SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **May 2015**, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

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

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(71 Documents)

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9764 / May 1, 2015

In the Matter of DEUTSCHE BANK AG	ORDER UNDER RULE 405 OF THE SECURITIES ACT OF 1933, GRANTING A WAIVER FROM BEING AN INELIGIBLE ISSUER

Deutsche Bank AG (the "Company") has submitted a letter, dated April 23, 2015, constituting an application for relief from the Company being considered an "ineligible issuer" under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act of 1933 ("Securities Act"). The Company requests relief from being considered an "ineligible issuer" under Rule 405, due to the entry by DB Group Services (UK) Ltd. ("DBGS") of a plea agreement with the United States Department of Justice on April 23, 2015 ("Plea Agreement"), in which DBGS pleaded guilty to one count of wire fraud, in violation of Title 18, United States Code, Section 1343.

Under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer becomes an ineligible issuer and thus unable to avail itself of WKSI status, if "within the past three years, the issuer or any entity that at the time was a subsidiary of the issuer was convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934." Title 18, United States Code, Section 1343 is included in Section 15(b)(4)(B) of the Exchange Act. Under Paragraph 2 of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.

Based on the facts and representations in the Company's April 20, 2015 request, and assuming DBGS complies with the terms of the Plea Agreement, the Commission has determined that the Company has made a showing of good cause that the Company will not be considered an ineligible issuer by reason of the entry of the Plea Agreement. Accordingly, the relief requested in the Waiver Letter regarding the Company being an ineligible issuer under Rule 405 by reason of the entry of the Plea Agreement is granted, on the condition that that DBGS fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Paragraph two of the definition of ineligible issuer in Rule 405 of the Securities Act, that a waiver from the Company being an ineligible issuer under Rule 405 of the Securities Act is hereby granted.

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. 74867 / May 4, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16524

In the Matter of **Kingsway Capital, Inc.,** **Luvoo Int. Inc., and** **Pacific Clean Water Technologies, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Kingsway Capital, Inc., Luvoo Int. Inc., and Pacific Clean Water Technologies, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Kingsway Capital, Inc. (CIK No. 1368569) is a Delaware corporation located in Fountain Valley, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Kingsway 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.

2. Luvoo Int. Inc. (CIK No. 1401562) is a revoked Nevada corporation located in Tujunga, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Luvoo 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 19, 2008, which reported a net loss of $915,701 for the six months ended June 30, 2007. As of April 27, 2015, the securities of Luvoo (symbol "LUVT") were traded on the over-the-counter market.

3. Pacific Clean Water Technologies, Inc. (CIK No. 1482073) is a forfeited Delaware corporation located in Irvine, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pacific Clean 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, 2013, which reported a net loss of $103,377 for the prior six months. As of April 27, 2015, the securities of Pacific Clean (symbol "PCWT") were traded on the over-the-counter market.

B. DELINQUENT PERIODIC FILINGS

4. 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.

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

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74869 / May 5, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16525

In the Matter of A.B. Watley Group, Inc., Cambridge Heart, Inc., iGenii Inc., and RKO Resources, Inc. (a/k/a Shamika 2 Gold, 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 A.B. Watley Group, Inc., Cambridge Heart, Inc., iGenii Inc., and RKO Resources, Inc. (a/k/a Shamika 2 Gold, Inc.).

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. A.B. Watley Group, Inc. (CIK No. 1035632) 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). A.B. Watley Group is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2005, which reported a net loss of $668,120 for the prior three months. As of April 28, 2015, the company's stock (symbol "ABWG") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Cambridge Heart, Inc. (CIK No. 913443) is a void Delaware corporation located in Foxborough, Massachusetts with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Cambridge Heart 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, 2012, which reported a net loss of $4,231,902 for the prior nine months. As of April 28, 2015, the company's stock (symbol "CAMH") was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. iGenii Inc. (CIK No. 1441573) 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). iGenii 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, 2012, which reported a net loss of $35,939 for the prior nine months. As of April 28, 2015, the company's stock (symbol "IGNI") was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. RKO Resources, Inc. (a/k/a Shamika 2 Gold, Inc.) (CIK No. 1330323) is a defaulted Nevada corporation located in Montreal, Quebec, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). RKO Resources is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2012, which reported a net loss of $3,712,606 from the company's January 13, 2010 inception through September 30, 2012. As of April 28, 2015, the company's stock (symbol "SHMX") was quoted on OTC Link, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74871 / May 5, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-12540

In the Matter of **FRED ALGER MANAGEMENT, INC. AND FRED ALGER & COMPANY, INCORPORATED,** **Respondents.**	**NOTICE OF PROPOSED PLAN OF DISTRIBUTION AND OPPORTUNITY FOR COMMENT**

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

On January 18, 2007, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order") against Fred Alger Management, Inc. and Fred Alger & Company, Incorporated (collectively, "Respondents" or "Alger") (Exchange Act Rel. No. 55118). The Order stated that Respondents allowed market timing and late trading of mutual funds in the Alger Fund Group ("Alger Fund"), which contradicted representations set out in the Statement of Additional Information ("SAI") attached to the Alger Fund's prospectuses that limited shareholders to six exchanges per year. Additionally, Alger failed to disclose that Alger Inc. had entered into numerous arrangements with select investors, including "sticky asset" arrangements, to permit them to time the Alger Fund portfolios. The Order required the Respondents to pay $30,000,000 in disgorgement and $10,000,000 as a civil penalty for a total of $40,000,000, and created a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended.

The Fair Fund has been deposited at the United States Department of the Treasury's Bureau of the Fiscal Service ("BFS") for investment. Other than potential interest income from the BFS investment, the Commission does not anticipate that the Fair Fund will receive additional funds. The assets of the Fair Fund are subject to the continuing jurisdiction and control of the Commission.

OPPORTUNITY FOR COMMENT

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

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

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

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

Comments submitted should include "Administrative Proceeding File No. 3-12540" in the subject line. Comments received will be publicly available. Persons should submit only information that they wish to make publicly available.

DISTRIBUTION PLAN

The Fair Fund is comprised of $40,000,000 in disgorgement and a civil penalty paid by Respondents, plus any accumulated interest and less any federal, state, or local taxes and fees and expenses. The Distribution Plan seeks to distribute to accountholders, in order of priority: (1) a proportionate share of the Fair Fund as compensation for dilution losses they may have suffered as a result of market timing and late trading during the period spanning September 12, 2001 through October 15, 2003, in the Alger Fund portfolios and (2) a proportionate share of advisory fees paid by Alger Fund portfolios that suffered such losses during the period of such market timing and late trading.

The Distribution Plan describes the procedures by which eligible accountholders are identified, the procedures used to calculate the amounts to be paid, and how these amounts will be distributed. Accordingly, eligible accountholders will not need to go through a claims process.

By the Commission.

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74887 / May 6, 2015

Admin. Proc. File No. 3-15544

In the Matter of

DIAN MIN MA,
GANG MA, and
JIN TIAN

ORDER MODIFYING SANCTIONS AND NOTICE THAT INITIAL DECISION, AS MODIFIED, HAS BECOME FINAL

The time for filing a petition for review of the initial decision in this proceeding has expired. No such petition has been filed by Dian Min Ma, Gang Ma, or Jin Tian. The Commission has determined to review the decision on its own initiative for the limited purpose described below.

On February 5, 2015, the administrative law judge issued an initial decision with respect to Dian Min Ma, Gang Ma, and Jin Tian.[1] Among other things, the law judge found that the respondents were in default. The initial decision ordered that: a) pursuant to Section 21C of the Securities Exchange Act of 1934, Dian Min Ma shall cease and desist from committing or causing any violations or future violations of Section 10(b), 13(a), and 13(b)(2)(A) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, 13a-14, 13b2-1, and 13b2-2(a) thereunder; b) pursuant to 21C of the Exchange Act, Gang Ma shall cease and desist from committing, causing, or aiding and abetting any violations or future violations of Sections 10(b), 13(a), and 13(b)(2)(A) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, 13a-14, 13b2-1 and 13b2-2(a) thereunder; c) pursuant to Section 21C of the Exchange Act Jin Tian shall cease and desist from committing, causing, or aiding and abetting any violations of Sections 10(b), 13(a), and 13(b)(2)(A) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, 13b2-1, and 13b2-2(a) thereunder; and d) pursuant to Section 21B of the Exchange Act, Dian Min Ma, Gang Ma, and Jin Tian shall each pay a civil money penalty in the amount of $400,000.

