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Capital Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended February 29, 2008. As of October 17, 2014, the company's stock (symbol "AMHC") was traded on the over-the-counter market.

7. Dynamic Health Products, Inc. (CIK No. 949925) is a dissolved Florida corporation located in Largo, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Dynamic Health Products is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2007, which reported a net loss of over $1.1 million for the prior three months.

8. Spa-E (CIK No. 891781) is a void Delaware corporation located in Miami, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Spa-E is delinquent in its periodic filings with the Commission,

having not filed any periodic reports since it filed a Form 10 registration statement on May 14, 2007.

B. DELINQUENT PERIODIC FILINGS

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

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

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

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73454 / October 28, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16219

In the Matter of **KENNETH G. EADE, Esq.,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e)(3) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting

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[1] Rule 102(e)(3)(i), 17 C.F.R. § 201.102(e)(3)(i), provides, in relevant part, that:

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

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 Public Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Kenneth G. Eade, age 56, is an attorney licensed to practice law in the State of California since 1980. From at least May 2009 through March 2011, Eade served as corporate counsel for Gold Standard Mining Corporation, formerly known as Fluid Solutions Inc.

2. On June 29, 2012, the Commission filed a complaint against Eade and others in SEC v. Gold Standard Mining Corp., et al. (C.D. Calif. Civil Action No. 2:12-cv-5662-JGB-CW). On September 30, 2014, the United States District Court for the Central District of California entered an order permanently enjoining Eade by consent from aiding and abetting future violations of Section 13(a) of the Securities Exchange Act of 1934 ("Exchange Act") and Rules 12b-20, 13a-11, and 13a-13. Eade was also ordered to pay $34,250 in disgorgement, $5,379.52 in prejudgment interest, and $34,500 as a civil money penalty.

3. The Commission's complaint alleged, among other things, that from May 2009 through March 2011, Eade, as the corporate counsel and major shareholder of Gold Standard Mining Corporation, aided and abetted the company's violations of the reporting requirements of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13. The complaint also alleged that Eade drafted false and misleading periodic and current reports that the company filed with the Commission. Further, the complaint alleges that in these reports Eade omitted material facts about the company's failure to register its acquisition of a Russian gold mining company with Russian regulatory authorities, its agreement to pay certain profits of the acquired mining company to the former Russian owner, and misrepresented that the company's financial statements were prepared in conformance with generally accepted accounting principles ("GAAP"), when in fact they were not. According to the complaint, Eade knew the representations were false and misleading.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice, effective immediately, that:

A. Eade is suspended from appearing or practicing before the Commission as an attorney for five years from the date of this Order.

B. After five years from the date of this Order, Respondent may request that the Commission consider his application to resume appearing and practicing before the Commission as an attorney. The application should be sent to the attention of the Office of the General Counsel.

C. In support of such an application, Respondent must provide a certificate of good standing from each state bar where Respondent is a member.

D. In support of such an application, Respondent must also submit an affidavit truthfully stating, under penalty of perjury:

1. that Respondent has complied with the Order;

2. that Respondent:

   a. is not currently suspended or disbarred as an attorney by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession; and

   b. since the entry of the Order, has not been suspended as an attorney for an offense involving moral turpitude by a court of the United States (or any agency of the United States) or the bar or court of any state, territory, district, commonwealth, or possession, except for any suspension concerning the conduct that was the basis for the Order;

3. that Respondent, since the entry of the Order, has not been convicted of a felony or misdemeanor involving moral turpitude as set forth in Rule 102(e)(2) of the Commission's Rules of Practice; and

4. that Respondent, since the entry of the Order:

   a. has not been found by the Commission or a court of the United States to have committed a violation of the federal securities laws, except for any finding concerning the conduct that was the basis for the Order;

   b. has not been charged by the Commission or the United States with a violation of the federal securities laws, except for any charge concerning the conduct that was the basis for the Order;

c. has not been found by a court of the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, to have committed an offense involving moral turpitude, except for any finding concerning the conduct that was the basis for the Order; and

d. has not been charged by the United States (or any agency of the United States) or any state, territory, district, commonwealth, or possession, or any bar thereof, with having committed an offense involving moral turpitude, except for any charge concerning the conduct that was the basis for the Order.

E. If Respondent provides the documentation required in paragraphs C and D, and the Commission determines that he truthfully attested to each of the items required in his affidavit, he shall by Commission order be permitted to resume appearing and practicing before the Commission as an attorney.

F. If Respondent is not able to truthfully attest to the statements required in subparagraphs D(2)(b) or D(4), Respondent shall provide an explanation as to the facts and circumstances pertaining to the matter and the Commission may hold a hearing to determine whether there is good cause to permit him to resume appearing and practicing before the Commission as an attorney.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73455 / October 28, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16221

In the Matter of 4301, Inc., Alpine Management Ltd., Amazing Nutritionals, Inc., America First Associates Corp., American Interactive Media, Inc., ILMI Corp., Superior Holdings, Inc., and Ultimistics, Inc. (n/k/a Continental Holdings International, Inc.), Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents 4301, Inc., Alpine Management Ltd., Amazing Nutritionals, Inc., America First Associates Corp., American Interactive Media, Inc., ILMI Corp., Superior Holdings, Inc., and Ultimistics, Inc. (n/k/a Continental Holdings International, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. 4301, Inc. (CIK No. 1353492) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). 4301, Inc. 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 $600 for the prior three months.

2. Alpine Management Ltd. (CIK No. 1418243) is a dissolved Delaware Nevada corporation located in Alpine, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Alpine 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, 2011, which reported a net loss of $72,730 for the prior six months.

3. Amazing Nutritionals, Inc. (CIK No. 1276050) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Amazing Nutritionals is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on December 28, 2004, which reported a net loss of $66,147 for the prior nine months.

4. American First Associates Corp. (CIK No. 1145479) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American First Associates is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on July 24, 2001.

5. American Interactive Media, Inc. (CIK No. 942415) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Interactive is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on May 14, 1999, which reported a net loss of over $35 million for the year ended December 31, 1998.

6. ILMI Corp. (CIK No. 854136) is a permanently revoked Nevada corporation located in Wall, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ILMI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 1999, which reported a net loss of $463 for the prior three months.

7. Superior Holdings, Inc. (CIK No. 875784) is a dissolved Colorado corporation located in Newport, Rhode Island with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Superior Holdings is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on May 12, 1998.

8. Ultimistics, Inc. (n/k/a Continental Holdings International, Inc.) (CIK No. 843490) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ultimistics is delinquent in its periodic filings with the Commission, having not filed any

periodic reports since it filed a Form 10 registration statement on June 3, 1996, which reported a net loss of $40,122 for the year ended December 31, 1995.

B. DELINQUENT PERIODIC FILINGS

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

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

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

Brent J. Fields
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. 3960 / October 29, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16223

In the Matter of **SANDS BROTHERS ASSET MANAGEMENT, LLC, STEVEN SANDS, MARTIN SANDS AND CHRISTOPHER KELLY,** **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**

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 (the "Advisers Act") against Sands Brothers Asset Management, LLC ("SBAM"), Steven Sands ("S. Sands"), Martin Sands ("M. Sands") and Christopher Kelly ("Kelly") (collectively, "Respondents").

II.

A. SUMMARY

After an investigation, the Division of Enforcement alleges that:

1. For the fiscal years 2010, 2011 and 2012, SBAM failed to timely distribute audited financial statements to the investors of the pooled investment vehicles managed by SBAM in violation of the "custody rule" – Rule 206(4)-2 under Section 206(4) of the Advisers Act – and without regard to an Order issued by the Commission in October 2010 requiring SBAM, S. Sands and M. Sands to cease and desist from violating or causing any future violations of that rule.

2. S. Sands, M. Sands and Kelly – respectively, the two co-chairmen, and the Chief Compliance/Chief Operating Officer of SBAM – aided, abetted and caused SBAM's custody rule violations, and ignored the Commission's 2010 Cease-And-Desist Order by failing to implement any procedures or safeguards to ensure compliance. In fact, none of the Respondents made adequate efforts to ensure that SBAM met its custody rule obligations, either by disseminating the audited financial statements that investors in SBAM's-managed funds were entitled to receive, or alternatively by submitting to a surprise examination to verify client assets.

B. RESPONDENTS

3. **SBAM** is a New York limited liability company formed in June 1998, which has been registered with the Commission as an investment adviser since July of that same year. SBAM maintains offices in New York, Connecticut and California, and provides investment advisory services to various pooled investment vehicles. As of July 2014, SBAM had approximately $64 million under management.[1] SBAM is owned by the Julios and Targhee Trusts, which are set up for the benefit of the families of M. Sands and S. Sands, SBAM's principals. In 2010, SBAM was the subject of a settled administrative proceeding, *In re Sands Brothers Asset Management LLC, et al.*, Release No. 3099 (Oct. 22, 2010) ("*In re SBAM*"), by which the Commission censured SBAM, ordered it to cease and desist from violating the Advisers Act, including Rule 206(4)-2, and ordered it to pay a $60,000 civil money penalty. SBAM has consented to sanctions by the Connecticut Department of Banking for violations of Section 36b-23 of the Connecticut Uniform Securities Act and a prior consent order entered into with that agency. *See* Stipulation and Agreement, *In the Matter of Sands Brothers Asset Management LLC*, Docket No. RCF-2007-7093-S (September 9, 2009).

4. **S. Sands**, age 55, resides in Locust Valley, New York. He is a principal, co-founder, and controlling person of SBAM, and acts as a senior portfolio manager. He is also a controlling person or director of the managing members / general partners for the pooled investment vehicles that SBAM advises. S. Sands held Series 7, 24 and 63 licenses while previously employed at a number of broker dealers, including Lane Capital Markets, LLC, Laidlaw & Company, Ltd. and Sands Brothers & Co. In 2010, in *In re SBAM*, the Commission censured S. Sands and imposed a cease-and-desist order against him for, among other things, violating Rule 206(4)-2. S. Sands has been sanctioned by the securities authorities in Wisconsin (Consent Order of Prohibition, Case No. X-91034(L) (May 21, 1991)), had his license suspended and been fined by the NASD (Decision & Order of Offer of Settlement, NASD Case No. E102004106801 (July 25, 2006)), and had his broker-dealer registration subject to a number of conditions by Connecticut (Stipulated Agreement Conditioning Registration, No. ST-09-7655-S (July 31, 2009)). S. Sands has also been the subject of a number of customer complaints concerning misappropriation of assets, at least one of which resulted in an NASD arbitration award of $2.15 million. *See Ramberg v. Sands Brothers & Co.*, No. 03-09201, 2004 WL 2093154 (Sept. 3, 2004).

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[1] SBAM is appropriately registered with the Commission under the Advisers Act, because its principal office and place of business is in New York State, which does not subject state-registered advisers to routine examinations. *See* 15 U.S.C. § 80b-3a(a)(2)(B)(i).

5. **M. Sands**, age 53, resides in Greenwich, Connecticut. He is a principal, co-founder, and controlling person of SBAM, and acts as a senior portfolio manager. He is also a controlling person or director of the managing members / general partners for the pooled investment vehicles that SBAM advises. M. Sands held Series 3, 7, 8, 24, 63 and 65 licenses while previously employed at a number of broker dealers, including Lane Capital Markets, LLC, Laidlaw & Company, Ltd. and Sands Brothers & Co. In 2010, in *In re SBAM*, the Commission censured M. Sands and imposed a cease-and-desist order against him for, among other things, violating Rule 206(4)-2. M. Sands has been sanctioned by the securities authorities in Wisconsin (Consent Order of Prohibition, Case No. X-91034(L) (May 21, 1991)), twice been temporarily barred from association or suspended from holding supervisory positions, censured and fined by the New York Stock Exchange (*In re Sands Brothers & Co.*, Panel Decision 00-174 (Oct. 5, 2000); *In re Martin Scott Sands*, Panel Decision 03-222 (Dec. 18, 2003)), had his broker-dealer registration and his investment adviser agent registration subject to a number of conditions by Connecticut (Consent Order Conditioning Registration, No. CO-04-7093-S (Nov. 29, 2004)), and consented to withdrawal of his salesperson registration in Illinois (Consent Order of Withdrawal, No. 0400325 (May 16, 2005)). M. Sands has also been the subject of a number of customer complaints concerning misappropriation of assets, at least one of which resulted in an NASD arbitration award of $2.15 million. *See Ramberg*, 2004 WL 2093154.

6. **Kelly**, age 57, resides in Greenwich, Connecticut. From 2008 through at least May 2014, Kelly was the Chief Compliance Officer, Chief Operating Officer and a partner at SBAM. According to the reports prepared by an independent compliance consultant retained by SBAM as a result of disciplinary proceedings instituted by the Connecticut Department of Banking, Kelly was responsible for all of SBAM's operations other than those that involved investment decision-making. Kelly is a lawyer and is presently licensed to practice in New York. Kelly previously held a Series 7 license.

C. FACTS

The Custody Rule

7. Rule 206(4)-2, promulgated under Section 206(4) of the Advisers Act (the "custody rule"), is designed to protect investor assets. The custody rule requires that advisers who have custody of client assets put in place a set of procedural safeguards to prevent loss, misuse or misappropriation of those assets.

8. An adviser has "custody" of client assets if it holds, directly or indirectly, client funds or securities, or if it has the ability to obtain possession of those assets. 17 C.F.R. § 275.206(4)-2(d)(2).

9. An adviser who has custody must, among other things: (i) ensure that a qualified custodian maintains the client assets; (ii) have a reasonable basis for believing that the qualified custodian sends quarterly account statements to clients; and (iii) ensure that client funds and securities are verified by actual examination each year by an independent public accountant. *Id.* § 275.206(4)-2(a)(1), (3), (4).

10. The custody rule provides an alternative for advisers to pooled investment vehicles. In relevant part, the rule prescribes that an adviser "shall be deemed to have complied with" the independent verification requirement if the adviser "distributes its audited financial statements prepared in accordance with generally accepted accounting principles to all limited partners (or members or other beneficial owners) within 120 days of the end of its fiscal year." *Id.* § 275.206(4)-2(b)(4)(i). The accountant performing the audit must be an independent public accountant that is registered with, and subject to regular inspection by, the Public Company Accounting Oversight Board. *Id.* § 275.206(4)-2(b)(4)(ii). An adviser that takes this approach is also not required to satisfy the account statements delivery requirement described above. *Id.* § 275.206(4)-2(b)(4).

SBAM's History of Non-Compliance with the Custody Rule

11. SBAM provides investment advisory services to a number of pooled investment vehicles. At all times relevant hereto, SBAM served as investment adviser to the following pooled investment vehicles: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP, Vantage Point Partners LP, Select Access LLC, Select Access (Institutional) LLC, Select Access III LLC, and SB Opportunity Technology Associates Institution LLC.

12. In 1999, the staff of the Commission's Office of Compliance Inspection and Examinations ("OCIE") performed an examination of SBAM. As a result of that examination, a deficiency letter was issued that concluded, among other things, that SBAM wrongly stated in its Form ADV that it does not have custody of client assets. To the contrary, by virtue of the relationship of the Adviser to its pooled investment vehicles, and the relationship between S. Sands and M. Sands and the managing members / general partners of those vehicles, SBAM did in fact appear to have custody of client assets.[2]

13. The deficiency letter, addressed to M. Sands, went on to spell out some of the requirements that SBAM had to meet as a custodian of investor assets.

14. In 2010, as a result of subsequent OCIE examinations in 2004 and 2009 and an investigation by the Division of Enforcement, SBAM, M. Sands and S. Sands consented, without

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[2] All but one of the funds at issue in the 1999 deficiency letter were different from the funds that SBAM advises today. Nonetheless, the arrangements cited in 1999 leading the staff to conclude that SBAM had custody over client assets exist with respect to SBAM's current funds. As to the one fund that SBAM still advises that was addressed in the 1999 deficiency letter – Katie and Adam Bridge Partners, L.P. – the exam staff concluded that SBAM appeared to have custody of investor assets because a provision in the Limited Partnership Agreement provided that the General Partner, controlled by S. Sands and M. Sands, had authority to "open, maintain, and close bank accounts and draw checks or other orders for the payment of monies…." That arrangement remained the same.

admitting or denying the findings therein, to the entry of an Order Instituting Settled Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act (the "2010 Order").

15. Among other findings, the Commission's 2010 Order found that SBAM willfully violated the custody rule by improperly relying on the pooled investment vehicle alternative, which allowed for the distribution of audited financial statements in lieu of submitting to a surprise examination by an independent public accountant to verify custody of assets, among other requirements. In particular, SBAM: (i) failed to submit to an adequate audit performed in accordance with generally accepted standards; and (ii) did not timely distribute audited financial statements. The Commission's 2010 Order further found that SBAM continued to state in its Forms ADV that it did not have custody over client funds when, in fact, it did.[3] (2010 Order ¶¶ 7-11.)