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1 *China Ruitai Int'l Holdings Co., Ltd., Dian Min Ma, Gang Ma, and Jin Tian,* Initial Decision Release No. 742 (Feb. 5, 2015), 110 SEC Docket 16, 2015 WL 468886.

Rule of Practice 155 grants the hearing officer the authority "to determine the proceeding against" a party that defaults "upon consideration of the record, including the order instituting proceedings."[2] The Order Instituting Proceedings in this matter was brought under Section 21C of the Exchange Act,[3] which does not authorize orders to cease and desist from aiding and abetting violations. The law judge therefore did not have authority to order Gang Ma and Jin Tian to cease and desist from aiding and abetting violations.

Accordingly, it is ordered that the administrative law judge's order directing Gang Ma and Tin Jian to cease and desist from aiding and abetting violations be, and hereby is, set aside.

Further, notice is hereby given, pursuant to Rule 360(d) of the Commission's Rules of Practice,[4] that, as modified above, the initial decision of the administrative law judge has become the final decision of the Commission.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

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2 17 C.F.R. § 201.155.

3 15 U.S.C. § 78u-3.

4 17 C.F.R. § 201.360(d).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74893 / May 6, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16428

In the Matter of GLOBAL LEADERSHIP INSTITUTE, INC.	ORDER VACATING INITIAL DECISION AND REMANDING FOR FURTHER PROCEEDINGS

We instituted this administrative proceeding against respondent Global Leadership Institute, Inc. ("Global Leadership") on March 11, 2015 based on its failure timely to make periodic filings required by Section 13(a) of the Securities Exchange Act of 1934 and Rules 13a-1 and 13a-3 thereunder.[1] On April 1, 2015, the law judge issued an initial decision finding Global Leadership in default for failing to file an answer to the Order Instituting Proceedings within ten days of service and revoking the registration of its registered securities.[2] On April 8, 2015, Global Leadership filed an unopposed motion seeking to vacate the initial decision, which raised questions regarding the form and timing of service in this matter.

Based on our consideration of the particular circumstances of this case, we believe that Global Leadership should be afforded an opportunity to file an answer to the OIP. We find that the interests of justice would be served, and the disposition of this matter facilitated, by vacating the March 11 initial decision and scheduling a hearing in this proceeding.[3]

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1 *Global Leadership Institute, Inc.*, Securities Exchange Act Release No. 74471, 2015 WL 1046076 (Mar. 11, 2015) (Order Instituting Administrative Proceedings and Notice of Hearing Pursuant to Section 12(j) of the Securities Exchange Act of 1934).

2 *Global Leadership Institute, Inc.*, Initial Decision Release No. 762, 2015 WL 1456626 (Apr. 1, 2015) (Initial Decision Making Findings and Revoking Registration by Default).

3 *See Michael Lee Mendenhall*, Exchange Act Release No. 74532, 2015 WL 1247374, at *2 (Mar. 19, 2015) (vacating initial decision entered following respondent's failure to oppose motion for summary disposition given concerns regarding service of relevant order).

Accordingly, it is ORDERED that respondent Global Leadership Institute, Inc.'s unopposed motion is GRANTED, and that the initial decision is vacated and that the matter is remanded for further proceedings as set forth herein. It is further ORDERED that the law judge shall issue an initial decision within 120 days from the date of this order.

By the Commission.

Brent J. Fields
Secretary

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9766 / May 6, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74891 / May 6, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15974

In the Matter of NATURAL BLUE RESOURCES, INC., JAMES E. COHEN, and JOSEPH A. CORAZZI	ORDER GRANTING EXTENSION

Chief Administrative Law Judge Brenda P. Murray has moved, pursuant to Commission Rule of Practice 360(a)(3),[1] for an extension of three months to issue the initial decision in these proceedings. For the reasons below, we grant her motion.

On July 16, 2014, we issued an Order Instituting Proceedings against James E. Cohen and Joseph A. Corazzi for their alleged roles in a penny stock offering by Natural Blue Resources, Inc. ("Natural Blue").[2] The order alleges that Cohen and Corazzi orchestrated a fraudulent scheme to secretly operate Natural Blue, a publicly traded company, by calling themselves outside consultants. This arrangement allegedly enabled Cohen and Corazzi to be de facto officers of Natural Blue without disclosing their own criminal and regulatory violations to potential investors. The OIP contends that Cohen and Corazzi used Natural Blue to obtain money and significant shares of stock, while making decisions that resulted in Natural Blue generating no revenue and engaging in no viable business operations. Because of this alleged

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1 17 C.F.R. § 201.360(a)(3).

2 *Natural Blue Res., Inc.*, Securities Exchange Act Release No. 72617, 2014 WL 3491568 (July 16, 2014). The law judge issued an initial decision by default against Natural Blue on November 26, 2014, for failing to file an answer or otherwise defend the proceeding. In doing so, the law judge ordered Natural Blue to cease and desist from violations of the antifraud and reporting provisions of the federal securities laws and to pay a civil penalty of $130,000. *Natural Blue Res., Inc.*, Initial Decision Release No. 710, 2014 WL 6680118, at *3 (Nov. 26, 2014). The Commission issued an order that the default decision had become final as to Natural Blue on January 7, 2015.

misconduct, the OIP asserts that Cohen and Corazzi violated Securities Act Sections 17(a)(1) and 17(a)(3),[3] Exchange Act Section 10(b),[4] and Exchange Act Rules 10b-5(a) and 10b-5(c).[5]

The initial decision in these proceedings is currently due by May 18, 2015. In seeking an extension of that deadline, Chief Judge Murray represents that the administrative law judge assigned to this matter, Judge Carol Fox Foelak, held seven days of hearings in this matter in February 2015, but that, "[d]ue to a family emergency, Judge Foelak has had to be out of the office for an extended time, and it will not be possible for her to prepare the Initial Decision by the original due date." Chief Judge Murray adds that "Judge Foelak estimates she will need an additional three months to prepare the Initial Decision."

We adopted Rule of Practice 360(a) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for issuance of an initial decision.[6] That rule provides for extensions of those deadlines under certain circumstances if supported by a motion from the Chief Administrative Law Judge and if we determine, as we do here, that "additional time is necessary or appropriate in the public interest."[7]

Accordingly, it is ORDERED that the deadline for filing the initial decision in these proceedings is extended to August 18, 2015.

By the Commission.

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

[3] 15 U.S.C. § 77q(a)(1) and (3).

[4] *Id.* § 78j(b).

[5] 17 C.F.R. § 240.10b-5(a) and (c).

[6] *See Adopting Release*, Exchange Act Release No. 48018, 2003 WL 21354791, at *2 (June 11, 2003) ("[T]he Commission has determined that timely completion of proceedings can be achieved more successfully through the adoption of mandatory deadlines and procedures designed to meet these deadlines.").

[7] 17 C.F.R. § 201.360(a)(3).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9765 / May 6, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74883 / May 6, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4077 / May 6, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31594 / May 6, 2015

Admin. Proc. File No. 3-15967

In the Matter of LAWRENCE M. LABINE	ORDER GRANTING EXTENSION

Chief Administrative Law Judge Brenda P. Murray has moved, pursuant to Commission Rule of Practice 360(a)(3),[1] for an extension of 300 days to issue the initial decision in this proceeding. As discussed below, we grant her motion.

On July 8, 2014, we issued an Order Instituting Administrative and Cease-and-Desist Proceedings against Lawrence M. LaBine, formerly an investment adviser representative and a registered representative associated with DeWaay Advisory, LLC and DeWaay Financial Network, Inc., an investment advisory firm and brokerage firm.[2] The OIP alleges that, in 2008 and 2009, LaBine violated federal securities anti-fraud provisions by, among other things, selling to more than 100 of his advisory and brokerage customers "an alternative investment in a class of debt securities issued by a start-up company named Domin-8 Enterprise Solutions, Inc." without disclosing material information. Specifically, the OIP alleges that LaBine failed to disclose that: (1) his expected compensation for those sales included warrants to purchase shares in the Company; (2) LaBine was the principal fundraiser for Domin-8, which was depending "almost exclusively on LaBine" to raise its operating capital; (3) LaBine's ability to sell the debentures to his clients "was the only thing keeping the Company afloat;" and (4) he misrepresented the risk

[1] 17 C.F.R. § 201.360(a)(3).

[2] *Lawrence M. LaBine*, Securities Exchange Act Release No. 72562, 2014 WL 3101428 (July 8, 2014).

of loss to the clients by, among other things, telling clients that the investment was "safe and that they would get all of their investment back if something went wrong."[3]

On November 12, 2014, an administrative law judge stayed the proceeding pursuant to Rule of Practice 161(c)(2), pending the Commission's consideration of LaBine's settlement offer.[4] Chief Judge Murray states that, on April 7, 2015, her office was informed that the Commission had rejected the settlement offer, causing the stay to lapse.[5] According to Chief Judge Murray's motion, the initial decision in these proceedings is due by mid-May 2015. In her motion, Chief Judge Murray asserts that "[b]ecause this proceeding was stayed before any substantive matters materialized, the proceeding will now start essentially anew." She therefore requests a 300-day extension, accruing from April 8, 2015.

We adopted Rule of Practice 360(a) to enhance the timely and efficient adjudication and disposition of Commission administrative proceedings by setting deadlines for issuance of an initial decision.[6] That rule provides, however, for deadline extensions under certain circumstances if supported by a motion from the Chief Administrative Law Judge and if it appears, as here, that "additional time is necessary or appropriate in the public interest."[7]

Accordingly, IT IS ORDERED that the deadline for filing the initial decision in this proceeding is extended to February 2, 2016.

By the Commission.

Brent J. Fields
Secretary

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

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3 The OIP specifically alleges that LaBine willfully violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Sections 206(1) and 206(2) of the Investment Advisers Act of 1940.

4 *See* 17 C.F.R. § 201.161(c)(2) (allowing the hearing officer to stay a proceeding pending Commission consideration of a settlement offer).

5 *See* 17 C.F.R. § 201.161(c)(2)(ii) (stating that, if the Commission rejects a settlement offer, "the hearing officer must be promptly notified and, upon notification of the hearing officer, the stay shall lapse and the proceeding will continue").

6 *See Adopting Release*, Exchange Act Release No. 48018, 2003 WL 21354791, at *2 (June 11, 2003) ("[T]he Commission has determined that timely completion of proceedings can be achieved more successfully through the adoption of mandatory deadlines and procedures designed to meet these deadlines.").

7 17 C.F.R. § 201.360(a)(3).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74892; File No. 4-657)

May 6, 2015

Joint Industry Plans; Order Approving the National Market System Plan to Implement a Tick Size Pilot Program by BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc., NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, The Nasdaq Stock Market LLC, New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc., as Modified by the Commission, For a Two-Year Period

I. Introduction

On August 25, 2014, NYSE Group, Inc., on behalf of BATS Exchange, Inc., BATS Y-Exchange, Inc., Chicago Stock Exchange, Inc., EDGA Exchange, Inc., EDGX Exchange, Inc., Financial Industry Regulatory Authority, Inc. ("FINRA"), NASDAQ OMX BX, Inc., NASDAQ OMX PHLX LLC, the Nasdaq Stock Market LLC, New York Stock Exchange LLC, NYSE MKT LLC, and NYSE Arca, Inc., (collectively "SROs" or "Participants"), filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 11A of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 608 thereunder,[2] a proposed national market system ("NMS") Plan to Implement a Tick Size Pilot Program on a one-year basis ("NMS plan").[3] The Participants filed the NMS plan to comply with an order issued by the Commission on June 24, 2014 ("June 2014 Order").[4] The NMS plan, which included the details of Participants' proposal of the Tick Size Pilot Program ("Tick Size Pilot"), was published for comment in the Federal

1 15 U.S.C. 78k-1.

2 17 CFR 242.608.

3 See Letter from Brendon J. Weiss, Vice President, Intercontinental Exchange, Inc., to Secretary, Commission, dated August 25, 2014.

4 See Securities Exchange Act Release No. 72460 (June 24, 2014), 79 FR 36840 (June 30, 2014).

Register on November 7, 2014.[5] The Commission received 77 comment letters in response to the NMS plan.[6] On February 26, 2015, the Commission extended the deadline for Commission

5 See Securities and Exchange Act Release No. 73511 (November 3, 2014), 79 FR 66423 ("Notice").

6 See Letters from John Richardson, dated August 26, 2014 ("Richardson Letter"); Arthur T. Ling, dated August 26, 2014 ("Ling Letter"); Dan Blecha, dated August 26, 2014 ("Blecha Letter"); Tom Sosnoff, dated August 27, 2014 ("Sosnoff Letter"); Michael Choffy, dated August 28, 2014 ("Choffy Letter"); Joseph Runsdorf, dated August 29, 2014 ("Runsdorf Letter"); Tony J. Gagliano, dated September 1, 2014 ("Gagliano Letter I"); Howard L. Greenblatt, dated September 2, 2014 ("Greenblatt Letter"); Ernest Callipari, dated September 2, 2014 ("Callipari Letter"); Ali Bangura, dated September 3, 2014 ("Bangura Letter"); Tony J. Gagliano, dated September 3, 2014 ("Gagliano Letter II"); Theodore R. Lazo, Managing Director and Associate General Counsel of Securities Industry and Financial Markets Association ("SIFMA"), dated September 9, 2014 ("SIFMA Letter I"); John C. Nagel, Managing Director and Sr. Deputy General Counsel of Citadel, LLC, dated September 12, 2014 ("Citadel Letter I"); Christopher Nagy, CEO, and Dave Lauer, President, KOR Group LLC, dated September 15, 2014 ("KOR Letter I"); Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel of Managed Funds Association, dated September 20, 2014 ("MFA Letter I"); John Daley, Chairman of the Board and James Toes, President & CEO of Security Traders Association, dated September 23, 2014 ("STA Letter I"); Brian A. Johnson, Executive Director for Research of Committee on Capital Markets Regulation, dated September 26, 2014 ("CMR Letter I"); Jeffrey P. Ricker, dated October 6, 2014 ("Ricker Letter"); David Adorney, Professional Equity Trader, dated November 11, 2014 ("Adorney Letter"); Richard B. Gorelick, CEO of RGM Advisors, LLC, dated November 13, 2014 ("RGM Letter"); Representative Sean P. Duffy, U.S. House of Representatives, dated November 17, 2014 ("Duffy Letter"); Joseph Galinskie, dated November 18, 2014 ("Galinskie Letter"); Tom Quaadman, Vice President, U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, dated November 20, 2014 ("CCMC Letter I"); David Shields, Vice Chairman & Co-CEO, Wellington Shields & Co., dated December 2, 2014 ("Wellington Shields Letter"); Dave Weild, Chairman & CEO, IssuWorks, Inc., dated December 3, 2014 ("IssuWorks Letter"); Tim Quast, President, ModernNetworks IR, LLC, dated December 8, 2014 ("ModernNetworks Letter"); Larry Tabb, Founder & CEO, Tabb Group, dated December 10, 2014 ("Tabb Letter"); John Endean, President, American Business Conference, dated December 12, 2014 ("ABC Letter"); Scott Kupor, Managing Partner, Andreessen Horowitz and Jeffrey M. Solomon, CEO Cowen and Company; Equity Capital Formation Task Force, dated December 18, 2014 ("ECFTF Letter"); Eduardo A. Repetto, Co-Chief Executive Officer and Co-Chief Investment Officer, Dimensional Fund Advisors, dated December 18, 2014 ("DFA Letter"); Sal Arnuk and Joseph Saluzzi, Partners and Co-Founders, Themis Trading, LLC, dated December 19, 2014 ("Themis Letter"); Simon D. Yates, CEO, Two Sigma Securities, LLC, dated December 19, 2014 ("Two Sigma Letter"); Mortimer J. Buckley, Managing