16. The Commission's 2010 Order concluded that, as the lead principals primarily responsible for the relevant SBAM actions, S. Sands and M. Sands willfully aided, abetted and caused SBAM's violations of the custody rule. (*Id.* ¶¶ 4, 13(e).)

17. In light of these and other violations of the Advisers Act, the Commission's 2010 Order ordered that: (i) SBAM, S. Sands and M. Sands cease and desist from committing or causing violations or future violations of, among other things, the custody rule; (ii) SBAM, S. Sands and M. Sands be censured; and (iii) SBAM pay a civil money penalty of $60,000. (*Id.* § IV(A)-(C).)

SBAM Continued to Violate the Custody Rule After the 2010 Order

18. The 2010 Order notwithstanding, SBAM failed to comply with the custody rule in the years that followed. SBAM neither submitted to a surprise examination, nor distributed its audited financials in the 120-day window imposed by the rule. Indeed, SBAM took no remedial action in response to the 2010 Order to implement policies or procedures aimed at ensuring compliance with the custody rule.

19. For the period 2010 through 2012, SBAM had custody of client assets within the meaning of Rule 206(4)-2(d)(2). At no time from 2010 through the present has SBAM submitted to a surprise examination by an independent public accountant.

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3 In addition to the custody rule deficiencies, the 2010 Order found violations of Advisers Act Section 204 and Rule 204-2 for failing to make, keep and furnish copies of certain books and records to the Commission, and Sections 204 and 207 and Rule 204-1 for making inaccurate statements in, and failing to properly file, its Form ADV.

20. SBAM distributed its funds' audited financial statements for the fiscal years 2010 – 2012 after the 120-day custody rule deadline.[4]

a. Audited financial statements for the fiscal year 2010 were distributed at least 40 days late for the following funds: Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, Sands Brothers Venture Capital IV LLC, Katie & Adam Bridge Partners LP, Granite Associates, LLC, 280 Ventures LLC, Genesis Merchant Partners LP, Genesis Merchant Partners II LP and Vantage Point Partners LP (collectively, the "Ten Funds");

b. Audited financial statements for the fiscal year 2011 were distributed at least 191 days (over 6 months) late and up to 242 days (nearly 8 months) late for the Ten Funds; and

c. Audited financial statements for the fiscal year 2012 were distributed at least 84 days and up to 93 days (approximately 3 months) late for the Ten Funds.

21. The circumstances that led the audits to be delayed were predictable and not unforeseeable. As SBAM's auditors noted with respect to the audit for the fiscal year 2012, "[t]here was a delay in the timely receipt from [SBAM] management of the information supporting the valuation of non-performing loans . . . which significantly affected the completion of the audit and the timely issuance of the financial statements." The conditions underlying that delay "were known or identifiable before the commencement of the audits," and therefore "a more proactive timely approach by your valuation staff in identifying these situations and obtaining the necessary documentation . . . could alleviate most of the audit issues." Indeed, the auditors had repeated difficulty obtaining the information they needed to value the same portfolio companies year over year. This was so even though for some of those companies, S. Sands and/or M. Sands served on the company's board, and for one such portfolio company, Kelly acted as President and Chief Executive Officer.

22. S. Sands and M. Sands knew or were reckless in not knowing about, and substantially assisted, SBAM's violations of the custody rule. In the wake of the 2010 Order – which specifically found that S. Sands and M. Sands aided, abetted and caused SBAM's custody rule violations – S. Sands and M. Sands were aware of the custody rule requirements; indeed, S. Sands and M. Sands executed a notarized offer of settlement to enter into the 2010 Order. And, they knew about SBAM's failure to timely distribute audited financial statements because they regularly communicated with the auditors during the audit process and signed representation letters immediately prior to the completion of each year's audit. Further, as the principals and founders of SBAM, S. Sands and M. Sands were responsible for ensuring that SBAM's

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[4] Even after SBAM, S. Sands, and M. Sands received Wells notices in April 2009 and engaged in negotiations leading to the 2010 Order (but prior to the Order's issuance), SBAM was two weeks late sending out financials for four funds – Sands Brothers Venture Capital LLC, Sands Brothers Venture Capital II LLC, Sands Brothers Venture Capital III LLC, and Sands Brothers Venture Capital IV LLC – for the fiscal year 2009.

compliance personnel has the authority to implement whatever procedures and policies are necessary to ensure that SBAM complied with the Advisers Act. Additionally, as subjects of the 2010 Order, they were responsible for ensuring that SBAM did not engage in future violations of the custody rule.

23. Kelly knew or was reckless in not knowing about, and substantially assisted, SBAM's violations of the custody rule. Kelly executed the notarized offer of settlement to enter into the 2010 Order on behalf of SBAM. Further, SBAM's compliance manual tasked Kelly with "ensur[ing] compliance with the restrictions and requirements of Rule 206(4)-2 adopted under the Advisers Act." Kelly engaged the auditors for full audits (but not surprise examinations); he also signed representation letters to, and was a principal contact for, the auditors. He knew that the audited financial statements were not being distributed on time. Despite his responsibility to do so, Kelly, who was responsible for compliance and for all of SBAM's non-investment operations, implemented no policies or procedures to ensure compliance with the custody rule – even after the 2010 Order and after SBAM continued to miss its custody rule deadline year after year. At most, he simply reminded people of the custody rule deadline without taking any more substantial action. Kelly did not make any attempt to notify the staff of the Commission of any difficulties the Adviser was encountering in meeting the custody rule deadlines.

D. VIOLATIONS

24. As a result of the conduct described above, SBAM willfully violated Section 206(4)-2 of the Advisers Act, which prohibits a registered investment adviser from engaging in fraudulent, deceptive or manipulative conduct, and Rule 206(4)-2 thereunder, which requires an adviser to take certain enumerated steps to safeguard client assets over which it has custody.

25. As a result of the conduct described above, S. Sands, M. Sands and Kelly willfully aided and abetted and caused SBAM's violations of Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against SBAM, pursuant to Section 203(e) of the Advisers Act, including, but not limited to, censure, limitations on its activities, functions or operations, suspension or revocation of its registration, and civil penalties pursuant to Section 203 of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against S. Sands, M. Sands, and Kelly, pursuant to Section 203(f) of the Advisers Act, including, but not limited to, censure, limitations on their activities, suspension or bar from association with an investment adviser, broker, dealer, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical ratings organization, and civil penalties pursuant to Section 203 of the Advisers Act;

D. 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, Section 206(4) of the Advisers Act and Rule 206(4)-2 thereunder, and whether Respondents should be ordered to pay civil penalties pursuant to Section 203(i) of the Advisers Act.

IV.

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

IT IS FURTHER ORDERED that each 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 Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as under 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 as provided for in the Commission's Rules of Practice.

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.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73466 / October 29, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16224

In the Matter of **EHPREN W. TAYLOR II,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) 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)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Ephren W. Taylor II ("Respondent" or "Taylor").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Sections III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) 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. Taylor, age 31, was the Chairman and Chief Executive Officer of City Capital Corporation ("City Capital"), a now-defunct, OTC Link quoted Nevada corporation which offered various securities in the 2008-2010 time frame.

2. On August 8, 2012, a partial judgment was entered by consent against Taylor, permanently enjoining him from future violations of Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(b) of the Exchange Act, and Rule 10b-5 thereunder, in the civil action entitled *SEC v. City Capital Corp., et al*, Civil Action Number 1:12-CV-1249, in the United States District Court for the Northern District of Georgia, Atlanta Division.

3. The Commission's complaint alleged that, in connection with the offer and sale of promissory notes allegedly to fund various small businesses and the offer and sale of interests in sweepstakes machines Taylor: misused and misappropriated investor funds; falsely stated to investors that their funds were invested and earning returns and that a portion of investment proceeds would be donated to charity; sent out phantom monthly returns to investors to conceal poor performance; and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors. The complaint also alleged that Taylor offered and sold unregistered securities, and effected transactions in the purchase or sale of securities without being registered as a broker or dealer, or being associated with a registered broker or dealer.

IV.

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

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

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73467 / October 29, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16225

In the Matter of **WENDY J. CONNOR,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) 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)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Wendy J. Connor ("Respondent" or "Connor").

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 Sections III.2. below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) 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. Connor was the Chief Operating Officer for City Capital Corporation ("City Capital"), a now-defunct, OTC Link quoted Nevada corporation which offered various securities in the 2008-2010 time frame. Connor owned private businesses that provided call-center and operational support for City Capital, for which they were paid with investor funds. Connor, 44 years old, resides near Raleigh, North Carolina.

2. On November 5, 2012, a partial judgment was entered by consent against Connor, permanently enjoining her from future violations of Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(b) of the Exchange Act, and Rule 10b-5 thereunder, in the civil action entitled *SEC v. City Capital Corp., et al*, Civil Action Number 1:12-CV-1249, in the United States District Court for the Northern District of Georgia, Atlanta Division.

3. The Commission's complaint alleged that, in connection with the offer and sale of promissory notes allegedly to fund various small businesses and the offer and sale of interests in sweepstakes machines Connor: misused and misappropriated investor funds; falsely stated to investors that their funds were invested and earning returns and that a portion of investment proceeds would be donated to charity; sent out phantom monthly returns to investors to conceal poor performance; and otherwise engaged in a variety of conduct which operated as a fraud and deceit on investors. The complaint also alleged that Connor offered and sold unregistered securities, and effected transactions in the purchase or sale of securities without being registered as a broker or dealer, or being associated with a registered broker or dealer.

IV.

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

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

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

INVESTMENT ADVISERS ACT OF 1940
Release No. 3961 / October 29, 2014

Admin. Proc. File No. 3-15271

In the Matter of TOBY G. SCAMMELL

OPINION OF THE COMMISSION

INVESTMENT ADVISER PROCEEDING

Grounds for Remedial Action

Injunction

Respondent was permanently enjoined from violating antifraud provisions of the federal securities laws. *Held*, it is in the public interest to bar Respondent from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

APPEARANCES:

Leo P. Cunningham and *Charlene Koski*, of Wilson Sonsini Goodrich & Rosati, for Toby G. Scammell.

David J. Van Havermaat and *Teri M. Melson*, for the Division of Enforcement.

Appeal filed: November 27, 2013
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43 of 49

Toby G. Scammell appeals from the decision of an administrative law judge barring him from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization ("NRSRO")—generally known as a collateral[1] or an industry-wide bar—based on his having been enjoined from violating antifraud provisions of the federal securities laws.[2] We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

I.

A. During the relevant period, Scammell was associated with Madrone Advisers, an unregistered investment adviser.

From August 3, 2009 to February 12, 2010 (the "Relevant Period"), Scammell worked as an associate at Madrone Advisors, LLC, an unregistered investment adviser, where he performed due diligence reviews of potential investment opportunities and engaged in financial analyses of existing and potential portfolio companies. His work was for the benefit of Madrone Advisors and a related firm, Madrone Capital Partners, LLC (collectively, "Madrone"), also an unregistered investment adviser.

Madrone is affiliated with the family of Samuel Moore Walton, the late founder of Wal-Mart Stores, Inc. Madrone provides investment advice to certain "family clients" in exchange for compensation, and considers itself a "family office" within the meaning of Rule 202(a)(11)(G)-1 of the Investment Advisers Act of 1940 (the "Family Office Rule"),[3] adopted in 2011 pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act").[4]

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1 A collateral bar excludes an associated person of a regulated entity not only from the type of business the person was in when the violations of the federal securities laws occurred, but also from any aspect of the securities business. *See* Thomas Lee Hazen, 6 Law Sec. Reg. § 16.2 (Jan. 2014).

2 *See Toby G. Scammell*, Initial Decision No. 516, 2013 WL 5960707 (Nov. 7, 2013). By order of January 28, 2014, we granted the Division of Enforcement's cross-petition for review regarding certain evidentiary issues. *Toby G. Scammell*, Securities Exchange Act Release No. 71432, 2014 WL 296089, at *1 (Jan. 28, 2014).

3 17 C.F.R. § 275.202(a)(11)(G)-1 (defining "family offices" excluded from the definition of an "investment adviser" under the Advisers Act and thus not subject to any of the Advisers Act's provisions); *see generally Family Offices*, Investment Advisers Act Release No. 3220, 2011 WL 2482889 (June 22, 2011) (adopting release); *Family Offices*, Advisers Act Release No. 3098, 2010 WL 3994796 (Oct. 12, 2010) (proposing release).

4 Pub. L. No. 111-203, 124 Stat. 1376 (2010).

The Advisers Act generally requires the registration of all "investment advisers,"[5] which it defines as "any person who, for compensation, engages in the business of advising others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities . . . ."[6] During the relevant period, Madrone provided advice about securities to certain investment funds and, in exchange for those services, received fees based on a percentage of the investment funds' returns. Madrone was not registered, however, based on an exemption from the registration requirement applicable to any investment adviser that, during the preceding twelve months, had fewer than fifteen clients, and neither held itself out as an investment adviser nor advised a registered investment company or a business development company.[7] Although Madrone did not register as an investment adviser, it declined to seek, and never obtained, an order exempting it from the definition of an "investment adviser," as permitted by the Advisers Act[8] and rules.[9]

B. Scammell was permanently enjoined for violating antifraud provisions.

On August 11, 2011, we filed a civil action alleging that, in August 2009, Scammell engaged in unlawful insider trading in the securities of Marvel Entertainment, Inc., in violation of

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5 See 15 U.S.C. § 80b-3(a) (stating that, "[e]xcept as provided in subsection (b) and [Advisers Act] Section 203A, it shall be unlawful for any investment adviser, unless registered under this section, to make use of the mails or any means or instrumentality of interstate commerce in connection with his or its business as an investment adviser").

6 15 U.S.C. § 80b-2(a)(11).

7 15 U.S.C. § 80b-3(b)(3). The Dodd-Frank Act repealed this exemption, effective July 21, 2011, and replaced it with, among other things, the exclusion for "family offices." *Family Offices*, 2011 WL 2482889, at *1.

8 15 U.S.C. § 80b-2(a)(11)(G) (authorizing the Commission to exclude, by order, other persons or firms not within the intent of the definition of "investment adviser") (redesignated as Advisers Act Section 202(a)(11)(H) by the Dodd-Frank Act); *see* 15 U.S.C. § 80b-6a (authorizing the Commission to grant exemptions from any provisions of the Advisers Act where "necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this subchapter").

9 Persons or firms seeking exemptive relief under the Advisers Act must file an application for exemption and follow certain procedures and guidelines. *See* Advisers Act Rules 0-4 through 0-6, 17 C.F.R. §§ 275.04-.06, and *Commission Policy and Guidelines for Filing of Applications for Exemptions*, Advisers Act Release No. 969, 1985 WL 61498 (Apr. 30, 1985). We have granted exemptive relief, on application, to a number of family office advisers. *See, e.g., Gates Capital Partners, LLC*, Advisers Act Release No. 2599, 2007 WL 1001551 (Mar. 20, 2007); *Riverton Mgmt., Inc.*, Advisers Act Release No. 2471, 2006 WL 119133 (Jan. 6, 2006); *Bear Creek Inc.*, Advisers Act Release No. 1935, 2001 WL 327593 (Apr. 4, 2001); *Moreland Mgmt. Co.*, Advisers Act Release No. 1705, 1998 WL 102669 (Mar. 10, 1998).

Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5.[10] Specifically, the complaint alleged that Scammell "knowingly or recklessly" misappropriated material, nonpublic information regarding The Walt Disney Company's impending acquisition of Marvel, "in breach of a fiduciary duty or similar relationship of trust or confidence owed to his girlfriend."

According to the complaint, Scammell's girlfriend worked on the Marvel acquisition while she was an extern in Disney's corporate strategy department. Beginning in June 2009, she learned confidential information about the Marvel acquisition, including that Disney would pay $50 per share and that the acquisition would be announced around Labor Day 2009. By the end of June 2009, she had emailed Scammell and described the acquisition in detail without mentioning Marvel by name. By no later than August 13, 2009, the complaint alleged, Scammell "had obtained the identity of the acquisition target from his girlfriend, whether through overhearing one or more of his girlfriend's Marvel-related conversations, by seeing electronic or paper documents in her possession related to the Marvel acquisition, or through her conversations with him."