Director and Chief and Investment Officer, The Vanguard Group, Inc., dated December 19, 2014 ("Vanguard Letter"); Rob Flatley, CEO and Dave Weisberger, MD, Head of Market Structure Analysis, CoreOne Technologies LLC, submitted December 19, 2014 ("CoreOne Letter"); Alan F. Hill, CEO and William K. Jones, Executive Chairman, JonesTrading Institutional Services LLC, dated December 19, 2014 ("JonesTrading Letter"); R. Glenn Hubbard, Co-Chair, John L. Thornton, Co-Chair and Hal S. Scott, Director, Committee on Capital Markets Regulation, dated December 19, 2014 ("CMR Letter II"); John Daley, Chairman of the Board and James Toes, President & CEO, Security Traders Association, dated December 19, 2014 ("STA Letter II"); John McCarthy, General Counsel, KCG Holdings, Inc., dated December 19, 2014 ("KCG Letter"); Douglas A. Cifu, Chief Executive Officer, Virtu Financial, dated December 19, 2014 ("Virtu Letter"); E. Cartier Esham, Executive Vice President, Emerging Companies, Biotechnology Industry Organization, dated December 22, 2014 ("BIO Letter"); Micah Hauptman, Financial Services Counsel, Consumer Federation of America, dated December 22, 2014 ("CFA Letter"); Bobby Franklin, President & CEO, National Venture Capital Association, dated December 22, 2014 ("NVCA Letter"); Eric Swanson, General Counsel and Secretary, BATS Global Markets, Inc. dated December 22, 2014 ("BATS Letter"); Theodore R. Lazo, Managing Director and Associate General Counsel, SIFMA, dated December 22, 2014 ("SIFMA Letter II"); Daniel G. Weaver, PhD, Professor of Finance, Director, Master of Financial Analysis Program, Associate Director, Whitcomb Center for Research in Financial Services, Rutgers, The State University of New Jersey, dated December 22, 2014 ("Weaver Letter"); Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, Managed Funds Association, dated December 22, 2014 ("MFA Letter II"); Kurt N. Schacht, Managing Director and James C. Allen, Head, CFA Institute, dated December 22, 2014 ("CFA Institute Letter"); Robert J. McCarthy, Director of Regulatory Policy, Wells Fargo Advisors, LLC, dated December 22, 2014 ("Wells Fargo Letter"); Daniel Keegan, Managing Director, Head of Equities for the Americas, Citigroup Global Markets Inc., dated December 22, 2014 ("Citigroup Letter"); Richie Prager, Managing Director; Hubert DeJesus, Managing Director; Supurna Vedbrat, Managing Director; Joanne Medero, Managing Director, BlackRock, Inc., dated December 22, 2014 ("BlackRock Letter"); Adam Sussman, Head of Market Structure, Liquidnet, Inc., dated December 22, 2014 ("Liquidnet Letter"); Manisha Kimmel, Managing Director, Financial Information Forum, dated December 22, 2014 ("FIF Letter"); Tom Quaadman, Vice President, U.S. Chamber of Commerce, Center for Capital Markets Competitiveness, dated December 22, 2014 ("CCMC Letter II"); Ari Burstein, Senior Counsel, Investment Company Institute, dated December 22, 2014 ("ICI Letter"); Jeff Brown, Senior Vice President, Legislative and Regulatory Affairs, Charles Schwab & Co., Inc., dated December 22, 2014 ("Schwab Letter"); Kimberly Unger, CEO and Executive Director, Security Traders Association of New York, dated December 22, 2014 ("STANY Letter"); Scott C. Goebel, Senior Vice President & General Counsel, Fidelity Management & Research Co., dated December 22, 2014 ("Fidelity Letter"); Dennis Dick, CFA, Head, Equity Market Structure, Bright Trading LLC, dated December 22, 2014 ("Bright Trading Letter"); Raymond M. Tierney III, President and Chief Executive Officer, Gary Stone, Chief Strategy Officer, Bloomberg Tradebook LLC dated action on the NMS plan and designated May 6, 2015 as the new date by which the Commission would be required to take action.[7] This order approves the NMS plan, as modified by the Commission, for a two-year period. A copy of the NMS plan, as modified by the Commission, is attached as Exhibit A hereto.

II. Background

Since the inception of decimalization[8] in 2001, there has been a significant shift in the nature of trading, the structure of the markets, and the roles of market participants. In the context

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December 22, 2014 ("Bloomberg Letter"); Mao Ye, Assistant Professor of Finance, University of Illinois, Urbana-Champaign, dated December 22, 2014 ("Ye Letter"); Paul J. Jiganti, Managing Director, Market Structure and Client Advocacy and John S. Markle, Deputy General Counsel – Retail and Clearing Operations, TD Ameritrade, Inc., dated December 22, 2014 ("TD Ameritrade Letter"); James J. Angel, Ph.D., CFA, Associate Professor of Finance, Georgetown University dated December 22, 2014 ("Angel Letter"); Christopher Nagy and Dave Lauer, KOR Group, LLC dated December 22, 2014 ("KOR Letter II"); James G. Ongena, General Counsel, Chicago Stock Exchange, Inc., dated December 22, 2014 ("CHX Letter"); Andrew Stevens, General Counsel, IMC Financial Markets, dated December 30, 2014 ("IMC Letter"); Michael Jacejko, Chief Executive Manager, Birch Bay Capital, LLC, dated December 31, 2014 ("Birch Bay Letter"); James P. Selway III, Managing Director, Head of Electronic Brokerage, ITG Inc., dated January 5, 2015 ("ITG Letter"); John C. Nagel, Managing Director & Sr. Deputy General Counsel, Citadel LLC, dated January 5, 2015 ("Citadel Letter II"); Thomas Wittman, Executive Vice President, The NASDAQ OMX Group, LLC, dated January 16, 2015 ("Nasdaq Letter"); Brendon J. Weiss, Co-Head Government Affairs, NYSE, LLC, dated January 16, 2015 ("NYSE Letter"); Senators Mark R. Warner and Pat Toomey, The United States Senate, dated January 23, 2015 ("Warner-Toomey Letter"); Daniel Zinn, General Counsel, OTC Markets Group Inc., dated February 24, 2015 ("OTC Markets Letter"); Jared Albert, dated March 10, 2015 ("Albert Letter"); Representative Juan Vargas, U.S. House of Representatives, dated March 27, 2015 ("Vargas Letter"); and Atsushi Saito, Director and Representative Executive Officer, Group CEO, Japan Exchange Group, Inc., received April 17, 2015 ("Saito Letter"). The Commission received two comment letters after the June 2014 Order was issued and before the proposed NMS plan was submitted. These comment letters are included in the comment file with the other comment letters received in response to the NMS plan. See also Letters from Shawn Leary, dated August 24, 2014 ("Leary Letter"); and Tony BenBrahim, dated August 24, 2014 ("BenBrahim Letter").

7 See Securities and Exchange Act Release No. 74388, 80 FR 12054 (March 5, 2015).

8 Decimalization refers to setting the tick size at penny increments. A tick is the minimum

of decimalization, market participants and others have raised concerns that the shift to quoting and trading in the one penny minimum price variation may have had a detrimental impact on the market quality for securities of small and middle capitalization companies. For example, a few studies issued after the implementation of decimalization raised questions regarding whether decimalization has reduced incentives for underwriters to pursue public offerings of smaller companies, limited the production of sell-side research for small and middle capitalization companies and made it less attractive to become a market maker in the shares for smaller companies.[9]

In 2012, the Jumpstart Our Business Startups Act ("JOBS Act")[10] directed the Commission to conduct a study and report to Congress on how decimalization affected the number of initial public offerings ("IPOs"), and the liquidity and trading of securities of smaller capitalization companies.[11] The JOBS Act also provided that the Commission could, by rule, designate a minimum increment for the securities of emerging growth companies[12] that is greater than $0.01 but less than $0.10 for use in all quoting and trading of securities in any exchange or

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pricing increment that can be used to trade securities. Prior to 2001, securities in the U.S. equity markets were generally quoted and traded in fractional tick sizes, ranging from $1/32 or $1/64 for low-priced securities to $1/8 or $1/4 for higher-priced securities.

9 See June 2014 Order, supra note 4, for a complete discussion of the background on decimalization.

10 Jumpstart Our Business Startups Act, Pub. L. No. 112-106, 126 Stat. 306 (2012).

11 Section 106(b) of the JOBS Act. 15 U.S.C. 78k-1(c)(6).

12 An "emerging growth company" is defined in the Securities Act of 1933 ("Securities Act") and the Act as an issuer with total annual gross revenues of less than $1 billion during its most recently completed fiscal year. See Section 2(a)(19) of the Securities Act and Section 3(a)(80) of the Act.

other execution venue, if the Commission determined that such securities should be quoted and traded using a minimum increment of greater than $0.01.[13]

The Commission submitted the staff study to Congress in July 2012 ("Decimalization Report").[14] The Decimalization Report did not reach any firm conclusions about the impact of decimalization on the number of IPOs or the liquidity and trading of the securities of small capitalization companies.[15] However, based on the information considered in the Decimalization Report, staff recommended that "[t]he Commission should not proceed with the specific rulemaking to increase tick sizes, as provided for in Section 106(b) of the JOBS Act, but should consider additional steps that may be needed to determine whether rulemaking should be undertaken in the future."[16] The Decimalization Report suggested a public roundtable, where recommendations could be presented on a pilot program that would generate data to allow the Commission to further assess decimalization's impact.

The Commission staff convened a Decimalization Roundtable, in February 2013, with broad participation from market participants, academics and others, including an issuer representative. Many panelists believed that factors other than decimalization were more significant contributors to the decline of IPOs in recent years. Although participants offered diverging views on the likely outcome of any increase in the minimum tick size, there was broad support among the panelists for the Commission to conduct a pilot program to gather further information, particularly with respect to the impact of wider tick sizes on liquidity in the

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13 Id.

14 Report to Congress on Decimalization (July 2012) available at http://www.sec.gov/news/studies/2012/decimalization-072012.pdf.

15 See Decimalization Report supra note 13. See also June 2014 Order supra note 4 (describing the Decimalization Report).

16 Id.

securities of small capitalization companies. Some panelists, however, expressed concern about the potential costs to investors of wider minimum tick sizes.[17]

In June 2014, the Commission issued the June 2014 Order, pursuant to Section 11A(a)(3)(B) of the Act,[18] directing the Participants to act jointly in developing and filing with the Commission an NMS plan to implement a pilot program that, among other things, would widen the quoting and trading increment for certain small capitalization stocks.[19] The Commission issued the June 2014 Order to further study and assess the impact of decimalization on the securities of small capitalization companies. Pursuant to the June 2014 Order, on August 25, 2014, the Participants filed the proposed NMS plan.[20]

As discussed in detail throughout this order, the Commission believes that the Tick Size Pilot, as reflected in the proposed NMS plan, and subject to the modifications prescribed by the Commission, should support further examination and analysis on the impact of tick sizes on the trading and liquidity of the securities of small capitalization companies. The Commission believes that altering tick sizes could result in significant market-wide benefits and improvements to liquidity and capital formation. Yet, as discussed in detail below, these changes could also impose costs, including on investors resulting from larger spreads. Because of the potential significance of the benefits and costs, as well as the uncertainty that currently exists about the likely outcome of changing tick sizes, the Commission believes it is appropriate to test these important issues in a way that can produce robust results that informs future policy

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17 Information about the Decimalization Roundtable, including the transcript, comment letters and list of panelists is available at http://www.sec.gov/spotlight/decimalization.shtml.

18 15 U.S.C. 78k-1(a)(3)(B).

19 See June 2014 Order supra note 4.

20 See NMS plan supra note 3.

making. The Tick Size Pilot is therefore, by design, an objective, data-driven test that is designed to evaluate how a wider tick size would impact trading, liquidity, and market quality of securities of smaller capitalization companies. The Commission believes that the Tick Size Pilot, as now constructed, is necessary to provide for a test that can produce robust results that will allow the Commission to effectively test the potential benefits and costs of permanently changing tick sizes for smaller capitalization stocks.

The Commission believes that the potential magnitude of the benefits that would be revealed by the Tick Size Pilot justify the costs of running these tests. The effect of wider tick sizes for small capitalization stocks on trading, liquidity, and market quality is not clear and the Tick Size Pilot will provide data to analyze any such effects. A wider tick size for small capitalization stocks may change the composition of market participants for these stocks as well as the behavior of market participants. The wider tick size may incentivize market makers to increase their market making activities in these stocks. This, in turn, may attract more investors and with increased interest in those stocks, trading activity may increase, which may also improve liquidity and market quality. There are many interconnected dimensions to trading, liquidity, and market quality. If a wider tick size leads to more active market making and attracts more investors to small capitalization stocks, we may observe positive effects on trading, liquidity, and market quality as measured by metrics such as trading volume, displayed depth, effective spreads, or execution costs for small and large trades.

Improved liquidity and market quality would be desirable for any stock, but would be particularly beneficial for small capitalization stocks because these stocks tend to be difficult and/or expensive to trade, which may discourage investment. Were there to be improved liquidity, investors and issuers would benefit. Investors would benefit because it would be easier and less expensive for them to trade in these stocks. Issuers would benefit from improved liquidity and market quality in two ways. First, more trading activity and investor attention may make an issuer's stock more attractive, which may reduce the company's cost of capital as well as increase their opportunities to raise capital. Second, improved liquidity may reduce an issuer's cost of capital because stocks with higher liquidity tend to have lower cost of capital. Consequently, improved liquidity may reduce liquidity risk and translate into lower cost of capital.[21] We expect these benefits would manifest during the Pilot Period if they are in fact present.

The Commission, however, recognizes that these benefits may not manifest in the manner or to the extent anticipated. And, as noted above, we cannot know in advance the full effects, whether they be positive or negative, of a wider tick size on the market behavior of market participants in response to the Tick Size Pilot. As discussed in detail below, the Commission has seriously considered the concerns about costs that implementation of the Tick Size Pilot would create for market participants and the complexity of the Tick Size Pilot, and has tried to mitigate both where possible without undermining the objectives of the Tick Size Pilot. The Commission nevertheless believes that incurring the costs of the Tick Size Pilot is appropriate in these circumstances. The Tick Size Pilot will provide the Commission and interested parties with real-world data regarding the effect of wider tick sizes on trading, liquidity and market quality for small-capitalization companies, and this empirical data will inform analyses and potential future

[21] See, e.g., Amihud, Y., Mendelson, H., Asset pricing and the bid-ask spread, 17 Journal of Financial Economics 223, (1986); Easley, D., Hvidkjaer, S. O'Hara, M., Is Information Risk a Determinant of Asset Returns?, 57 Journal of Finance 2185 (2002); Easley, D., O'Hara, M., Information and the Cost of Capital, 59 Journal of Finance 1553 (2004); Acharya, V., Pedersen, L., Asset Pricing with Liquidity Risk, 77 Journal of Financial Economics 375 (2005).

regulatory actions to, among other things, capture any benefits from wider tick sizes on a permanent basis.[22]

Therefore, the Commission finds that the NMS plan is necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanism of, a national market system, or otherwise in furtherance of the purposes of the Act.

III. Description of the Proposed NMS Plan and the Tick Size Pilot

The NMS plan filed by the Participants contained provisions to implement the Tick Size Pilot,[23] including provisions related to the administration and operation of the Tick Size Pilot, the data to be collected and made public, and the specific assessments to be conducted by the Participants. In this section, the proposed NMS plan is described, and further below there is discussion and analysis of the comments received and the NMS plan, as approved with Commission modifications.