From August 13, 2009 through August 28, 2009, Scammell, who had never before invested in Marvel, purchased 659 Marvel call options for $5,465, using his own money and money that he "secretly" took from his brother's account over which he had trading authority.[11] Scammell purchased the Marvel call options at strike prices between $40 and $50, even though he knew Marvel's stock had never traded above $41.74. Nearly all of the Marvel call options were set to expire on September 19, 2009, just weeks after the acquisition was to be announced. The complaint alleged that Scammell was "familiar with insider trading laws based upon his experience, as well as his work and training at a consultant company," and that he had "researched the law regarding insider trading prior to making most of his Marvel trades."

On August 31, 2009, the day on which Disney publicly announced the Marvel acquisition, Marvel's shares closed at $48.37, up more than 25% from the closing price of $38.65 on August 28, 2009, the previous trading day. Over the next week, Scammell sold all of the Marvel call options he purchased, realizing a profit of $192,497. Scammell did not tell his girlfriend or brother about his Marvel trades and, in fact, took steps to conceal approximately $100,000 in

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10 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5. "Illegal insider trading generally occurs when a security is bought or sold in breach of a fiduciary duty or other relationship of trust and confidentiality while in possession of material nonpublic information." http://www.sec.gov/answers/insider.htm.

11 "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." *Scott Reiman*, Exchange Act Release No. 69379, 2013 WL 1562522, at *2 n.2 (Apr. 15, 2013) (settled order).

trading profits in his brother's account by transferring the $100,000 to a new account.[12] The complaint alleged that Scammell "exploited his personal relationship [with his girlfriend] for monetary gain, and his misuse of confidential information gave him an illegal advantage over other traders in the market."

On June 15, 2012, Scammell consented, without admitting or denying the allegations, to the entry of a permanent injunction prohibiting him from violating Exchange Act Section 10(b) and Exchange Act Rule 10b-5.[13] In addition to entering the injunction, the district court ordered Scammell to disgorge his trading profits of $192,497, plus prejudgment interest of $30,997, and to pay a civil money penalty of $557,491, for a total of $800,985.[14] In his consent agreement, Scammell specifically agreed that he would not contest the factual allegations of the complaint in any administrative proceeding before the Commission. Scammell also agreed not to make or permit to be made "any public statement denying, directly or indirectly, any allegation in the complaint or creating the impression that the complaint is without factual basis."[15]

C. Scammell's injunction provided the basis for this follow-on proceeding.

On April 10, 2013, we instituted these "follow-on" administrative proceedings pursuant to Advisers Act Section 203(f) based on the injunction that was entered against Scammell to determine, among other things, whether it was in the public interest to impose sanctions on him.[16] The parties filed timely motions for summary disposition, oppositions, and replies with supporting exhibits pursuant to Rule 250(a) of the Commission's Rules of Practice.[17] The law

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12 According to the complaint, Scammell's brother did not learn about the Marvel trades or $100,000 in profits in his account until months later when Commission staff contacted him as part of its investigation of Scammell's trading.

13 *SEC v. Scammell*, No. 2:11-cv-6597 (C.D. Cal. June 15, 2012) (consent agreement).

14 *SEC v. Scammell*, No. 2:11-cv-6597 (C.D. Cal. Mar. 17, 2014) (final judgment). We take official notice of this judgment pursuant to 17 C.F.R. § 201.323.

15 Scammell further acknowledged that the district court's entry of a permanent injunction "may have collateral consequences [for him] under federal or state law and the rules and regulations of self-regulatory organizations, licensing boards, and other regulatory organizations."

16 15 U.S.C. § 80b-3(f). An administrative proceeding that seeks to impose sanctions after an individual is enjoined from acts involving securities or investment fraud is commonly called a follow-on proceeding. *Chris G. Gunderson*, Exchange Act Release No. 61234, 2009 WL 4981617, at *5 n.39 (Dec. 23, 2009) (citing *Gibson v. SEC*, 561 F.3d 548, 550 n.1 (6th Cir. 2009)).

17 *See* 17 C.F.R. § 201.250(a) (providing that a motion for summary disposition may be granted "if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law"). We have repeatedly upheld the use of summary disposition in circumstances where a respondent has been enjoined or convicted

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judge admitted four of the Division's fifty exhibits—the injunctive complaint, Scammell's consent, the district court's order entering the injunction, and a declaration from a Madrone official—but excluded the remainder of the Division's exhibits and all of Scammell's forty-nine exhibits. The law judge determined that there was no genuine dispute as to any material fact and granted summary disposition in favor of the Division. Finding that Scammell's conduct was "egregious and recurrent and involved at least a reckless degree of scienter," among other things, the law judge concluded that the public interest weighed in favor of a collateral bar.[18] The law judge observed that a bar was supported by established precedent and consistent with sanctions imposed by the Commission in other follow-on proceedings based on antifraud injunctions.

D. During the pendency of this appeal, Scammell pled guilty in a parallel criminal case.

On April 21, 2014, while this appeal was pending, Scammell signed a plea agreement in connection with a parallel criminal case in which he admitted that he "knowingly and with intent to defraud" engaged in a fraudulent scheme involving purchases of Marvel call options.[19] In particular, Scammell admitted that he "knowingly obtained, possessed, and misappropriated material nonpublic information" about the Marvel acquisition and "used the material nonpublic information for his own personal benefit and profit," "in breach of his relationship and duty of trust and confidence with" his girlfriend. He admitted that he "took steps to conceal approximately $100,000 in trading profits from his brother . . . by opening another account . . . and transferring the $100,000 to avoid questions about the funds." And he admitted that he was pleading guilty to securities fraud because he "is, in fact, guilty of" that offense. As with his earlier settlement of the civil action, Scammell agreed not to contest facts agreed to in the plea agreement and acknowledged that his criminal conviction could subject him to collateral consequences.

On April 25, 2014, the Division moved for leave to adduce Scammell's plea agreement into evidence pursuant to Rule of Practice 452.[20] We have determined to grant the Division's motion. Rule 452 permits a party to submit additional evidence "at any time prior to issuance of a decision by the Commission" as long as the party can "show with particularity that such

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and the sole determination concerns the appropriate sanction. *See, e.g., Jeffrey L. Gibson*, Exchange Act Release No. 57266, 2008 WL 294717, at *5 (Feb. 4, 2008), *petition denied*, 561 F.3d 548 (6th Cir. 2009).

18 *Scammell*, 2013 WL 5960707, at *5.

19 *United States v. Scammell*, No. 2:13-cr-00733-SJO-1 (C.D. Ca. Apr. 21, 2014). We have held that, for purposes of follow-on proceedings under the Exchange Act and Advisers Act, a "conviction" includes a plea of guilty. *See Gregory Bartko*, Exchange Act Release No. 71666, 2014 WL 896758, at *8 (Mar. 7, 2014), *appeal filed* No. 14-1070 (D.C. Cir. May 6, 2014). Subsequently, Scammell was sentenced to three months in prison followed by four years on supervised release.

20 17 C.F.R. § 201.452. Scammell declined to respond to the Division's motion.

additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously."[21] Those requirements have been met. We find that Scammell's plea agreement is material to our consideration of what, if any, remedial sanction is appropriate in the public interest. Although this follow-on proceeding was instituted based on the injunction and before Scammell's guilty plea in the parallel criminal action, we have previously considered a respondent's subsequent criminal conviction in assessing the public interest.[22] We also find that Scammell's plea agreement could not have been adduced earlier because Scammell signed it only after briefing in this proceeding had been completed.

II.

A. The Advisers Act authorizes sanctions based on Scammell's injunction.

Section 203(f) of the Advisers Act authorizes the Commission to bar a person from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or NRSRO[23] if the person has been, among other things, enjoined from any conduct or practice in connection with the purchase or sale of a security and if, at the time of the alleged misconduct, the person was associated with an investment adviser.[24]

We find that the statutory requirements for remedial sanctions have been satisfied. Scammell was enjoined from conduct in connection with the purchase or sale of securities, and

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21 *Id.*

22 *See, e.g.*, *Korem*, 2013 WL 3864511, at *5 & n.39 (considering in a follow-on administrative proceeding a respondent's subsequent criminal conviction, which was not included in the order instituting proceedings, in assessing the public interest); *Don Warner Reinhard*, Advisers Act Release No. 3139, 2011 WL 121451, at *5 (Jan. 14, 2011) (considering a subsequent criminal conviction as part of the public interest analysis in proceedings originally instituted in connection with a civil injunction); *see generally Robert Bruce Lohmann*, Exchange Act Release No. 48092, 56 SEC 573, 2003 WL 21468604, at *5 n.20 (June 26, 2003) (finding that matters "not charged in the OIP" may nevertheless be considered "in assessing sanctions").

23 The Dodd-Frank Act expanded the categories of associational bars authorized by Advisers Act Section 203(f) to include collateral bars. We have held that a collateral bar resulting from conduct predating the Dodd-Frank Act provides prospective relief from harm to public investors and the markets and is not "impermissibly retroactive." *See, e.g.*, *Johnny Clifton*, Exchange Act Release No. 69982, 2013 WL 3487076, at *13 (July 12, 2013); *John W. Lawton*, Advisers Act Release No. 3513, 2012 WL 6208750, at *10 (Dec. 13, 2012). Accordingly, the imposition of a collateral bar on Scammell, despite the fact that his alleged misconduct ended in 2009, before the Dodd-Frank Act, is an appropriate sanction if it is in the public interest. Scammell does not raise any retroactivity argument.

24 15 U.S.C. § 80b-3(f). The phrase "at the time of the alleged misconduct" means the time of the wrongful activity. *Kornman v. SEC*, 592 F.3d 173, 183-84 (D.C. Cir. 2010).

that conduct occurred while he was associated with Madrone, an investment adviser.[25] Scammell does not dispute that he was enjoined from violating antifraud provisions or that he was associated with Madrone during the Relevant Period, but argues that Madrone was exempt from investment adviser status because it was a "family office" at the time of Scammell's trades.[26] In support, Scammell notes that the declaration from a Madrone official admitted into evidence by the law judge showed that Madrone had no clients other than "family clients," was wholly owned by "family clients," was exclusively controlled by one or more family members and/or family entities, and did not hold itself out to the public as an investment adviser. Although Scammell concedes that Madrone "otherwise fit the definition of an investment adviser," he suggests that the Commission has not previously exercised jurisdiction over "family offices,"[27] that this reflects a recognition that there is "not a public interest sufficient to afford jurisdiction" where, as here, the firm is not offering services to the public, and that this approach was codified in 2010, shortly after the Relevant Period, when the Dodd-Frank Act amended the Advisers Act to exclude "family offices" from the definition of "investment adviser."[28]

We agree that it was possible for family offices to be exempt from the provisions of the Advisers Act during the Relevant Period. But the way to obtain such exemptive status, before the 2010 Dodd-Frank Act, was through an application for an exemptive order. As Scammell concedes, Madrone never obtained such an order and was therefore still subject to the Advisers Act's provisions, except for the registration requirement, which, as noted, it avoided based on its

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25 Advisers Act Section 202(a)(17) defines a "person associated with an investment adviser" to include "any employee" of an investment adviser. 15 U.S.C. § 80b-2(a)(17).

26 "'Family offices' are entities established by wealthy families to manage their wealth, plan for their families' financial future, and provide other services to family members." *Family Offices*, 2010 WL 3994796, at *2. We have stated that, absent an exemption, family offices generally meet the definition of "investment adviser" because they are in the business of providing advice about securities for compensation. *Id.* & n.5.

27 Even if this suggestion were true, we have held that the absence of prior action by a regulatory authority does not operate as an estoppel against later action. *See, e.g., William H. Gerhauser, Sr.*, Exchange Act Release No. 40639, 53 SEC 933, 1998 WL 767091, at *4 (Nov. 4, 1998) (rejecting argument that Applicants were not liable for net capital violations because NASD found no such violations when it audited firm; stating that, even if there had been an audit that found no violations, "a broker-dealer cannot shift its responsibility for compliance with applicable requirements to the NASD or to us. A regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation.").

28 To qualify for this exclusion under the Family Office Rule, a "family office" must: (1) provide advice about securities only to "family clients"; (2) be wholly owned by "family clients" and exclusively controlled by "family members" or "family entities"; and (3) not hold itself out to the public as an investment adviser. 17 C.F.R. § 275.202(a)(11)(G)-1.

limited number of its clients.[29] Although Madrone might have obtained an exemptive order had it sought one, and might be excluded from the definition of "investment adviser" under current law,[30] that does not affect Scammell's associational status during the Relevant Period, given the legal requirements in effect at the time and Madrone's failure to seek exemptive relief.[31]

B. The public interest requires that Scammell be barred.

We next turn to what sanctions, if any, are in the public interest.[32] In analyzing the public interest, we consider, among other things, the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful

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29 *See supra* note 7 and accompanying text. Pursuant to Advisers Act Section 203(f), 15 U.S.C. § 80b-3(f), we can impose sanctions for wrongdoing committed by persons associated with an investment adviser, even if the adviser is not registered under the Advisers Act. *See, e.g.*, *Teicher v. SEC*, 177 F.3d 1016, 1017-18 (D.C. Cir. 1999) (affirming the Commission's authority to bar persons from association with investment advisers, whether registered or unregistered), *cert. denied*, 529 U.S. 1003 (2000); *Korem*, 2013 WL 3864511, at *8 (stating that "[i]t is well-established that we are authorized to sanction an associated person of an unregistered broker-dealer or investment adviser in a follow-on administrative proceeding") & n.68 (collecting cases).

30 Although the Family Office Rule was enacted on June 22, 2011, the Commission provided entities with over nine months, or until March 30, 2012, either to meet the requirements of the Family Office Rule or to register with the Commission. *See Family Offices*, 2011 WL 2482889, at *14. Throughout these proceedings, Scammell's position has been that "to determine that Madrone was a family office in 2009, it is not necessary to apply the [Family Office] Rule at all, let alone retroactively."

31 *See, e.g., Landgraf v. USI Film Prods.*, 511 U.S. 244, 265 (1994) (stating that "'[t]he principle that the legal effect of conduct should ordinarily be assessed under the law that existed when the conduct took place has timeless and universal appeal'") (quoting *Kaiser Aluminum & Chem. Corp. v. Bonjorno*, 494 U.S. 827, 855 (1990) (Scalia, J., concurring)).

We reject Scammell's argument that the Commission lacks jurisdiction to sanction him because his trading in Marvel stock was unrelated to his employment at Madrone. Advisers Act Section 203(f) contains no requirement that there be such a nexus. Indeed, we have held that sanctions may be appropriate against associated persons whose functions are solely clerical or ministerial in nature (which is not the case here) and do not relate to the operations of the investment adviser. *See Michael Batterman*, Advisers Act Release No. 2334, 57 SEC 1031, 2004 WL 2785527, at *3-4 (Dec. 3, 2004); *cf. Bartko*, 2014 WL 896758, at *9 (stating that "[t]he securities laws authorize follow-on proceedings based on a variety of 'crimes that suggest a lack of fitness' for the industry; the predicate misconduct is not limited to one's action as a broker-dealer") (footnotes omitted).

32 15 U.S.C. § 80b-3(f).

nature of his conduct, and the likelihood that the respondent's occupation will present opportunities for future violations (the "*Steadman* factors").[33] Our "inquiry into . . . the public interest is a flexible one, and no one factor is dispositive."[34] We also consider the extent to which sanctions will have a deterrent effect.[35] Our "determination that a remedial sanction is in the public interest is based on the particular circumstances and entire record of the case."[36]

We have stated that conduct that violates the antifraud provisions of the federal securities laws, including insider trading, is "subject to the severest of sanctions."[37] "'Fidelity to the public interest' requires a severe sanction when a respondent's misconduct involves fraud because the 'securities business is one in which opportunities for dishonesty recur constantly.'"[38] "[O]rdinarily, and in the absence of evidence to the contrary," it will be in the public interest to bar from participation in the securities industry a respondent enjoined from violating antifraud provisions,[39] and, based on our consideration of the *Steadman* factors, we find that a bar is appropriate here.[40]

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33 *Vladimir Boris Bugarski*, Exchange Act Release No. 66842, 2012 WL 1377357, at *4 & n.18 (Apr. 20, 2012) (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)).

34 *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *15 (Dec. 21, 2007), *petition denied*, 334 F. App'x 334 (D.C. Cir. 2009) (per curiam), *cert. denied*, 559 U.S. 1008 (2010).

35 *See Schield Mgmt. Co.*, Exchange Act Release No. 53201, 58 SEC 1197, 2006 WL 231642, at *8 & n.46 (Jan. 31, 2006) (stating that "[w]e also consider the extent to which the sanction will have a deterrent effect"); *see also PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1066 (D.C. Cir. 2007) (noting that "'[a]lthough 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)); *Steadman*, 603 F.2d at 1142 (stating that "the Commission also may consider the likely deterrent effect its sanctions will have on others in the industry").