A. Criteria for Pilot Securities

Section V of the NMS plan sets forth five criteria for selection of NMS common stocks[24] that would be included in the Tick Size Pilot ("Pilot Securities"). The five criteria for

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22 The Commission notes that certain commenters believed that the Tick Size Pilot could provide valuable data and should be studied notwithstanding its potential costs. See Tabb Letter at 8; CFA Institute Letter at 2; CHX Letter at 17; Nasdaq Letter at 5-6; and NYSE Letter at 3.

23 See NMS plan supra note 3.

24 The NMS plan defines NMS common stock as an NMS stock that is common stock of an operating company. See NMS plan Section (I)(Q). NMS stock means any NMS security other than an option. See 17 CFR 242.600(b)(47). NMS security means any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options. See 17 CFR 242.600(b)(46).

determining the Pilot Securities are: (1) a market capitalization[25] of $5 billion or less on the last day of the Measurement Period;[26] (2) a Closing Price[27] of at least $2.00 on the last day of the Measurement Period; (3) a Closing Price on every U.S. trading day during the Measurement Period that is not less than $1.50; (4) a Consolidated Average Daily Volume ("CADV")[28] during the Measurement Period of one million shares or less; and (5) a Measurement Period Volume-Weighted Average Price ("VWAP")[29] of at least $2.00. Further, the Participants proposed that an NMS common stock for an issuer that had its IPO within 6 months of the start of the Pilot Period would not be eligible to be a Pilot Security.

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25 The NMS plan calculates market capitalization by multiplying the total number of shares outstanding on such day by the Closing Price of the security on such date. See NMS plan Section (V)(A)(1).

26 The NMS plan defines Measurement Period as the U.S. trading days during the three calendar month period ending at least 30 days prior to the effective date of the Pilot Period. See NMS plan Section (I)(N). The NMS plan defines Pilot Period as the operative period of the Tick Size Pilot, lasting one year from the date of implementation. See NMS plan Section (I)(U). As discussed further below, in response to comments and after additional consideration, the Commission has modified the market capitalization threshold to lower it to $3 billion or less. In addition, as discussed further below, in response to comments and after additional consideration, the Commission has modified the definition of Pilot Period to extend the duration of the Tick Size Pilot to two years. See infra Section V.B.

27 The NMS plan defines Closing Price as the closing auction price on the primary listing exchange or if not available, the last regular-way trade reported by the processor prior to 4:00 p.m. ET. See NMS plan Section (I)(H). The NMS plan defines processor as the single plan processor responsible for the consolidation of information for an NMS stock pursuant to Rule 603(b) of Regulation NMS. See NMS plan Section (I)(Y).

28 The NMS plan calculates CADV by adding the single-counted share volume of all reported transactions in the Pilot Security during the Measurement Period and dividing by the total number of U.S. trading days during the Measurement Period. See NMS plan Section (V)(A)(4).

29 The NMS plan calculates the Measurement Period VWAP by calculating the volume-weighted average price for each U.S. trading day during the Measurement Period, summing the daily volume-weighted average price across the Measurement Period, and dividing by the total number of U.S. trading days during the Measurement Period. See NMS plan Section (V)(A)(5).

B. Assignment of Pilot Securities

As proposed in the NMS plan, the Tick Size Pilot would consist of three Test Groups, with each Test Group consisting of 400 Pilot Securities. The Pilot Securities that are not placed in the Test Groups would be placed in the Control Group.

The Operating Committee[30] of the NMS plan would oversee the process of assigning the Pilot Securities into the Control Group and the three Test Groups. First, the Pilot Securities would be placed into a maximum of 27 categories by means of a stratified random sampling process. Each Pilot Security would be categorized as: (1) low, medium, or high share price based on the Measurement Period VWAP; (2) low, medium, or high market capitalization based on the last day of the Measurement Period; and (3) low, medium, or high trading volume based on the CADV during the Measurement Period. Each category (share price, market capitalization, trading volume) would then be divided into three sub-categories, each containing a third of the securities in the category. This process would yield 27 categories. However, if a single category contained fewer than ten securities, such category would be combined with another category that contains at least ten securities. If two or more categories contained fewer than ten securities each, those categories would be combined, provided that the combined category contains at least ten securities. If the combined category contains fewer than ten securities, then such category would be combined with another of the 27 categories that contains at least ten securities.

After the categories are finalized, the Pilot Securities would then be randomly selected from each category to be included in the three Test Groups, based on the percentage of Pilot Securities in such category. Each category would be represented in all three Test Groups based

30 See NMS plan Section (III)(C) on the composition of the Operating Committee. Each Participant will have one individual staff member to represent the Participant on the Operating Committee.

on the category's relative proportion to the population of Pilot Securities. Similarly, a primary listing exchange's securities would be selected from each category and included in the three Test Groups.

Each primary listing exchange would, free of charge, make publicly available on its website the list of Pilot Securities that are listed on such exchange and that are included in the Control Group and Test Groups. Appendix A to the NMS plan provides the specific details about the data that each exchange would make available on its website to identify the Pilot Securities.

C. Control Group and Test Groups

As noted above, the Tick Size Pilot would contain a Control Group and three Test Groups, each of which has incrementally different quoting and trading requirements.

1. Control Group

Pilot Securities in the Control Group would continue to be quoted and traded at any price increment currently permitted.

2. Test Group One: Widened Quote Increment

Pilot Securities in Test Group One would have a quoting increment of $0.05 but could continue to trade at any currently permitted price increment. The Participants would be required to adopt rules that would prohibit the Participants or any member of a Participant from displaying, ranking, or accepting from any person any displayable or non-displayable bids or offers, orders, or indications of interest in increments other than $0.05. Orders priced to execute based on the midpoint and orders entered in a Participant-operated retail liquidity program[31] could be ranked and accepted in increments of less than $0.05.

3. Test Group Two: Widened Quote and Trade Increment

Pilot Securities in Test Group Two would have the same quoting increment as Test Group One ($0.05) along with the applicable quoting exceptions, but could only be traded in $0.05 minimum increments. The Participants would be required to adopt rules that prohibit trading centers operated by the Participants and members of the Participants from executing orders in any Pilot Security in Test Group Two in price increments other than $0.05. The $0.05 trading increment would apply to all trades, including brokered cross trades, absent an exception.

Three exceptions to the $0.05 trading increment would be applicable. First, trading could occur at the midpoint of the National Best Bid ("NBB") and the National Best Offer ("NBO" and together with NBB, "NBBO"),[32] or the midpoint of the best protected bid and the best protected offer.[33] Second, Retail Investor Orders[34] could be executed with price improvement of at least $0.005 better than the best protected bid or the best protected offer. Finally, Negotiated Trades[35] could trade in increments less than $0.05.

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31 See NASDAQ OMX BX Rule 4780; BATS Y Rule 11.24; NYSE Rule 107C; NYSE MKT – Equities Rule 107C and NYSE Arca Equities Rule 7.44.

32 See 17 CFR 242.600(b)(42).

33 See 17 CFR 242.600(b)(57).

34 See NMS plan Section (I)(DD) (defining Retail Investor Order as "an agency order or a riskless principal order originating from a natural person, provided that, prior to submission, no change is made to the terms of the order with respect to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology. The Participant that is the DEA of a member of a Participant operating a trading center executing a Retail Investor Order will require such trading center to sign an attestation that substantially all orders to be executed as Retail Investor Orders will qualify as such under the [NMS] [p]lan").

35 See NMS plan Section (I)(P) (defining Negotiated Trades as "(i) a Benchmark trade,

4. Test Group Three: Widened Quote and Trade Increment with a Trade-At Prohibition

Pilot Securities in Test Group Three would be subject to the same quoting and trading increments as those in Test Group Two as well as the same exceptions. However, the trading of these securities would also be subject to a trade-at prohibition.[36] The trade-at prohibition, as defined under the NMS plan, would "(1) prevent a trading center that was not quoting from price-matching protected quotations and (2) permit a trading center that was quoting at a protected quotation to execute orders at that level, but only up to the amount of its displayed size" ("Trade-At Prohibition"). Specifically, the Participants would be required to adopt rules

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including, but not limited to, a VWAP trade or a Time-Weighted Average Price trade, provided that, if such trade is composed of two or more component trades, each component trade complies with the quoting and trading increment requirements of the [NMS] [p]lan, or with an exception to such requirements, or (ii) a Pilot Qualified Contingent Trade."). The NMS plan defines a Benchmark trade as "the execution of an order at a price that was not based, directly or indirectly, on the quoted price of a Pilot Security at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made." See NMS plan Section (I)(C). The NMS plan defines Pilot Qualified Contingent Trade as "a transaction consisting of two or more component orders, executed as agent or principal, where: (1) at least one component order is in an NMS common stock; (2) all components are affected with a product or price contingency that either has been agreed to by the respective counterparties or arranged for by a broker-dealer as principal or agent; (3) the execution of one component is contingent upon the execution of all other components at or near the same time; (4) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined at the time the contingent order is placed; (5) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or since canceled; and (6) the transaction is fully hedged (without regard to any prior existing position) as a result of the other components of the contingent trade." See NMS plan Section (I)(V).

36 A "trade-at" is defined under the NMS plan as an execution by a trading center of a sell order for a Pilot Security at the price of a protected bid or the execution of a buy order for a Pilot Security at the price of a protected offer. See NMS plan Section (I)(LL). As discussed further below, after additional consideration, the Commission modified the definition of trade-at to clarify that it applies during Regular Trading Hours. See infra Section V.D.4.

prohibiting trading centers operated by the Participants and members of the Participants from executing a sell order for a Pilot Security at the price of a protected bid, or from executing a buy order for a Pilot Security at the price of a protected offer, unless such executions fall within certain enumerated exceptions.

The NMS plan contains thirteen exceptions to the Trade-At Prohibition. These exceptions describe when a trading center would be permitted to execute an order for a Pilot Security at a price equal to a protected bid or protected offer. The first exception would be for when an order is executed by a trading center that is displaying a quotation, via either a processor or an SRO quotation feed, at a price equal to the traded-at protected quotation, but only up to the trading center's full displayed size ("Size Limitation"). A further condition to this exception proposed by the Participants would limit trading centers' ability to execute an incoming order by requiring that executions occur on the venue where the protected quote was displayed. Specifically, the Participants proposed that where the quotation is displayed through a national securities exchange, the execution at the size of the order must occur against the displayed size on such national securities exchange ("Exchange Venue Limitation"). Where the quotation is displayed through the Alternative Display Facility ("ADF") or another facility approved by the Commission that does not provide execution functionality, the execution of the order must occur against the displayed size in accordance with the rules of the ADF or such approved facility ("ADF Venue Limitation" together with Exchange Venue Limitation, "Venue Limitation").[37]

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37 As discussed further below, in response to comments and after additional consideration, the Commission has modified the NMS plan to remove the Venue Limitation. See infra Section V.D.4.d.

In addition, the NMS plan provides that Block Size orders[38] and Retail Investor Orders executed with at least $0.005 price improvement would be excepted from the Trade-At Prohibition. These exceptions were also set forth in the June 2014 Order.

The next exceptions (numbers 4 through 12) are based on the exceptions that are found in Rule 611 of Regulation NMS.[39] Specifically, the NMS plan provides that trading centers would be permitted to execute an order for a Pilot Security at a price equal to a protected bid or protected offer in the following situations: (1) when the trading center displaying the protected quotation that was traded-at was experiencing a failure, material delay, or malfunction of its systems or equipment; (2) when an order is executed as part of a transaction that was not a "regular way" contract; (3) when an order is executed as part of a single-priced opening, reopening, or closing transaction by the trading center; (4) when a protected bid was priced higher than a protected offer in the Pilot Security; (5) when an order is identified as an Intermarket Sweep Order; (6) when an order is executed by a trading center that simultaneously routed Trade-at Intermarket Sweep Orders[40] to execute against the full displayed size of the protected quotation that was traded-at; (7) when the order is executed as part of a Negotiated

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[38] See 17 CFR 242.600(b)(9). As discussed further below, in response to comments and after additional consideration, the Commission has modified the definition of Block Size for purposes of the Tick Size Pilot. See infra Section V.D.4.e.

[39] 17 CFR 242.611.

[40] The NMS plan defines Trade-at Intermarket Sweep Orders as "a limit order for a Pilot Security that meets the following requirements: (1) When routed to a trading center, the limit order is identified as an Intermarket Sweep Order; and (2) Simultaneously with the routing of the limit order identified as an Intermarket Sweep Order, one or more additional limit orders, as necessary, are routed to execute against the full displayed size of any protected bid, in the case of a limit order to sell, or the full displayed size of any protected offer, in the case of a limit order to buy, for the Pilot Security with a price that is equal to the limit price of the lit order identified as an Intermarket Sweep Order. These additional routed orders also must be marked as Intermarket Sweep Orders." See NMS plan Section (I)(MM).

Trade; (8) when the trading center displaying the protected quotation that was traded-at, had displayed, within one second prior to execution of the transaction that constituted the trade-at, a best bid or best offer, as applicable, for the Pilot Security with a price that was inferior to the price of the trade-at transaction; and (9) when the order executed by a trading center which, at the time of order receipt, the trading center had guaranteed an execution at no worse than a specified price ("stopped order") where: (A) the stopped order was for the account of a customer; (B) the customer agreed to the specified price on an order-by-order basis; and (C) the price of the trade-at transaction was, for a stopped buy order, equal to the NBB in the Pilot Security at the time of execution or, for a stopped sell order, equal to the NBO in the Pilot Security at the time of execution.

Lastly, the NMS plan contains an exception for an order of a fractional share of a Pilot Security, provided that such fractional share order was not the result of breaking an order for one or more whole shares of a Pilot Security into orders for fractional shares or was not otherwise effected to evade the requirements of the Trade-At Prohibition or any other provisions of the Tick Size Pilot.

D. Collection and Assessment of Tick Size Pilot Data

1. Trading Center Data

The Participants would be responsible for collecting data specified in Appendix B of the NMS plan, which generally includes daily market quality statistics, data on specific orders, and data on market makers[41] ("Trading Center Data").[42] In addition, each Participant that is the

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41 A "market maker" is defined under the NMS plan as "a dealer registered with any self-regulatory organization, in accordance with the rules thereof, as (i) a market maker or (ii) a liquidity provider with an obligation to maintain continuous, two-sided trading interest." See NMS plan Section (I)(L).

Designated Examining Authority ("DEA")[43] of a member of a Participant operating a trading center would require such member to collect and provide to the DEA data related to daily market quality statistics and data related to specific orders consistent with the terms and conditions specified in Appendix B of the NMS plan. The Participants and each member of a Participant operating a trading center would also be required to collect such data for dates starting six months prior to the Pilot Period through six months after the end of the Pilot Period. Each Participant would make available to other Participants a list of members designated as market makers on that Participant's trading center.

On a monthly basis, the Participants and the DEA for each member of a Participant operating a trading center would make the specified Trading Center Data publicly available on their websites for free and would report such data to the Commission on a disaggregated basis by trading center. The publicly available data would not identify the trading center that generated the data.

2. Market Maker Profitability Data[44]

Each Participant that is the DEA of a market maker would require such market maker to provide the DEA the data specified in Appendix C of the NMS plan regarding daily market

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42 See NMS plan Appendix B.

43 A DEA is defined under the NMS plan as "the self-regulatory organization responsible for (i) examining such member for compliance with the financial responsibility requirements imposed by the Exchange Act, or by Commission or self-regulatory organization rules, (ii) receiving regulatory reports from such member, (iii) examining such member for compliance with, and enforcing compliance with, specified provisions of the Exchange Act, the rules and regulations thereunder, and self-regulatory organization rules, and (iv) carrying out any other specified regulatory functions with respect to such member." See NMS plan Section (I)(I).