36 *Marshall E. Melton*, Advisers Act Release No. 2151, 56 SEC 695, 2003 WL 21729839, at *2 (July 25, 2003).

37 *Gunderson*, 2009 WL 4981617, at *5 (quoting *Justin F. Ficken,* Exchange Act Release No. 58802, 2008 WL 4610345, at *3 (Oct. 17, 2008)).

38 *Id.* (quoting *Ficken*, 2008 WL 4610345, at *3).

39 *Ficken*, 2008 WL 4610345, at *3.

40 "We give considerable weight to the injunctive allegations in assessing the public interest in administrative proceedings based on consent injunctions." *Schield Mgmt. Co.*, 2006 WL 231642, at *6 & n.35; *see Melton*, 2003 WL 21729839, at *2 ("[A]s we have stated in a number of decisions, we have adopted the policy in administrative proceedings based on consent

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Scammell's conduct was egregious, recurrent, and involved a high degree of scienter.[41] Over a two-week period, Scammell repeatedly traded in Marvel call options based on material nonpublic information about Disney's impending acquisition of Marvel, in breach of a duty of trust or confidence he acknowledged he owed to his girlfriend.[42] As we have observed,

> [t]he prohibitions against insider trading play an essential role in maintaining the fairness, health, and integrity of our markets. We have long recognized that the fundamental unfairness of insider trading harms not only individual investors, but also the very foundations of our markets, by undermining investor confidence in the integrity of the markets.[43]

As noted, Scammell was familiar with prohibitions against insider trading and had researched insider trading law before making most of his trades. His conduct was the direct result of his knowing decision to violate insider trading laws in an attempt to enrich himself. Indeed, Scammell's insider trading turned out to be highly profitable for him. He made illegal profits of $192,497 on an initial investment of $5,465—a 3,000% return in less than one month.[44] Scammell's intentional acts of concealment, which enabled his scheme to go undetected for months, provide further evidence that he acted with a high degree of scienter.[45] Scammell secretly used money entrusted to him by his brother to purchase the Marvel call options, and then

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injunctions that the injunctive allegations may be given considerable weight in assessing the public interest.").

[41] "Scienter is a mental state consisting of an intent to deceive, manipulate, or defraud, and includes recklessness, commonly defined as 'an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the [respondent] or so obvious that the [respondent] must have been aware of it.'" *Clifton*, 2013 WL 3487076, at *10 n.67 (quoting *Makor Issues & Rights, Ltd. v. Tellabs, Inc.*, 513 F.3d 702, 704 (7th Cir. 2008)).

[42] Scammell contends that his insider trading was a "one-time violation related to a single deal," but his contention ignores the entirety of the scheme, which lasted at least two months.

[43] *Selective Disclosure and Insider Trading*, Exchange Act Release No. 42259, 1999 WL 1217849, at *17 (Dec. 20, 1999); *see also* H.R. Rep. No. 98-355, at 2 (1984), *reprinted in* 1984 U.S.C.C.A.N. 2274, 2275 (finding that insider trading destroys the integrity of the marketplace "by undermining the public's expectations of honest and fair securities markets where all participants play by the same rules").

[44] "[T]he degree of harm to investors and the marketplace resulting from the violation" is measured by Scammell's unlawful profits, *Melton*, 2003 WL 21729839, at *2, which we consider to be substantial, notwithstanding his claim that "the amount of profit was out of [his] control and not so significant as to warrant a bar."

[45] *See, e.g., Korem*, 2013 WL 3864511, at *6 (finding that concealment of misconduct demonstrates scienter).

concealed the scheme from his girlfriend and brother, including diverting $100,000 of his trading profits from his brother's account to a new account to avoid detection.[46]

While Scammell has provided some assurances against future violations,[47] the high degree of scienter involved in his offense and his intentional acts of concealment cause us concern about the sincerity of his assurances.[48] Moreover, Scammell has not fully acknowledged his wrongful conduct. In his opening brief on appeal, for example, he characterizes his egregious insider trading as a mere "lapse in judgment."[49] Scammell's failure to recognize meaningfully the seriousness of his insider trading offense indicates there is a significant risk that, given the opportunity, he would commit further misconduct in the future.[50] Although he asserts that "at this time" he has no intention of working in the securities industry, his asserted involvement in "found[ing]" a start-up company and "helping that company grow,"[51] coupled with his admitted

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46 Scammell contends that he "has not been convicted of a crime or even found liable in a civil proceeding." As discussed, during the pendency of this appeal, Scammell pled guilty to securities fraud in the parallel criminal action. In the context of a follow-on proceeding, we have held that a guilty plea is the equivalent of a "conviction." *See supra* note 19. As for Scammell's civil liability, Advisers Act Section 203(f) draws no distinction between an injunction entered after litigation or by consent. *Melton*, 2003 WL 21729839, at *8. The Division is not required to prove the allegations of an injunctive complaint in a follow-on proceeding before any disciplinary action can be taken. *Id.*

47 Scammell states that he has "stopped trading altogether," "has no intention of ever trading on his own behalf again," "has voluntarily stopped managing [his] brother's finances," and "is determined to avoid violating securities laws in the future."

48 *Korem*, 2013 WL 3864511, at *6.

49 *See Michael T. Studer*, Exchange Act Release No. 50411, 57 SEC 890, 2004 WL 2104496, at *4 (Sept. 20, 2004) (finding that respondent did not recognize the wrongful nature of his misconduct when he admitted "mistakes in judgment"), *aff'd*, 148 F. App'x 58 (2d Cir. 2005).

50 *See Christopher A. Lowry*, Advisers Act Release No. 2052, 55 SEC 1133, 2002 WL 1997959, at *5 (Aug. 30, 2002) (stating that "Lowry's refusal to recognize his wrongdoing and his public posture that his behavior was appropriate demonstrate that his conduct poses a future threat of harm"), *aff'd*, 340 F.3d 501 (8th Cir. 2003).

51 Scammell identifies the start-up technology company as "Oto Analytics, Inc.," which does business as "Womply, Inc." Scammell asserts that Womply currently employs twenty-five people in three states and has received investments from approximately forty private investors. The extent of Scammell's role at this company is unclear from the record.

"fascination" with the markets, indicates that he is likely to return to the securities industry in some capacity and thereby threaten the public interest, if so permitted.[52]

We also believe that Scammell's conduct justifies the law judge's decision to impose not merely a bar from associating with an investment adviser, but a full collateral bar. The antifraud provisions that Scammell violated apply broadly to the conduct of all participants in the securities industry. Brokers, dealers, municipal securities dealers, municipal advisors, and transfer agents, like investment advisers, "routinely gain access to sensitive financial and investment information about investors and other market participants," and they "routinely learn confidential and potentially market-moving information about securities, issuers, and potential transactions."[53] All securities professionals have heightened responsibilities to safeguard such information and not to misuse their access to sensitive or confidential information for their own financial gain.[54] Scammell's misappropriation of material, nonpublic information for his own personal benefit and profit demonstrates that he is unfit to take on such heightened responsibilities in any capacity in the securities industry.[55] Imposing a collateral bar on Scammell will both protect the investing public from the likelihood that he will commit future securities law violations and deter others from engaging in insider trading schemes.[56]

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[52] *See Ficken*, 2008 WL 4610345, at *4 (stating that respondent's failure to recognize the wrongful nature of his actions or to show remorse indicates a significant risk of further misconduct); *Jose P. Zollino*, Exchange Act Release No. 55107, 2007 WL 98919, at *6 (Jan. 16, 2007) (stating that failure to acknowledge guilt or show remorse indicates a significant risk that respondent would commit further misconduct if given the opportunity). If Scammell is sincere in his intent not to work in the securities industry, then a bar will impose no substantial burden on him while prophylactically protecting the investing public. *Korem*, 2013 WL 3864511, at *6.

[53] *Lawton*, 2012 WL 6208750, at *11.

[54] *See id.*

[55] *See, e.g., Lohmann*, 2003 WL 21468604, at *5 (upholding a bar from association with a broker, dealer, or investment adviser, and stating that "[i]nsider trading constitutes clear defiance and betrayal of basic responsibilities of honesty and fairness to the investing public") (internal quotation marks and citation omitted).

[56] Scammell argues that a collateral bar would be unfair "because of the additional reputational harm it would cause him and the collateral harm it would cause to his new company and career." In his consent agreement, however, Scammell acknowledged that the district court's entry of the injunction "may have collateral consequences under federal or state law and the rules and regulations of self-regulatory organizations, licensing boards, and other regulatory organizations." Scammell made a similar acknowledgment in his guilty plea agreement. Under the circumstances, it is hardly unfair for the Commission to hold Scammell to the terms of the agreements that he signed. *Bugarsky*, 2012 WL 1377357, at *4.

C. Scammell's arguments against the imposition of a bar lack merit.

Our well-established policy is that a respondent in a follow-on proceeding may put forward mitigating evidence concerning the circumstances surrounding the underlying misconduct, but is not permitted to contest the allegations of the complaint to which he consented.[57] Relying on this precedent, Scammell argues that the law judge failed to consider his mitigating evidence concerning the circumstances surrounding his insider trading. But Scammell's argument ignores a fundamental difference between facts that mitigate the complaint's allegations and facts that contradict those allegations.

The vast majority of what Scammell characterizes as mitigating facts are actually claims that impermissibly contradict the allegations of the complaint.[58] For instance, Scammell argues that the complaint "failed to identify a single document, conversation, or email that contained the allegedly misappropriated confidential information"; that there was "no direct evidence that [he] obtained nonpublic information"; that "every suspicious circumstance had an explanation"; that "[i]t is particularly difficult to ascribe scienter to [Scammell] given the exotic legal theory the Commission resorted to here"; and that the Division's evidence against him was "circumstantial, weak, and based on a highly questionable legal theory that a boyfriend owes a girlfriend a fiduciary duty even where there is no proof that they have a history of sharing confidential business information with each other." By arguing that he was not in possession of material, nonpublic information and that he did not act with scienter, Scammell is contradicting the allegations in the complaint, in violation of his consent agreement, which prohibited him from "denying, directly or indirectly, [the] allegation[s] in the complaint" and from "creat[ing] the impression that the complaint is without factual basis." Having agreed to be bound by the allegations of the complaint, Scammell cannot now object that "none of the evidence or facts at issue in this case have ever been litigated."

Scammell asserts that other mitigating factors justify a sanction less than a bar, citing his youth (twenty-four years old) and inexperience at the time of his misconduct, his decision to cooperate with the Division's investigation in the civil action and not to exercise his constitutional rights, his agreement to settle the civil action, his lack of prior securities law or other violations, the fact that he "was not a registered investment adviser or broker at the time of the alleged violation," and the hardships he has suffered and will continue to suffer as a result of these proceedings, including the loss of his job at Madrone, the "permanent[] alter[ation]" of his career

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57 *See Peter Siris*, Exchange Act Release No. 71068, 2013 WL 6528874, at *8 & nn.52-53 (citing cases) (Dec. 12, 2013), *appeal filed* No. 14-71133 (9th Cir. Apr. 17, 2014); *see also, e.g.*, *Kornman*, 592 F.3d at 187 (recognizing Commission ruling that respondent was estopped from making "mitigation arguments" that were "essentially collateral attacks on his conviction"); *Elliot v. SEC*, 36 F.3d 86, 87 (11th Cir. 1994) (refusing to entertain a collateral attack in a follow-on proceeding).

58 To the extent that any of these so-called mitigating facts do not directly contradict the allegations of the injunctive complaint, we find that those facts do not diminish the seriousness of Scammell's misconduct.

path, the humiliation from the Division's investigation, and his payment of large sums in disgorgement, civil penalties, and legal fees. We find that the mitigating impact, if any, of these factors is outweighed by the *Steadman* factors discussed above, particularly the egregiousness of Scammell's conduct, his high degree of scienter, and his failure to recognize the seriousness of his violations.[59]

Scammell argues that the law judge's decision "reads as if maximum sanctions are automatic following consent to an antifraud injunction," and that she "fail[ed] to consider whether the *Steadman* factors were satisfied by a preponderance of the evidence." As discussed, under our well-established precedent,[60] we typically have imposed a permanent bar where a respondent has been enjoined from violating antifraud provisions of the securities laws because such injunctions have "especially serious implications for the public interest."[61] In any event, as part of our de novo review,[62] we have considered Scammell's case in light of each of the *Steadman* factors.[63] Our consideration of those factors causes us to agree with the determination to impose a bar.

Scammell also argues that the law judge committed "prejudicial error" by excluding his forty-three exhibits and six declarations "demonstrating the weak nature of the Division's

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59 *See, e.g.*, *Montford & Co., Inc.*, Advisers Act Release No. 3829, 2014 WL 1744130, at *20 (May 2, 2014) (finding that respondent's cooperation and lack of disciplinary history did not outweigh concern that respondent would pose a continued threat to investors if permitted to remain in the industry); *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *21 (May 27, 2011) (finding that respondent's settlements with customers did not mitigate sanctions imposed where settlements were entered into after customers complained and respondent's firm had investigated), *aff'd*, 693 F.3d 251 (1st Cir. 2012); *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at *9 n.40 (Feb. 13, 2009) (finding that respondent's age, lack of disciplinary history, and financial loss did not mitigate the gravity of his conduct), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010).

60 The law judge noted, but did not cite, established Commission precedent, which includes our recent opinions in *Tzemach David Netzer Korem,* Exchange Act Release No. 70044, 2013 WL 3864511 (July 26, 2013), and *Alfred Clay Ludlum, III,* Advisers Act Release No. 3628, 2013 WL 2479060 (July 11, 2013).

61 *Melton*, 2003 WL 21729839, at *9.

62 "Once [Scammell] filed his petition for review, the law judge's decision ceased to have any force or effect. As a result, the Commission was free to decide, in the first instance, what remedial sanctions would be appropriate and should be ordered." *Johnny Clifton*, Exchange Act Release No. 7039, 2013 WL 5553865, at *2 (Oct. 9, 2013) (order denying reconsideration).

63 *See Kornman*, 2009 WL 367635, at *9 n.44 (stating that Commission's de novo review of the record cures any errors, if any, committed by the law judge).

evidence."[64] Rule of Practice 320 provides that "the hearing officer may receive relevant evidence and shall exclude all evidence that is irrelevant, immaterial or unduly repetitious."[65] We have stated that law judges have broad discretion in deciding whether to admit or exclude evidence.[66] We have reviewed Scammell's exhibits and declarations attached as appendices to his opening brief and determined that, with the exception of Exhibit 45, Declaration of Toby G. Scammell in Support of Respondent's Motion for Summary Disposition, they contain irrelevant and immaterial matter,[67] and/or are offered to relitigate the allegations of the complaint, in direct contravention of Scammell's consent.[68] Accordingly, we find that the law judge acted within her discretion in excluding Scammell's exhibits and declarations, with the exception of Exhibit 45,

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[64] We have scrutinized the record to determine whether there is any evidence that Scammell suffered specific prejudice as a result of the exclusion of his exhibits and declarations. We find none. *See, e.g., China-Biotics, Inc.*, Exchange Act Release No. 70800, 2013 WL 5883342, at *18 & n.129 (citing cases) (Nov. 4, 2013) (failure to substantiate claim of prejudice).

[65] 17 C.F.R. § 201.320.

[66] *Guy P. Riordan*, Exchange Act Release No. 61153, 2009 WL 4731397, at *15 (Dec. 11, 2009), *petition denied*, 627 F.3d 1230 (D.C. Cir. 2010).

[67] We considered the following exhibits to be irrelevant and immaterial to our consideration of the public interest: the email exchanges (Resp. Exs. 5, 9, 20, 29, 32-37); the web articles on options trading (Resp. Exs. 6-7); a complaint filed by the Commission in an unrelated matter (Resp. Ex. 11); a Senate report (Resp. Ex. 19); various financial records (Resp. Exs. 21, 22, 30, 31); declarations submitted by counsel (Resp. Exs. 44, 47, & 49); and Scammell's declaration submitted in support of his opposition to the Division's motion for summary disposition (Resp. Ex. 48).

We note that three of Scammell's exhibits duplicated exhibits introduced by the Division and admitted into evidence by the law judge: the August 2011 complaint in *SEC v. Scammell* (Resp. Ex. 4); Scammell's June 2012 consent agreement (Resp. Ex. 8); and the declaration of a Madrone official (Resp. Ex. 46). Several other exhibits were already included in the record on appeal or were matters of which we could take official notice: the Order Instituting Administrative Proceedings (Resp. Ex. 1); the May 10, 2013 prehearing order issued by the law judge (Resp. Ex. 2); Scammell's amended answer to the OIP (Resp. Ex. 10); and the Commission's press release in *SEC v. Scammell.* (Resp. Ex. 23).

[68] Those exhibits included Scammell's Wells Submission (Resp. Ex. 3); excerpts from Scammell's deposition testimony (Resp. Exs. 12-15 & 25-27, 38-40); excerpts from Scammell's brother's deposition testimony (Resp. Exs. 16, 28 & 41); excerpts from Scammell's girlfriend's deposition testimony (Resp. Exs. 17-18 & 42-43); and Scammell's Google web history (Resp. Ex. 24).

which we admit into evidence.[69] However, even considering the excluded evidence, we would reach the same conclusion that a collateral bar is warranted.

Scammell's knowing and intentional misappropriation of material, nonpublic information, in breach of a duty of trust and confidence, and his intentional concealment of his misconduct demonstrate his fundamental unfitness to remain in the securities industry in any capacity. A bar from associating with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or NRSRO is remedial and serves the public interest.

An appropriate order will issue.[70]

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN; Commissioners GALLAGHER and PIWOWAR concurring in part and dissenting with respect to the bars from association with municipal advisors and nationally recognized statistical rating organizations).

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

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69 We further find that the law judge acted within her discretion in excluding all but four of the Division's exhibits.

70 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3961 / October 29, 2014

Admin. Proc. File No. 3-15271

In the Matter of TOBY G. SCAMMELL

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Toby G. Scammell be barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9674 / October 31, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73486 / October 31, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31325 / October 31, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16229

In the Matter of **GREGORY OSBORN** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER, AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b), and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Company Act"), against Gregory Osborn ("Osborn" or "Respondent").

II.

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

Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Company Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, and Notice of Hearing ("Order"), as set forth below.

III.

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

Summary

1. From December 2009 through March 2011, Respondent made and disseminated false and misleading statements concerning the risks of investing in the short-term notes ("Notes") of Navagate, Inc., ("Navagate"), a start-up venture purporting to create and sell sales force automation software. Specifically, in an effort to sell Navagate's Notes (the "Notes Offering"), Respondent, in the course of his employment as a Managing Partner of registered broker-dealer Middlebury Securities, LLC ("Middlebury"), knowingly or recklessly made and disseminated a number of false and misleading statements concerning (1) the assets purporting to guarantee the Notes; and (2) the use of the proceeds from the Notes Offering. Despite Respondent's awareness, or reckless disregard, of these false statements, Respondent participated in the preparation and distribution of certain offering documents (the "Offering Documents") containing these falsehoods and reiterated the false statements to prospective investors both orally and in writing.

2. Between December 2009 and April 2011, Respondent, Navagate, and Gregory Rorke ("Rorke")—Navagate's CEO and controlling officer—sold approximately $3.2 million worth of the Notes. The Notes were purportedly backed by a personal guarantee from Rorke (the "Personal Guarantee").

3. To demonstrate that he had sufficient assets to make good on his Personal Guarantee, Rorke signed a personal financial statement (the "Personal Financial Statement"). The Personal Financial Statement purported to show that (1) Rorke solely owned over $12 million in assets, including $6 million in liquid assets, consisting of cash and readily-marketable securities, and over $1 million in real estate; and (2) Rorke had no liabilities.

4. In fact, as Respondent knew or recklessly disregarded:

   a. Virtually all of the $6 million in liquid assets—including almost all of the purportedly pledged cash and readily marketable securities—as well as the real estate, belonged solely to Rorke's wife, who did not pledge any of her assets in connection with the Notes Offering (or otherwise obligate herself to make good on Rorke's Personal Guarantee);

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

b. Even including his wife's unpledged assets, Rorke overstated the value of the liquid assets (the cash and readily-marketable securities) listed in the Personal Financial Statement by over 36%; and

c. Rorke failed to disclose over $1,000,000 owed in federal taxes for which he was personally liable.

5. As a result of the above—as Respondent knew or was reckless in not knowing—Rorke did not have anywhere near sufficient liquid assets to make good on his Personal Guarantee of the Notes. Nonetheless, Respondent distributed and touted Rorke's Personal Guarantee and Personal Financial Statement to investors, orally and in emails, as a key reason to invest in the Notes.

6. In addition, Respondent, knowingly or recklessly, used some of the proceeds of the Notes to pay back earlier investors, contrary to the disclosed use of proceeds in the Offering Documents.

7. Ultimately Navagate defaulted on the Notes and Rorke did not make good on his promise under the Personal Guarantee.

Respondent

8. **Osborn**, age 50, is a resident of New Jersey, and was primarily responsible for Middlebury's relationship with Navagate. At all relevant times, Osborn was a Managing Partner at Middlebury, although he did not have an ownership interest in Middlebury and was not registered as a general securities principal. Osborn was registered with FINRA from 1988 until April 2014, when he was permanently barred from associating with any FINRA-registered member as part of a settlement of charges brought against him by FINRA.

Other Relevant Entity and Individuals

9. **Navagate** is a Delaware limited liability company with its principal place of business in New York. Navagate's business is purportedly to create and sell computer software that provides sales force automation to financial services organizations.

10. **Rorke**, age 59, is a resident of New York, and is the co-founder and CEO of Navagate.

11. **Middlebury** is a FINRA-registered broker-dealer organized as a Delaware limited liability company with offices in Vermont, New Jersey, and New York. Middlebury was the placement agent for the Navagate Notes Offering from approximately December 2009 to April 2011.

Background

12. In 2000, Rorke formed a Delaware limited liability company named G2X and began raising money for the development of software purportedly designed to automate certain

sales and customer-relationship processes (called "sales force automation software"). In 2006, G2X changed its name to Navagate.

13. Navagate developed its software into a program known as Agility Source Platform, which purports to provide customer relations management and sales force automation software.

14. On October 12, 2009, Navagate and Rorke hired Middlebury to act as placement agent to assist Navagate in selling its securities.

15. Around October 2009, Navagate and Rorke decided to raise capital by selling the Notes. The Notes had a six-month maturity and bore interest at an annual rate of 12%, increasing to 15% (and eventually 20%) in the event of default. Respondent, Middlebury, Navagate, and Rorke contemplated that the Notes would serve as a bridge to an eventual public offering of Navagate equity securities. The Notes Offering would initially raise between $2 and $2.5 million for Navagate, but that amount was increased to $3.25 million in or about March 2011.

The Personal Guarantee

16. In offering the Notes, Respondent, Middlebury, Rorke and Navagate, prepared and disseminated the Offering Documents, with the assistance of counsel.

17. The Offering Documents stated that the Notes were backed by Rorke's Personal Guarantee. The first drafts of the Offering Documents, prepared around November 2009, contained a general personal guarantee based on Rorke's wealth. In approximately December 2009, a potential investor asked that, in addition to Rorke's general personal guarantee, Rorke's wife execute a personal guarantee to back the Notes. As Respondent knew or recklessly disregarded, Rorke refused to request that his wife sign any guarantee. After negotiations later that month, the potential investor agreed to participate in the Notes Offering based on a Personal Guarantee signed only by Rorke, "provided that [Rorke] provides some evidence of not being 'judgment proof' ie [sic] a personal financial statement." Rorke agreed to provide the Personal Guarantee and a more detailed Personal Financial Statement.

18. The Personal Guarantee, which Respondent and Rorke each read, represented to investors that Rorke had the "full power and capacity to execute and deliver" the Personal Guarantee and to incur and perform the obligations therein contemplated. Similarly, the signature block of the Personal Financial Statement contained a specific representation that Rorke:

> [H]ad no liabilities, direct or contingent, business or accommodation, except as set forth in this statement, and that the title to all assets therein set forth is in [Rorke's] name solely, except as may be otherwise noted.

19. The Personal Financial Statement stated that Rorke solely owned the following assets: (1) $200,000 in cash on hand; (2) $800,000 in cash in banks; (3) $5,000,000 in readily marketable securities in a brokerage account; (4) $1,400,000 in real estate (his primary residence); (5) $4,000,000 in shares of Navagate; and (6) $1,000,000 in illiquid investments in two other, unrelated companies.

20. Rorke executed the Personal Financial Statement on or around April 21, 2010, and forwarded the document to Respondent and others at Middlebury for inclusion in the Offering Documents.

21. The Personal Financial Statement contained a number of false and misleading statements concerning Rorke's assets and liabilities:

a. First, virtually none of the liquid assets Rorke pledged as his own were actually in his name. Of the $6,000,000 Rorke claimed to have in cash and readily marketable securities, only $1,527 was held by him alone. His wife held $4,355,502 of the assets, and they jointly held an additional $33,635. Rorke also did not own the $1,400,000 in real estate listed, having transferred his primary residence to his wife in October 2008. Rorke had no legal authority to pledge his wife's assets, and his wife never agreed to such a pledge.

b. Second, Rorke substantially inflated the value of the assets he was purporting to pledge. Although the Personal Financial Statement stated that Rorke's liquid assets totaled $6 million; in reality, the value of these assets was approximately $4,391,000 (an overstatement of more than 36%).

c. Third, in his Personal Financial Statement, Rorke claimed that he had zero liabilities when, in fact, he was personally liable for at least $1 million in taxes owed to the IRS.

22. In order to further convince prospective investors that the Personal Guarantee provided meaningful protection in the case of a default on the Notes, Rorke also represented that he would not:

> [S]ell, assign or transfer any of the Guarantor's rights in the Pledged Assets, or . . . create any other security interest in, mortgage or otherwise encumber the Pledged Assets . . . .

23. This statement was misleading because Rorke did not hold title to most of the listed assets, and did not, therefore, have the ability to keep his wife from transferring or otherwise encumbering them.

24. In the Personal Guarantee, Rorke further agreed that he would:

> [P]romptly obtain a mortgage on [his] primary residence located in Bronxville, NY . . . in the event that [the Notes were in default and] the Pledged Assets . . . [we]re not sufficient to satisfy all outstanding Indebtedness.

25. This statement was also misleading as it was not within Rorke's power to mortgage the property as he had transferred title to this residence to his wife in October 2008.

26. Respondent repeatedly touted the Personal Guarantee and the Personal Financial Statement as a selling point during the Notes Offering. Indeed, Respondent stated that he viewed the Personal Guarantee and the Personal Financial Statement as a "key" term of the Notes Offering.

Respondent Knew or was Reckless in Not Knowing the False and Misleading Statements Contained in Rorke's Personal Guarantee and Personal Financial Statement

27. Despite repeatedly touting the Personal Guarantee and Personal Financial Statement, Respondent knew or was reckless in not knowing that these documents were materially false and misleading for a number of reasons.

28. First, Rorke told Respondent in April 2010 that the readily marketable securities in the brokerage account—the largest liquid asset—in the Personal Financial Statement were *jointly* held with his wife. Rorke's statement to Respondent was false because the brokerage account was held solely by Rorke's wife. Respondent, thus, knew that Rorke did not solely hold this asset as he had represented in the Personal Financial Statement.

29. Osborn and Middlebury understood or recklessly disregarded the important distinction regarding ownership of the assets backing the Notes; if Rorke did not solely own the assets, he could not pledge them to mitigate the risk of default on the Notes. Indeed, in December 2009, Rorke had refused to request that his wife be an additional party to the Personal Guarantee, which made clear that he did not intend to put her assets at risk.

30. Second, in early 2010, Middlebury hired a private detective agency to undertake a background check on Rorke. The agency provided a written report to Respondent and others at Middlebury on April 21, 2010, saying that Rorke had transferred his primary residence to his wife in October 2008.

31. Third, in April 2010, Middlebury's attorney told Respondent, in an email, that Rorke was personally liable for approximately $1.8 million of Navagate's past-due payroll tax liabilities. In a follow-up email, Rorke admitted to Respondent that he was personally liable for at least $1 million of those taxes. Thus, Respondent knew or recklessly disregarded that Rorke's claim in his Personal Financial Statement to have no liabilities was false.

Misrepresentations Regarding the Use of Proceeds From the Notes

32. In a schedule titled "Use of Proceeds," the Offering Documents also stated that the proceeds of the Notes were to be used only "to fund [Navagate's] sales efforts, for other working capital purposes and to satisfy certain tax liabilities."

33. Nonetheless, in October 2010, Respondent orchestrated using over $275,000 in Notes proceeds to pay back four investors who had purchased Notes in December 2009. These individuals had important business relationships with Middlebury and Respondent, repayment on their Notes was overdue, and three of them had demanded prompt repayment.

34. However, Osborn and Middlebury knew or recklessly disregarded that the Offering Document's "Use of Proceeds" section allowed for the offering proceeds to be used only as set forth above, and not for Navagate to repay prior investors with new investors' money.

35. In one instance, Respondent misrepresented the fact that Navagate was improperly using newly-raised funds to pay back old Navagate investors by calling one repayment Middlebury's repayment of an outstanding "'loan' to 'Middlebury' by [the old investor]." But Respondent knew or was reckless in not knowing that the purported "loan" to Middlebury did not exist and that this was merely a ruse to allow Navagate to use Note proceeds to repay investors whose Notes were past due.

36. Respondent never told any investors that their investments in the Notes would be used to repay other investors whose Notes were in default (or that such payments had occurred).

37. The use of investor proceeds was material to investors in the Notes.

Navagate Defaults on the Notes

38. Starting in June 2010, Navagate began defaulting on the Notes. Despite these defaults, Respondent, Middlebury, Navagate, and Rorke continued selling the Notes, but failed to tell any new investors about the defaults. Indeed, following the first defaults, Navagate raised another approximately $2.2 million from sales of the Notes.

39. Despite the defaults, Rorke did not fulfil his obligations under the Personal Guarantee and Personal Financial Statement to repay investors.

40. As of early 2014, Navagate owed over $1.25 million in principal and $1.4 million in interest on the Notes.

Violations

41. As a result of the conduct described above, Respondent willfully violated Section 17(a) of the Securities Act, which makes it unlawful for any person in the offer or sale of any securities, directly or indirectly, to employ any device, scheme, or artifice to defraud, or to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

42. As a result of the conduct described above, Respondent willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which make it unlawful for any person, directly or indirectly, to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

43. As a result of the conduct described above, Respondent willfully aided and abetted and caused Rorke's and Navagate's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

Respondent undertakes to do the following: In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent (i) will appear and be interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) appoints Respondent's undersigned attorneys as agents to receive service of such notices and subpoenas; and (iv) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

V.

Pursuant to this Order, Respondent agrees to additional proceedings to determine the amount of disgorgement and civil penalties, plus prejudgment interest if ordered, pursuant to Section 8A of the Securities Act, Section 21B of the Exchange Act, and Section 9(d) of the Company Act, against Respondent that is in the public interest. In connection with such additional proceedings: (a) Respondent agrees that he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

VI.

In view of the foregoing, the Commission deems it appropriate, in the public interest and for the protection of investors to impose the sanctions set forth in Respondent's Offer, and to institute proceedings to determine what, if any, disgorgement, civil penalties, and prejudgment interest are appropriate.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent is hereby barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal adviser, transfer agent, or nationally recognized statistical rating organization; prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

VII.

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

If Respondent fails to appear at a hearing after being duly notified, 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, 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.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9673 / October 31, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73485 / October 31, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16228

In the Matter of

NAVAGATE, INC. and
GREGORY RORKE

Respondents.

ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Navagate, Inc. ("Navagate") and Gregory Rorke ("Rorke") (collectively, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

Summary

1. From December 2009 through March 2011, Respondents made and disseminated false and misleading statements concerning the risks of investing in short-term notes of Navagate, a start-up venture purporting to create and sell sales force automation software. Specifically, in an effort to sell the notes (the "Notes"), Respondents made a number of false and misleading statements concerning (a) the assets purporting to guarantee the Notes and (b) Navagate's tax liabilities. Despite Respondents' awareness, or reckless disregard, of these false statements, Respondents prepared and distributed certain offering documents (the "Offering Documents") containing these falsehoods and reiterated the false statements to prospective investors. In

addition, Respondents knew or recklessly disregarded that Navagate's placement agent, Middlebury Securities, LLC ("Middlebury") and one of its principals, Gregory Osborn ("Osborn"), were also repeating many of the same false and misleading statements to prospective investors.

2. Between December 2009 and April 2011, Respondents, Middlebury, and Osborn sold approximately $3.2 million worth of the Notes (the "Notes Offering"). The Notes were purportedly backed by a personal guarantee from Rorke (the "Personal Guarantee").

3. To demonstrate that he had sufficient assets to make good on his Personal Guarantee, Rorke signed a personal financial statement (the "Personal Financial Statement"). The Personal Financial Statement purported to show that (a) Rorke solely owned over $12 million in assets, including $6 million in liquid assets, consisting of cash and readily-marketable securities, and over $1 million in real estate; and (b) Rorke had no liabilities.

4. In fact, as Respondents knew or recklessly disregarded:

a. Virtually all of the $6 million in liquid assets—including almost all of the purportedly pledged cash and readily marketable securities—as well as the real estate, belonged solely to Rorke's wife, who did not pledge any of her assets in connection with the Notes Offering (or otherwise obligate herself to make good on Rorke's Personal Guarantee);

b. Even including his wife's unpledged assets, Rorke overstated the value of the liquid assets (the cash and readily-marketable securities) listed in the Personal Financial Statement by over 36%; and

c. Rorke failed to disclose over $1,000,000 owed in federal taxes for which he was personally liable.

5. As a result of the above—as Respondents knew or recklessly disregarded—Rorke did not have anywhere near sufficient liquid assets to make good on his Personal Guarantee of the Notes. Nonetheless, Respondents, along with Middlebury and Osborn, distributed and touted Rorke's Personal Guarantee and Personal Financial Statement to investors as a key reason to invest in the Notes.

6. Respondents also knowingly or recklessly made false and misleading statements about Navagate's federal tax liabilities, understating the tax liability by at least $1 million and then falsely representing to Middlebury and Osborn that they had repaid at least a portion of the tax debt (when they knew they had not).

7. Ultimately, Navagate defaulted on the Notes and Rorke did not make good on his promise under the Personal Guarantee.

Respondents

8. **Navagate** is a Delaware limited liability company with its principal place of business in New York. Navagate's business is purportedly to create and sell computer software that provides sales force automation to financial services organizations.

9. **Rorke**, age 59, is a resident of New York, and is the co-founder and CEO of Navagate.

Other Relevant Entity and Individuals

10. **Middlebury** is a FINRA-registered broker-dealer organized as a Delaware limited liability company with offices in Vermont, New Jersey, and New York. Middlebury was the placement agent for the Notes Offering from approximately December 2009 to April 2011.

11. **Osborn**, age 50, is a resident of New Jersey, and was primarily responsible for Middlebury's relationship with Navagate. At all relevant times, Osborn was a Managing Partner at Middlebury.

Background

12. Rorke is an experienced businessman. From at least 1989, Rorke specialized in turning around companies facing financial difficulties and building new businesses.

13. From 1997 through 2012, Rorke was also an adjunct professor at Columbia Business School, teaching turnaround management, bankruptcy, and restructuring in the MBA program.

14. In 2000, Rorke formed a Delaware limited liability company named G2X, which purportedly developed software to automate certain sales and customer-relationship processes. In 2006, G2X changed its name to Navagate.

15. Navagate developed its software into a program known as Agility Source Platform, which purports to provide customer relations management and sales force automation software.

16. In approximately October of 2009, Respondents hired Middlebury and Osborn to act as placement agents to assist Navagate in selling its securities.

17. Around October 2009, Respondents decided to raise capital by selling the Notes. The Notes had a six-month maturity and bore interest at an annual rate of 12%, increasing to 15% (and eventually 20%) in the event of default. Respondents intended for the Notes to serve as a bridge to an eventual public offering of Navagate equity securities. They originally planned to sell between $2 and $2.5 million in Notes. That amount was increased to $3.25 million in or about March 2011.

The Personal Guarantee

18. In offering the Notes, Respondents, Middlebury, and Osborn, prepared and disseminated the Offering Documents.

19. The Offering Documents stated that the Notes were backed by Rorke's Personal Guarantee. The first drafts of the Offering Documents, prepared around November 2009, contained a general personal guarantee. In approximately December 2009, a potential investor asked that—in addition to Rorke's general personal guarantee—Rorke's wife execute a personal guarantee to back the Notes. Rorke refused to request that his wife sign any guarantee. Eventually, the potential investor agreed to participate in the Notes Offering based on a Personal Guarantee signed only by Rorke, "provided that [Rorke] provide[d] some evidence of not being 'judgment proof' ie [sic] a personal financial statement." Rorke agreed to provide the Personal Guarantee and a more detailed Personal Financial Statement.

20. In or around April 21, 2010, Middlebury's attorneys inserted the Personal Guarantee into the Offering Documents and Rorke signed the Personal Financial Statement. The Personal Guarantee represented to investors that Rorke had the "full power and capacity to execute and deliver" the Personal Guarantee and to incur and perform the obligations therein contemplated. Similarly, the signature block of the Personal Financial Statement contained a specific representation that Rorke:

> [H]ad no liabilities, direct or contingent, business or accommodation, except as set forth in this statement, and that the title to all assets therein set forth is in [Rorke's] name solely, except as may be otherwise noted.

21. The Personal Financial Statement stated that Rorke solely owned the following assets: (a) $200,000 in cash on hand; (b) $800,000 in cash in banks; (c) $5,000,000 in readily marketable securities in a brokerage account; (d) $1,400,000 in real estate (his primary residence); (e) $4,000,000 in shares of Navagate; and (f) $1,000,000 in illiquid investments in two other, unrelated companies. Rorke also represented in the Personal Guarantee that he had zero liabilities.

22. Rorke filled out and executed the Personal Financial Statement on or around April 21, 2010, and forwarded the document to Osborn and others at Middlebury for inclusion in the Offering Documents.

23. The Personal Financial Statement contained a number of false and misleading statements concerning Rorke's assets and liabilities:

a. First, virtually none of the liquid assets Rorke pledged as his own were actually in his name. Of the $6,000,000 Rorke claimed to have in cash and readily marketable securities, only $1,527 was held by him alone. His wife solely held $4,355,502 of the assets, and they jointly held an additional $33,635. Rorke also did not own the listed $1,400,000 in real estate, having transferred his primary residence to his wife in October 2008. Rorke had no legal authority to pledge his wife's assets, and his wife never agreed to such a pledge.

b. Second, Rorke substantially inflated the value of the assets he was purporting to pledge. Although the Personal Financial Statement stated that Rorke's liquid assets totaled $6 million, in reality, the value of these assets was approximately $4,391,000 (an overstatement of more than 36%).

c. Third, in his Personal Financial Statement, Rorke claimed that he had zero liabilities when, in fact, he was personally liable for at least $1 million in taxes owed to the IRS.

24. In order to further convince prospective investors that the Personal Guarantee provided meaningful protection in the case of a default on the Notes, Rorke also represented that he would not:

> [S]ell, assign or transfer any of the Guarantor's rights in the Pledged Assets, or . . . create any other security interest in, mortgage or otherwise encumber the Pledged Assets . . . .

25. This statement was misleading because Rorke did not hold title to most of the listed assets, and did not, therefore, have the ability to keep his wife from transferring or otherwise encumbering them.

26. In the Personal Guarantee, Rorke further agreed that he would:

> [P]romptly obtain a mortgage on [his] primary residence located in Bronxville, NY . . . in the event that [the Notes were in default and] the Pledged Assets . . . [we]re not sufficient to satisfy all outstanding Indebtedness.

27. This statement was also misleading as Rorke could not mortgage the property because he had transferred title to his wife in October 2008.

28. Respondents repeatedly touted the Personal Guarantee and the Personal Financial Statement as a selling point during the Notes Offering. For example, Rorke cited the guarantee as a reason to invest in the Notes to at least three investors.

29. In addition to the above, Respondents further knew or recklessly disregarded that the Personal Guarantee and Personal Financial Statement were materially false and misleading, for a number of reasons, including:

30. First, Rorke had been explicitly asked for evidence that he was not judgment proof as a condition for a potential investor foregoing its request for a personal guarantee from Rorke's wife. In addition, Rorke has held himself out as an experienced businessman and has been a professor at Columbia business school teaching bankruptcy-related classes. Thus, Rorke fully understood at the time of the Notes Offering that investors wanted to know which assets he solely

owned and, therefore, what protection existed against the danger of Navagate defaulting on its Notes.

31. Second, when pressed in July 2012 for documents to back up his assets, Rorke provided Osborn with a copy of one of his wife's account statements that he had altered by deleting the line showing that the account was in her name.

32. Third, Rorke had signed the document in October 2008 that had transferred his primary residence from joint ownership with his wife to sole ownership by his wife.

33. Fourth, Rorke never informed his wife that he was pledging her assets to support the Notes, and his wife never gave him authority to do so.

Misrepresentations with Respect to Navagate's Payroll Tax Liabilities

34. The Offering Documents also materially misrepresented Navagate's tax liabilities.

35. The early versions of the Offering Documents, given to investors who purchased the Notes between December 2009 and April 2010, stated that Navagate was current in its federal tax filing and tax payment obligations.

36. However, starting in mid-2008 and continuing through the end of 2009, Navagate had failed to stay current on the employer's share of Social Security and Medicare taxes (also known as payroll or trust fund taxes) to the IRS.

37. From mid-2008 and continuing through the end of 2009, Rorke was one of the Navagate officers responsible for remitting federal payroll taxes to the IRS. Rorke thus knew, or recklessly disregarded, that Navagate was not current on its federal payroll tax obligations. Moreover, because he was responsible for remitting these payments to the IRS, Rorke was personally liable for the unpaid payroll taxes, as Rorke knew or recklessly disregarded.

38. As a result of Navagate's failure to stay current on its payroll taxes, by late 2009 the IRS had filed tax liens against Navagate totaling approximately $1.7 million, accounting for principal, interest, and penalties.

39. Accordingly, the Offering Documents' statement that Navagate was current in its federal tax filing and tax payment obligations was false.

40. In January 2010, Middlebury and its lawyers uncovered approximately $543,000 of the total then-outstanding tax liens. Middlebury's lawyers asked Rorke about these liabilities, but Respondents failed to disclose to Middlebury and its lawyers that the existing tax liens were, at that time, greater than $543,000. In addition, Respondents represented to Middlebury and its lawyers that the tax liens would be extinguished within the next two weeks.

41. Respondents, however, did not pay down even the tax liens totaling $543,000.

42. Moreover, as noted, the tax liens were in fact significantly higher than $543,000. On April 29, 2010, Middlebury's lawyers conducted a follow-up tax lien search that revealed that (a) the $543,000 liens remained unsatisfied; (b) the IRS had filed other liens against Respondents in 2009, totaling approximately $1,165,000; and (c) the IRS filed an additional lien against Respondents in April of 2010 for approximately $133,000.

43. Thus, by April 2010, the tax liens against Respondents totaled approximately $1.8 million, contrary to the Offering Documents' statements that Navagate was current on its taxes, and to the Personal Financial Statement's disclosure that Rorke had no liabilities.

44. When confronted with these liens, Rorke agreed to amend the Offering Documents to state that Navagate owed approximately $790,000 in payroll taxes to the IRS and that Rorke would pay $350,000 to decrease this liability. Most investors who purchased Notes between September 2010 and April 2011 were given this updated disclosure. However, even this amended disclosure was materially false and misleading because the total amount of liens amounted to approximately $1.8 million and because Rorke never paid the $350,000 to decrease the tax liability (as discussed below).

45. As Rorke knew or recklessly disregarded, at least some investors requested that their funds be held in escrow until Rorke personally paid the $350,000 to the IRS.

46. When Rorke was asked by Middlebury's attorneys about his payment of the $350,000 to the IRS, Rorke responded by representing that he had sent a check directly to the IRS, and asking for a release of $100,000 of investor money in escrow. Middlebury's attorneys asked Rorke for proof that Rorke had paid the $350,000. To satisfy Middlebury and its attorneys, Rorke completed a notarized affidavit stating that he had sent the check to the IRS and attached a copy of the purported check. Based on Rorke's affidavit, Middlebury authorized releasing the investor funds from the escrow account to Navagate.

47. However, Rorke never actually paid the IRS the $350,000, and his affidavit was, therefore, false and misleading.

Navagate Defaults on the Notes

48. Starting in June 2010, Navagate began defaulting on the Notes. Despite these defaults, Respondents, continued selling the Notes, but failed to tell any new investors about the defaults. Indeed, following the first defaults, Navagate raised another approximately $2.2 million from sales of the Notes.

49. Despite the defaults, Rorke did not fulfil his obligations under the Personal Guarantee and Personal Financial Statement to repay investors.

50. As of early 2014, Navagate owed over $1.25 million in principal and approximately $1.4 million in interest on the Notes.

Violations

51. As a result of the conduct described above, Respondents willfully violated Section 17(a) of the Securities Act, which makes it unlawful for any person in the offer or sale of any securities, directly or indirectly, to employ any device, scheme, or artifice to defraud, or to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

52. As a result of the conduct described above, Respondents willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which make it unlawful for any person, directly or indirectly, to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

53. As a result of the conduct described above, Respondent Rorke caused Navagate's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 8A of the Securities Act including, but not limited to, disgorgement and civil penalties;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 21B and 21C of the Exchange Act including, but not limited to, disgorgement, civil penalties, and an appropriate order prohibiting him from acting as an officer and director pursuant to Section 21C(f); and

D. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act and Section 21C(e) of the Exchange Act.

IV.

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

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

If a Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, that Respondent may be deemed in default and the proceedings may be determined against it or 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 Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2).

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

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9672 / October 31, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73484 / October 31, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31324 / October 31, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16227

In the Matter of **MIDDLEBURY SECURITIES, LLC** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER, AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b), and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Company Act"), against Middlebury Securities, LLC ("Middlebury" or "Respondent").

II.

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

Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Company Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order, and Notice of Hearing ("Order"), as set forth below.

III.

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

Summary

1. From December 2009 through March 2011, Respondent made and disseminated false and misleading statements concerning the risks of investing in the short-term notes ("Notes") of Navagate, Inc., ("Navagate"), a start-up venture purporting to create and sell sales force automation software. Specifically, in an effort to sell Navagate's Notes (the "Notes Offering"), Respondent, through its principal Gregory Osborn ("Osborn"), and Gregory Rorke ("Rorke")—Navagate's CEO and controlling officer—made a number of false and misleading statements concerning (1) the assets purporting to guarantee the Notes; and (2) the use of the proceeds from the Notes Offering. Despite Respondent's awareness, or reckless disregard, of these false statements, Respondent prepared and distributed certain offering documents (the "Offering Documents") containing these falsehoods and reiterated the false statements to prospective investors both orally and in writing.

2. Between December 2009 and April 2011, Respondent, Navagate, and Rorke sold approximately $3.2 million worth of the Notes. The Notes were purportedly backed by a personal guarantee from Rorke (the "Personal Guarantee").

3. To demonstrate that he had sufficient assets to make good on his Personal Guarantee, Rorke signed a personal financial statement (the "Personal Financial Statement"). The Personal Financial Statement purported to show that (1) Rorke solely owned over $12 million in assets, including $6 million in liquid assets, consisting of cash and readily-marketable securities, and over $1 million in real estate; and (2) Rorke had no liabilities.

4. In fact, as Respondent knew or recklessly disregarded:

   a. Virtually all of the $6 million in liquid assets—including almost all of the purportedly pledged cash and readily marketable securities—as well as the real estate, belonged solely to Rorke's wife, who did not pledge any of her assets in connection with the Notes Offering (or otherwise obligate herself to make good on Rorke's Personal Guarantee);

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

b. Even including his wife's unpledged assets, Rorke overstated the value of the liquid assets (the cash and readily-marketable securities) listed in the Personal Financial Statement by over 36%; and

c. Rorke failed to disclose over $1,000,000 owed in federal taxes for which he was personally liable.

5. As a result of the above—as Respondent knew or recklessly disregarded—Rorke did not have anywhere near sufficient liquid assets to make good on his Personal Guarantee of the Notes. Nonetheless, Respondent distributed and touted Rorke's Personal Guarantee and Personal Financial Statement to investors, orally and in emails, as a key reason to invest in the Notes.

6. In addition, Respondent, acting through Osborn, knowingly or recklessly, used some of the proceeds of the Notes to pay back earlier investors, contrary to the disclosed use of proceeds in the Offering Documents.

7. Ultimately Navagate defaulted on the Notes and Rorke did not make good on his promise under the Personal Guarantee.

Respondent

8. **Middlebury** is a FINRA-registered broker-dealer organized as a Delaware limited liability company with offices in Vermont, New Jersey, and New York. Middlebury was the placement agent for the Notes Offering from approximately December 2009 to April 2011.

Other Relevant Entity and Individuals

9. **Navagate** is a Delaware limited liability company with its principal place of business in New York. Navagate's business is purportedly to create and sell computer software that provides sales force automation to financial services organizations.

10. **Rorke**, age 59, is a resident of New York, and is the co-founder and CEO of Navagate.

11. **Osborn**, age 50, is a resident of New Jersey, and was primarily responsible for Middlebury's relationship with Navagate. At all relevant times, Osborn was a Managing Partner at Middlebury. Osborn was registered with FINRA from 1988 until 2014, at which time he was permanently barred from associating with any FINRA-registered member as part of a settlement of charges brought against him by FINRA.

Background

12. In 2000, Rorke formed a Delaware limited liability company named G2X and began raising money for the development of software purportedly designed to automate certain sales and customer-relationship processes (called "sales force automation software"). In 2006, G2X changed its name to Navagate.

13. Navagate developed its software into a program known as Agility Source Platform, which purports to provide customer relations management and sales force automation software.

14. On October 12, 2009, Navagate and Rorke hired Respondent to act as placement agent to assist Navagate in selling its securities.

15. Around October 2009, Navagate and Rorke decided to raise capital by selling the Notes. The Notes had a six-month maturity and bore interest at an annual rate of 12%, increasing to 15% (and eventually 20%) in the event of default. Respondent, Osborn, Navagate, and Rorke contemplated that the Notes would serve as a bridge to an eventual public offering of Navagate equity securities. The Notes Offering would initially raise between $2 and $2.5 million for Navagate, but that amount was increased to $3.25 million in or about March 2011.

<u>The Personal Guarantee</u>

16. In offering the Notes, Respondent, Osborn, Rorke and Navagate, prepared and disseminated the Offering Documents with the assistance of counsel.

17. The Offering Documents stated that the Notes were backed by Rorke's Personal Guarantee. The first drafts of the Offering Documents, prepared around November 2009, contained a general personal guarantee based on Rorke's wealth. In approximately December 2009, a potential investor asked that, in addition to Rorke's general personal guarantee, Rorke's wife execute a personal guarantee to back the Notes. As Respondent knew or recklessly disregarded, Rorke had refused to request that his wife sign any guarantee. After negotiations later that month, the potential investor agreed to participate in the Notes Offering based on a Personal Guarantee signed only by Rorke, "provided that [Rorke] provides some evidence of not being 'judgment proof' ie [sic] a personal financial statement." Rorke agreed to provide the Personal Guarantee and a more detailed Personal Financial Statement.

18. The Personal Guarantee, which Osborn and Rorke each read, represented to investors that Rorke had the "full power and capacity to execute and deliver" the Personal Guarantee and to incur and perform the obligations therein contemplated. Similarly, the signature block of the Personal Financial Statement contained a specific representation that Rorke:

> [H]ad no liabilities, direct or contingent, business or accommodation, except as set forth in this statement, and that the title to all assets therein set forth is in [Rorke's] name solely, except as may be otherwise noted.

19. The Personal Financial Statement stated that Rorke solely owned the following assets: (1) $200,000 in cash on hand; (2) $800,000 in cash in banks; (3) $5,000,000 in readily marketable securities in a brokerage account; (4) $1,400,000 in real estate (his primary residence); (5) $4,000,000 in shares of Navagate; and (6) $1,000,000 in illiquid investments in two other, unrelated companies.

20. Rorke executed the Personal Financial Statement on or around April 21, 2010, and forwarded the document to Osborn for inclusion in the Offering Documents.

21. The Personal Financial Statement contained a number of false and misleading statements concerning Rorke's assets and liabilities:

a. First, virtually none of the liquid assets Rorke pledged as his own were actually in his name. Of the $6,000,000 Rorke claimed to have in cash and readily marketable securities, only $1,527 was held by him alone. His wife held $4,355,502 of the assets, and they jointly held an additional $33,635. Rorke also did not own the $1,400,000 in real estate listed, having transferred his primary residence to his wife in October 2008. Rorke had no legal authority to pledge his wife's assets, and his wife never agreed to such a pledge.

b. Second, Rorke substantially inflated the value of the assets he was purporting to pledge. Although the Personal Financial Statement stated that Rorke's liquid assets totaled $6 million; in reality, the value of these assets was approximately $4,391,000 (an overstatement of more than 36%).

c. Third, in his Personal Financial Statement, Rorke claimed that he had zero liabilities when, in fact, he was personally liable for at least $1 million in taxes owed to the IRS.

22. In order to further convince prospective investors that the Personal Guarantee provided meaningful protection in the case of a default on the Notes, Rorke also represented that he would not:

> [S]ell, assign or transfer any of the Guarantor's rights in the Pledged Assets, or . . . create any other security interest in, mortgage or otherwise encumber the Pledged Assets . . . .

23. This statement was misleading because Rorke did not hold title to most of the listed assets, and did not, therefore, have the ability to keep his wife from transferring or otherwise encumbering them.

24. In the Personal Guarantee, Rorke further agreed that he would:

> [P]romptly obtain a mortgage on [his] primary residence located in Bronxville, NY . . . in the event that [the Notes were in default and] the Pledged Assets . . . [we]re not sufficient to satisfy all outstanding Indebtedness.

25. This statement was also misleading as it was not within Rorke's power to mortgage the property as he had transferred title to this residence to his wife in October 2008.

26. Respondent repeatedly touted the Personal Guarantee and the Personal Financial Statement as a selling point during the Notes Offering. For example, Osborn told an investor in December 2010 that investment in the Notes was a "layup" because Rorke had "Personally Guaranteed the loan." Indeed, Osborn stated that he viewed the Personal Guarantee and the Personal Financial Statement as a "key" term of the Notes Offering.

Respondent Knew or Recklessly Disregarded the False and Misleading Statements Contained in Rorke's Personal Guarantee and Personal Financial Statement

27. Despite repeatedly touting the Personal Guarantee and Personal Financial Statement, Respondent, acting through Osborn, knew or recklessly disregarded that these documents were materially false and misleading for a number of reasons.

28. First, Rorke told Osborn in April 2010 that the readily marketable securities in the brokerage account—the largest liquid asset—in the Personal Financial Statement were *jointly* held with his wife. Rorke's statement to Osborn was false because the brokerage account was held solely by Rorke's wife. Osborn and Middlebury thus knew that Rorke did not solely hold this asset as he had represented in the Personal Financial Statement.

29. Osborn, and through him Middlebury, understood or recklessly disregarded the important distinction regarding ownership of the assets backing the Notes; if Rorke did not solely own the assets, he could not pledge them to mitigate the risk of default on the Notes. Indeed, in December 2009, Rorke refused to request that his wife be an additional party to the Personal Guarantee, which made clear that he did not intend to put her assets at risk.

30. Second, in early 2010, Middlebury hired a private detective agency to undertake a background check on Rorke. The agency provided a written report to Osborn on April 21, 2010, saying that Rorke had transferred his primary residence to his wife in October 2008.

31. Third, in April 2010, Middlebury's attorney told Osborn, in an email, that Rorke was personally liable for approximately $1.8 million of Navagate's past-due payroll tax liabilities. In a follow-up email, Rorke admitted to Osborn that he was personally liable for at least $1 million of those taxes. Thus, Osborn—and, therefore, Respondent—knew or recklessly disregarded that Rorke's claim in his Personal Financial Statement to have no liabilities was false.

Misrepresentations Regarding the Use of Proceeds From the Notes

32. In a schedule titled "Use of Proceeds," the Offering Documents also stated that the proceeds of the Notes were to be used only "to fund [Navagate's] sales efforts, for other working capital purposes and to satisfy certain tax liabilities."

33. Nonetheless, in October 2010, Osborn orchestrated using over $275,000 in Notes proceeds to pay back four investors who had purchased Notes in December 2009. These individuals had important business relationships with Middlebury and Osborn, repayment on their Notes was overdue, and three of them had demanded prompt repayment.

34. However, Osborn, and through him Middlebury, knew or recklessly disregarded that the Offering Document's "Use of Proceeds" section allowed for the offering proceeds to be used only as set forth above, and not for Navagate to repay prior investors with new investors' money.

35. In one instance, Osborn attempted to disguise the fact that Navagate was improperly using newly-raised funds to pay back old Navagate investors by calling one repayment Middlebury's repayment of an outstanding "'loan' to 'Middlebury' by [the old investor]." But Osborn knew or was reckless in not knowing that the purported "loan" to Middlebury did not exist and that this was merely a ruse to allow Navagate to use Note proceeds to repay those investors whose Notes were past due.

36. Osborn never told any investors that their investments in the Notes would be used to repay other investors whose Notes were in default (or that such payments had occurred).

37. The use of investor proceeds was material to investors in the Notes.

Navagate Defaults on the Notes

38. Starting in June 2010, Navagate began defaulting on the Notes. Despite these defaults, Respondent, Osborn, Navagate, and Rorke continued selling the Notes, but failed to tell any new investors about the defaults. Indeed, following the first defaults, Navagate raised another approximately $2.2 million from sales of the Notes.

39. Despite the defaults, Rorke did not fulfill his obligations under the Personal Guarantee and Personal Financial Statement to repay investors.

40. As of early 2014, Navagate owed over $1.25 million in principal and $1.4 million in interest on the Notes.

Violations

41. As a result of the conduct described above, Respondent willfully[2] violated Section 17(a) of the Securities Act, which makes it unlawful for any person in the offer or sale of any securities, directly or indirectly, to employ any device, scheme, or artifice to defraud, or to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, or to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

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[2] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

42. As a result of the conduct described above, Respondent willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which make it unlawful for any person, directly or indirectly, to employ any device, scheme, or artifice to defraud, to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

43. As a result of the conduct described above, Respondent willfully aided and abetted and caused Rorke's and Navagate's violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

IV.

Respondent undertakes to do the following: In connection with this action and any related judicial or administrative proceeding or investigation commenced by the Commission or to which the Commission is a party, Respondent (i) will make all reasonable efforts to ensure that its employees and members appear and are interviewed by Commission staff at such times and places as the staff requests upon reasonable notice; (ii) will accept service by mail or facsimile transmission of notices or subpoenas issued by the Commission for documents or testimony at depositions, hearings, or trials, or in connection with any related investigation by Commission staff; (iii) appoints Respondent's undersigned attorneys as agents to receive service of such notices and subpoenas; and (iv) consents to personal jurisdiction over Respondent in any United States District Court for purposes of enforcing any such subpoena.

V.

Pursuant to this Order, Respondent agrees to additional proceedings to determine the amount of disgorgement and civil penalties, plus prejudgment interest if ordered, pursuant to Section 8A of the Securities Act, Section 21B of the Exchange Act, and Section 9(d) of the Company Act, against Respondent that is in the public interest. In connection with such additional proceedings: (a) Respondent agrees that it will be precluded from arguing that it did not violate the federal securities laws described in this Order; (b) Respondent agrees that it may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of the Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

VI.

In view of the foregoing, the Commission deems it appropriate, in the public interest and for the protection of investors to impose the sanctions set forth in Respondent's Offer, and to institute proceedings to determine what, if any, disgorgement, civil penalties, and prejudgment interest are appropriate.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, and Section 9(b) of the Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent is censured.

VII.

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

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

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

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

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9675 / October 31, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73491 / October 31, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16157

In the Matter of **REGISTRAR AND TRANSFER COMPANY and THOMAS L. MONTRONE,** **Respondents.**	**ORDER MODIFYING ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTIONS 17A AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

On September 23, 2014, the Securities and Exchange Commission ("Commission") instituted cease-and-desist proceedings, making findings, and imposing remedial sanctions and a cease-and-desist order (the "September 23 Order") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 17A and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Registrar and Transfer Company ("R&T") and Thomas L. Montrone ("Montrone") (collectively, "Respondents").

II.

The remedial sanctions in the September 23 Order contained undertakings with certain timeframes.

III.

The Commission deems it appropriate to amend the September 23 Order to extend these deadlines by 90 days.

Accordingly, it is hereby ORDERED that:

A. Paragraphs 33-35 of the September 23 Order are amended as follows :

33. Provide the Commission's staff within 120 days after entry of this Order, an agreement for the services of an Independent Consultant, acceptable to the Commission's staff, and thereafter exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant. Respondent R&T shall retain the Independent Consultant to conduct a comprehensive review of, and recommend corrective measures concerning, R&T's policies and procedures relating to the issuance of securities and the transfer of penny stocks and restricted securities. Respondent R&T shall cooperate fully with the Independent Consultant and shall provide the Independent Consultant with access to R&T's files, books, records, and personnel as reasonably requested.

34. No more than 210 days after the date of the entry of this Order, submit to the staff of the Commission a written report that Respondent R&T will obtain from the Independent Consultant regarding R&T's policies and procedures. The report will include a description of the review performed, the conclusions reached, the Independent Consultant's recommendations for changes in or improvements to the policies and procedures, and a procedure for implementing any recommended changes.

35. Adopt all recommendations made by the Independent Consultant, provided, however, that within 240 days after the date of the entry of this Order, Respondent R&T will, in writing, advise the Independent Consultant and the staff of the Commission of any recommendations it considers unnecessary or inappropriate. With respect to any recommendation that Respondent R&T considers unnecessary or inappropriate, Respondent R&T need not adopt that recommendation at that time, but instead propose in writing an alternative policy, procedure, or system designed to achieve the same objective or purpose. As to any recommendation with respect to R&T's policies and procedures on which Respondent R&T and the Independent Consultant do not agree, they will attempt in good faith to reach an agreement within 180 days of the date of entry of this Order. In the event Respondent R&T and the Independent Consultant are unable to agree on an alternative proposal, Respondent R&T will abide by the determinations of the Independent Consultant.

B. All other provisions of the September 23 Order remain in effect.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

October 31, 2014

In the Matter of **Hall Tees, Inc.** **Phoenix Medical Software, Inc.** **Surface Coatings, Inc.** **Flint Int'l Services, 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 the issuers listed below.

1. Hall Tees, Inc. is a Nevada corporation located in Rowlett, Texas. Questions have arisen concerning the accuracy of information contained in its current Commission filings, including information concerning the individuals who control the company and their future intentions with respect to the company. The company is quoted on the OTC Link operated by OTC Markets Group, Inc. ("OTC Link"), under the stock symbol HTEE.

2. Phoenix Medical Software, Inc. is a Cayman Islands company located in Ovilla, Texas. Questions have arisen concerning the accuracy of information contained in its current Commission filings, including information concerning the individuals who control the company and their future intentions with respect to the company. The company is quoted on the OTC Link, under the stock symbol PHXMF.

3. Surface Coatings, Inc. is a Texas corporation located in Rockwall, Texas. Questions have arisen concerning the accuracy of information contained in its

current Commission filings, including information concerning the individuals who control the company and their future intentions with respect to the company. The company is quoted on the OTC Link, under the stock symbol SCTZ.

4. Flint Int'l Services, Inc. is a British Virgin Islands company located in Vaughn, Ontario, Canada. Questions have arisen concerning the accuracy of information contained in its current Commission filings, including information concerning the individuals who control the company and their future intentions with respect to the company. The company is quoted on the OTC Link, under the stock symbol FNTSF.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EDT on October 31, 2014, through 11:59 p.m. EST on November 13, 2014.

By the Commission.

Brent J. Fields
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73482; File No. SR-OCC-2014-803)

October 31, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Filing to Better Manage Risks Concentration and Other Risks Associated with Accepting Deposits of Common Stocks for Margin Purposes

On July 16, 2014, the Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-OCC-2014-803 pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act")[1] and Rule 19b-4(n)(1) under the Securities Exchange Act of 1934 ("Act").[2] The advance notice was published for comment in the Federal Register on August 15, 2014.[3] On September 8, 2014, pursuant to Section 806(e)(1)(D) of the Payment, Clearing and Settlement Supervision Act, the Commission required OCC to provide additional information concerning this

1 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated OCC a systemically important financial market utility on July 18, 2012. See Financial Stability Oversight Council 2012 Annual Report, Appendix A, http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf. Therefore, OCC is required to comply with the Payment, Clearing and Settlement Supervision Act and file advance notices with the Commission. See 12 U.S.C. 5465(e).

2 17 CFR 240.19b-4(n)(1).

3 Securities Exchange Act Release No. 72803 (August 11, 2014), 79 FR 48285 (August 15, 2014) (SR-OCC-2014-803). OCC also filed the proposal contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Act and Rule 19b-4 thereunder, which was published for comment in the Federal Register on August 5, 2014. 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4. See Securities Exchange Act Release No. 72717 (July 30, 2014), 79 FR 45523 (August 5, 2014) (SR-OCC-2014-14). The Commission did not receive any comments on the proposed rule change.

advance notice.[4] The Commission did not receive any comments on the advance notice publication. This publication serves as a notice of no objection to the changes proposed in the advance notice.

I. Description of the Advance Notice

According to OCC, the purpose of this change is to permit OCC to better manage concentration risk and wrong-way risk associated with accepting deposits of common stock for margin purposes. In order to manage such risks, OCC is adding an Interpretation and Policy to Rule 604, which specifies the forms of margin assets accepted by OCC, that will provide OCC with discretion with respect to giving value to assets deposited by a single clearing member to satisfy its margin requirement(s). In addition, OCC is making clarifying amendments to an existing Interpretation and Policy under Rule 604 that gives OCC discretion to not give value to a particular type of margin collateral across all clearing members.

a. Background

OCC Rule 604 lists the types of assets that clearing members may deposit with OCC to satisfy their margin requirement(s) as well as sets forth eligibility criteria for such assets. According to OCC, common stocks, including Exchange Traded Funds ("ETFs") and Exchange Traded Notes ("ETNs"), are the most common form of margin assets deposited by clearing members and currently comprise 68% of the $60.6 billion in clearing member margin deposits held by OCC (not including deposits in lieu of margin).

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4 12 U.S.C. 5465(e)(1)(D). The Commission received a response with further information for consideration of the advance notice on September 19, 2014, at which time a 60 day review period began pursuant to Sections 806(e)(1)(E) and (G) of the Payment, Clearing and Settlement Supervision Act. See 12 U.S.C. 5465(e)(1)(E) and 12 U.S.C. 5465(e)(1)(G).

According to OCC, since 2009, OCC has used its System for Theoretical Analysis and Numerical Simulations ("STANS"), which is OCC's daily automated Monte Carlo simulation-based margining methodology, to value common stocks deposited by clearing members as margin.[5] The value given to margin deposits depends on factors that include the price volatility and the price correlation relationship of common stock collateral to the balance of the cleared portfolio. The approach used by STANS incentivizes clearing members who chose to meet their margin obligations with deposits of common stocks to choose common stocks that hedge their related open positions.

According to OCC, notwithstanding the value STANS gives to deposits of common stocks, certain factors warrant OCC adjusting the value STANS gives to all clearing member margin deposits of a particular type of margin collateral. Such factors are set forth in Rule 604, Interpretation and Policy .14, and include the number of outstanding shares, number of outstanding shareholders and overall trading volume. OCC is proposing to add a new Interpretation and Policy to Rule 604 (the "Interpretation") so that OCC has discretion to not give margin credit to a particular clearing member when such clearing member deposits a concentrated amount of any common stock and when a common stock, deposited as margin, presents "wrong-way risk" to OCC. In addition, the Interpretation will provide OCC discretion to grant margin credit to a clearing member when it deposits shares of common stock that serve as a

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5 See Securities Exchange Act Release No. 58158 (July 15, 2008), 73 FR 42646 (July 22, 2008) (SR-OCC-2007-20).

hedge to the clearing member's related open positions and would otherwise be not be given margin credit.[6]

b. Concentrated Deposits of Common Stock

OCC has determined that in the event it is necessary to liquidate a clearing member's positions (including the clearing member's margin collateral), OCC may be exposed to risk arising from a large quantity of a particular common stock deposited as margin by a clearing member. Specifically, depending on the relationship between the average daily trading volume of a particular security and the number of outstanding shares of such security deposited by a clearing member as margin, it is possible that the listed equities markets may not be able to quickly absorb all of the common stock OCC seeks to sell, or OCC may not be able to auction such securities, without an appreciable negative price impact. This occurrence, referred to by OCC as "concentration risk," is greatest when the number of shares being sold is large and the average daily trading volume is low.

OCC's existing authority to not give value to otherwise eligible forms of margin only provides OCC with the discretion to not give value across all clearing member deposits of a particular common stock. However, concentration risk may be a clearing

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6 According to OCC, consistent with the language contained in existing Interpretation & Policy .14, the Interpretation provides OCC with discretion in determining the amount of margin credit given to deposits of common stock by an individual clearing member as such determination would be based on positions held and common stock deposits made by such clearing member on a given business day. However, as discussed in the following two sections, OCC states that it also has developed certain automated processes as well as additional internal policies that describe how OCC presently intends to exercise such discretion. According to OCC, these additional internal policies are included in OCC's collateral risk management policy, which will not be implemented until approval of this rule change with changes thereto being subject to additional rule filings.

member and account-specific risk. In order to mitigate the concentration risk of a single clearing member, OCC plans to implement automated processes to monitor the composition of a clearing member's margin deposits. Such processes will identify concentration risk at both an account level and across all accounts of a clearing member. OCC is adding the Interpretation so that OCC has discretion to limit the margin credit granted to an individual clearing member that maintains a concentrated margin deposit of otherwise eligible common stock.

According to OCC, for reasons stated above, OCC considers a common stock's average daily trading volume and the number of shares a clearing member deposited as margin to be the two most significant factors when making a decision to limit margin credit due to concentration risk. Accordingly, OCC will not give margin credit to clearing member margin deposits of a particular common stock in respect of a particular account when the deposited amount of such common stock is in excess of two times the average daily trade volume of such common stock over the most recent three month period. OCC's systems will continually assess the composition of clearing member margin deposits for each account maintained by the clearing member, including intra-day collateral substitutions in such accounts, to determine if a clearing member has a margin deposit with a concentrated amount of common stock. With respect to a given account, OCC's systems will automatically set appropriate limits on the amount of a particular common stock for which a clearing member may be given margin credit for any one of a its tier accounts. In addition, and with respect to all of a clearing member's accounts, OCC will impose an add-on margin charge if, in aggregate, a clearing member deposits a concentrated amount of a particular common stock as margin across all of its accounts.

The add-on margin charge will operate to negate the margin credit given to the concentrated margin deposit, and will be collected, when applicable, as part of OCC's standard morning margin process. OCC will assess the add-on margin charge across all of a clearing member's accounts on a pro-rata basis (based on the amount of the particular common stock in each of a clearing member's accounts).[7]

According to OCC, OCC staff has been monitoring concentrated common stock positions, assessing the impact of the proposed change described in this filing and contacting clearing members affected by the proposed change. OCC believes that clearing members will be able to comply with the proposed change without making significant changes to their day-to-day business operations. In December 2013, an information memo was posted to inform all members of the upcoming change. According to OCC, since January 2014, OCC staff has been in contact with any clearing member that would be affected by the proposed change. On a weekly basis, any clearing member that would see a reduction of 10% or more of its collateral value is contacted and provided an explanation of the policy and a list of concentrated positions observed in this analysis. On a monthly basis, all clearing members exhibiting any concentration risk are contacted to provide an explanation of the proposed policy and a list of concentrated positions. In both cases, clearing members are encouraged to proactively reduce

7 According to OCC, since a 2-day limit is first checked at each account, it is possible that a clearing member with multiple accounts may have more than 2-days of a given common stock on deposit in aggregate. To control this condition, a final check is done on the aggregate amount of shares held by a clearing member across all of its accounts. For example, if a particular clearing member has three accounts each holding 2-days volume of a specific common stock, the clearing member check would identify that the member was holding six days of volume in aggregate. To mitigate this risk, an add-on charge equal to the market value of four days of volume would be applied to all accounts holding that security on a pro-rata basis.

concentrated positions to conform to the proposed policy. As of June 2014, twenty-five members would be affected. Implementation of the Interpretation would result in disallowing $1.2 billion in collateral value and result in margin calls for six members totaling $710 million. Moreover, in July 2014, OCC made an automated report concerning concentrated margin deposits of common stock available to all clearing members.

c. Wrong-Way Risk

OCC also will use the Interpretation to address the risk that the common stock a clearing member has deposited as margin and which is issued by the clearing member itself or an affiliate of the clearing member will lose value in the event the clearing member providing such margin defaults, which is known as "wrong-way risk." According to OCC, wrong-way risk occurs when a clearing member makes a deposit of common stock issued by it or an affiliate and, in the event the clearing member defaults, the clearing member's common stock margin deposit will also be losing value at the same time because there is likely to be a strong correlation between the clearing member's creditworthiness and the value of such common stock. In order to address wrong-way risk, the Interpretation will implement automated systems that will not give margin credit to a clearing member that deposits common stock issued by such clearing member or an affiliate as margin collateral. OCC will define "affiliate" broadly in the Interpretation to include any entity with direct or indirect equity ownership of 10% of the clearing member, or any entity for which the clearing member holds 10% of the direct or indirect equity ownership.[8]

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8 This standard is based on the provisions of OCC Rule 215(a)(5).

OCC has addressed the impact of the change designed to address wrong-way risk. As of June 2014, there were 73 clearing members whose parent or an affiliate has issued securities trading on U.S. exchanges. As of June 2014, there are six clearing members that would be affected by virtue of having made margin deposits of their own or an affiliate's common stock. In total, these shares equaled $132 million and accounted for less than one half of one percent of the total market value of valued securities pledged as margin at OCC. In July 2014, OCC made information available to each clearing member that indicates which of its deposits of common stock would not receive margin credit under the proposed change due to wrong-way risk considerations, as described above.[9]

d. Deposits That Hedge Open Positions

In addition to the above, OCC also will include language in the Interpretation so that it has discretion to give margin credit to common stock deposited as margin that would otherwise not be given margin credit in circumstances when such common stock acts as a hedge (i.e., the member holds an equivalent short position in cleared contracts on the same underlying security). This condition will be checked in both the account and clearing member level. For example, if a clearing member deposits the common stock of an affiliate as margin collateral, which, pursuant to the above, would ordinarily not be given value for the purposes of granting margin credit, OCC may nevertheless give value to such common stock for the purposes of granting margin credit to the extent such common stock acts as a hedge against open positions of the clearing member. In this case, a decline in the value of the margin deposit would be wholly or partially offset by

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9 OCC believes that by providing such information clearing members will be better able to adjust their margin deposits at OCC to conform to the proposed change if it is approved.

an increase in the value in the open position. Moreover, in such a situation, OCC will systematically limit the margin credit granted to the lesser of a multiple of the daily trading volume or the "delta equivalent position"[10] for the particular common stock, taking into account the hedging position.[11] OCC believes that this policy will further encourage clearing members to deposit margin collateral that hedges their related open positions and is in line with the valuation methods within STANS. This policy will also facilitate OCC's management of its and its participants' credit exposure as well as the liquidation of a clearing member's portfolio should the need arise.

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10 According to OCC, the "delta equivalent position" is the equivalent number of underlying shares represented by the aggregation of cleared products on that same underlying instrument. This value is calculated using the "delta" of the option or futures contract, which is the ratio between the theoretical change in the price of the options or futures contract to the corresponding change in the price of an underlying asset. Thus, delta measures the sensitivity of an options or futures contract price to changes in the price of the underlying asset. For example, a delta of +0.7 means that for every $1 increase in the price of the underlying stock, the price of a call option will increase by $0.70. Delta for an option or future can be expressed in shares of the underlying asset. For example, a standard put option with a delta of -.45 would have a delta of -45 shares, because the unit of trading is 100 shares.

11 Assume, for example, an average daily trade volume of 250 shares, a threshold of 2 times the average daily trade volume, and a delta of -300 shares for the options on a particular security in a particular account. A position of 700 shares that did not hedge any short options or futures would receive credit for only 500 shares (i.e., 2 times the average daily trade volume). If the net long position in the account, when combined with the delta of short option and futures position, were only 400, credit would be given for the entire 700 shares since the delta equivalent position is below the 500 share threshold. However, if the option delta were +300, the net long position would be 1000, and credit would only be given for 500 shares because the delta equivalent position would exceed the 500 share threshold.

e. Other Proposed Changes

OCC also will make certain clarifying changes in order to accommodate the adoption of the Interpretation into its Rules. Primarily, OCC is adding language to OCC Rule 604, Interpretation and Policy .14, to clarify that such Interpretation and Policy concerns OCC's authority to not give value to certain margin deposits for all clearing members (whereas the Interpretation applies to particular clearing member(s)). In addition, OCC is removing language from OCC Rule 604, Interpretation and Policy .14, to improve readability as well as to remove "factors" concerning number of shares and affiliates since OCC's authority with respect to such factors will be more clearly described in the Interpretation. Finally, OCC is renumbering the Interpretations and Policies of Rule 604 in order to accommodate the adoption of the Interpretation.

II. Discussion and Commission Findings

Although the Payment, Clearing and Settlement Supervision Act does not specify a standard of review for an advance notice, the Commission believes its stated purpose is instructive.[12] The stated purpose 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 ("FMU") and strengthening the liquidity of systemically important FMUs.[13]

Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act[14] authorizes the Commission to prescribe risk management standards for the payment,

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12 See 12 U.S.C. 5461(b).

13 Id.

14 12 U.S.C. 5464(a)(2).

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 Payment, Clearing and Settlement Supervision Act [15] 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 has adopted risk management standards under Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act[16] and the Act ("Clearing Agency Standards").[17] The Clearing Agency Standards became effective on January 2, 2013 and establish, among other things, minimum requirements regarding how registered clearing agencies must maintain effective risk management procedures and controls.[18] Therefore, it is appropriate for the Commission to review advance notices against these Clearing Agency Standards and the objectives and principles of these risk management standards

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15 12 U.S.C. 5464(b).

16 12 U.S.C. 5464(a)(2).

17 See Rule 17Ad-22 of the Act. 17 CFR 240.17Ad-22. Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11).

18 See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11).

as described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act.[19]

The proposal in this advance notice is consistent with Clearing Agency Standards, Rule17Ad-22(b)(2) of the Act.[20] Rule 17Ad-22(b)(2) of the Act[21] requires a registered clearing agency that performs central counterparty services to, among other things, establish, implement, maintain and enforce written policies and procedures reasonably designed to use margin requirements to limit its credit exposures to participants under normal market conditions. This proposal is consistent with this rule because it is reasonably designed to permit OCC to use margin requirements to limit its credit exposures to clearing members under normal market conditions in two ways. First, it is reasonably designed to limit OCC's credit exposures to clearing members whose collateral portfolios could present concentration risk. Specifically, it addresses concentration risk by particular clearing member and by particular account by giving OCC discretion to disapprove as margin collateral certain securities, based on the number of shares deposited, by particular clearing member and by particular account, while also considering deposits that hedge open positions. It also clarifies that OCC's existing authority to not give value to certain margin deposits applies to all clearing members, as opposed to particular clearing members.[22] Second, it is reasonably designed to limit

19 12 U.S.C. 5464(b).

20 17 CFR 240.17Ad-22(b)(2).

21 Id.

22 See Rule 604, Interpretation and Policy .15 (providing OCC discretion to disapprove as margin collateral securities that meet certain factors, including trading volume, number of outstanding shareholder, number of outstanding shares, volatility and liquidity).

OCC's credit exposures to clearing members whose collateral portfolios could present wrong-way risk. Specifically, it addresses wrong-way risk presented by clearing members who deposit as margin securities that are issued by the clearing member itself or by an affiliate of the clearing member. It addresses this type of wrong-way risk by giving OCC discretion to disapprove as margin collateral, with respect to a particular clearing member, any security issued by such clearing member or by an affiliate of such clearing member, while also considering deposits that hedge open positions.

Rule 17Ad-22(b)(2) of the Act[23] also requires a registered clearing agency that performs central counterparty services to, among other things, establish, implement, maintain and enforce written policies and procedures reasonably designed to use risk-based models and parameters to set margin requirements. This proposal is consistent with this rule because it permits OCC to use risk-based models and parameters to set margin requirements in a way that takes into account concentration risk and wrong-way risk, as described above.

The proposal in this advance notice meets the objectives and principles described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act.[24] The changes to OCC's margin policy, as described above, are designed to reduce the risk that clearing member margin assets would be insufficient should OCC need to use such assets to close-out positions of a defaulted clearing member. The changes are also designed to facilitate OCC to timely meet its settlement obligations because the change will diminish the likelihood that a large percentage of the value of a defaulting clearing member's

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23 17 CFR 240.17Ad-22(b)(2).

24 12 U.S.C 5464(b); See also 12 U.S.C. 5464(a).

margin assets would not be available to OCC to cover losses in the event of a clearing member default. Therefore, the proposal (i) promotes robust risk management (including risk management of concentration risk and wrong-way risk), (ii) promotes safety and soundness, (iii) reduces systemic risks (including those caused by concentration risk and wrong-way risk), and (iv) supports the stability of the broader financial system.

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Payment, Clearing and Settlement Supervision Act,[25] that the Commission DOES NOT OBJECT to the proposal in OCC's advance notice (SR-OCC-2014-803) and OCC is AUTHORIZED to implement the proposal as of the date of this notice or the date of an order by the Commission approving a proposed rule change that reflects rule changes that are consistent with the proposal in this advance notice (SR-OCC-2014-14), whichever is later.

By the Commission.

Kevin M. O'Neill

Kevin O'Neill
Deputy Secretary

25 12 U.S.C. 5465(e)(1)(I).