44 As discussed further below, in response to comments and after additional consideration, the Commission has modified the Market Maker Profitability Data requirement. See infra Section V.E.2.

maker trading profits with respect to the Pilot Securities on a monthly basis ("Market Maker Profitability Data"). Each market maker would also be required to provide to its DEA the Market Maker Profitability Data for dates starting six months prior to the Pilot Period through six months after the end of the Pilot Period. Moreover, on a monthly basis, the DEA would aggregate the Market Maker Profitability Data and make the aggregated data publicly available via the DEA's website for free, and report such data to the Commission. The publicly available data would not identify the market makers that generated the data.

3. Assessment of Tick Size Pilot Data.

The Participants proposed to provide to the Commission, and make publicly available, a joint assessment of the impact of the Tick Size Pilot, no later than six months after the end of the Pilot Period.[45] As proposed, the assessment would include the statistical and economic impact of an increase in the quoting increment related to: (1) market quality, (2) the number of market makers, (3) market maker participation, and (4) market transparency.[46] The assessment would also evaluate:

- whether any market capitalization, daily trading volume, or other thresholds can differentiate the results of the above assessment across stocks;

45 As discussed further below, in response to comments and after additional consideration, the Commission has modified the NMS plan to require the assessment to be submitted to the Commission 18-months after the implementation of the Tick Size Pilot. See infra Section V.E.3.

46 As discussed further below, in response to comments and after additional consideration, the Commission has modified the NMS plan to require the Participants to conduct an assessment on market maker profitability. See infra Section V.E.3.

- the statistical and economic impact of the above assessments for the incremental impact of the trading increment and for the joint effect of an increase in both the quoting increment and the trading increment;

- the statistical and economic impact of the above assessments for the incremental impact of a Trade-At Prohibition and for the joint effect of an increase in the quoting increment, an increase in the trading increment, and a Trade-At Prohibition; and

- any other economic issues that Participants believe the Commission should consider in any rulemaking that may follow. The Participants may also individually submit to the Commission, and make publicly available, an additional supplemental assessment of the impact of the Tick Size Pilot.

E. Policies and Procedures

Pursuant to the NMS plan, the Participants and members of Participants would be required to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with the quoting and trading increments for the Pilot Securities. Each Participant would develop appropriate policies and procedures that provide for collecting and reporting to the Commission the Trading Center Data. Each Participant that is the DEA of a member of a Participant operating a trading center would require such member to develop appropriate policies and procedures for collecting and reporting the Trading Center Data to the DEA. Each Participant that is the DEA of a member of a Participant operating a trading center would develop appropriate policies and procedures for collecting and reporting the Trading Center Data to the Commission.

Further, each Participant that is the DEA of a market maker would require such market maker to develop policies and procedures for collecting the Market Maker Profitability Data and report it to the DEA. Each Participant that is the DEA of a market maker would develop appropriate policies and procedures that provide for collecting and reporting such data to the Commission on an aggregated basis.[47] The DEA would also develop policies and procedures reasonably designed to ensure the confidentiality of the non-aggregated data it receives from market makers.

F. Additional Components of the NMS Plan

In addition to setting forth the details of the Tick Size Pilot, the NMS plan contains operational details including provisions related to the admission of new participants, amendments, the composition and responsibilities of the Operating Committee, and withdrawal from the NMS plan.

IV. Summary of Comments

As noted above, the Commission received 77 comment letters on the Tick Size Pilot contained in the proposed NMS plan.[48] Thirty-three commenters generally supported the Tick

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47 The Market Maker Profitability Data would be aggregated by Pilot Security.

48 See supra note 6. The opinions' of the commenters are nuanced as many commenters support certain aspects of the NMS plan while opposing other aspects of the NMS plan. Eighteen comment letters were received in response to the Commission's press release announcing that the proposed NMS plan and Tick Size Pilot had been submitted. These comment letters are included in the comment file with the comment letters received in response to the Notice. The Commission notes that five of the comment letters received in response to the press release requested that the Commission provide an extended comment period. See CMR Letter I; MFA Letter I; KOR Letter I; SIFMA Letter I; and Citadel Letter I. See also CCMC Letter I. The Investor Advisory Committee ("IAC") established by Section 911 of The Dodd-Frank Act also submitted recommendations to the Commission with respect to a tick pilot. See Recommendation of the Investor Advisory Committee Decimalization and Tick Sizes, available at: http://www.sec.gov/spotlight/investor-advisory-committee-2012/investment-adviser-decimilization-recommendation.pdf ("IAC Recommendations"). The IAC's Recommendations were issued prior to the Commission's June 2014 Order. The Commission discussed the IAC Recommendations in the June 2014 Order.

Size Pilot,[49] although almost all of these commenters suggested that certain aspects of the proposed Tick Size Pilot be modified prior to approval and implementation.[50] Several of the commenters supporting the Tick Size Pilot believed that a wider tick increment would improve the quality of trading for small capitalization securities or that it is valuable to test this hypothesis.[51] Additionally, some of these commenters believed that a wider tick increment would increase depth and liquidity.[52] For example, one commenter stated that a well-designed Tick Size Pilot would "[allow] for a true empirical test of the effects of wider spreads and limited

49 See Gagliano Letter I; Callipari Letter; Gagliano Letter II; STA Letter I; Duffy Letter; Galinskie Letter; IssuWorks Letter; Tabb Letter; ABC Letter; ECFTF Letter; Themis Letter; Two Sigma Letter; STA Letter II; KCG Letter; Virtu Letter; BIO Letter; NVCA Letter; BATS Letter; SIFMA Letter II; Weaver Letter; CFA Institute Letter; Citigroup Letter; BlackRock Letter; STANY Letter; Bright Trading Letter; Bloomberg Letter; KOR Letter II; CHX Letter; IMC Letter; Nasdaq Letter; NYSE Letter; Warner-Toomey Letter; OTC Markets Letter; and Vargas Letter.

50 Four of these commenters, while supporting a pilot to test wider tick sizes, nevertheless questioned whether wider ticks would have a positive impact on liquidity or would support increased research for small capitalization companies. See Tabb Letter at 1 ("While I am a strong proponent of the Tick Size Pilot, I do not foresee positive results, such as greater research coverage, more small/mid-cap[italization] IPOs, a wider diversity of market makers, reduced impact of high-frequency traders, lower transaction costs, or better quality of equity markets."); CFA Institute Letter at 1 (stating "skeptic[ism] that wider trading increments for small cap[italization] stocks will enhance the liquidity of those securities. . ."); KOR Letter II at 4 (stating the "idea that increased market making profitability will lead to better research/analyst coverage and encourage more IPOs is an idea that is out of touch with modern markets post-Regulation NMS"); and IMC Letter at 1 (noting reservations about the effect of wider ticks on IPOs and job growth). See also CoreOne Letter at 2 (stating that it is unlikely the Tick Size Pilot will increase the amount of research coverage for Pilot Securities).

51 See Gagliano Letter I (arguing that five cent spreads will greatly enhance participation, volume and increase market depth); Callipari Letter; ECFTF Letter at 1; STA Letter II at 2; BIO Letter at 2; NVCA Letter at 2; BATS Letter at 1; SIFMA Letter II at 1; STANY Letter at 2; Bloomberg Letter at 2; CHX Letter at 1; Nasdaq Letter at 3; and NYSE Letter at 1.

52 See Gagliano Letter I; Callipari Letter; BIO Letter at 2; NVCA Letter at 2; and NYSE Letter at 1.

increments in small-cap[italization] stocks [would] encourage fundamental buyers and sellers to meaningfully engage with each other."[53]

Conversely, twenty commenters generally opposed the Tick Size Pilot.[54] Some of these commenters were concerned that a wider tick increment would increase investor execution costs or that the Tick Size Pilot would be unduly disruptive.[55] Three commenters argued that the impact of tick sizes had already been studied.[56] One commenter noted that increasing tick sizes would impact his ability to trade efficiently.[57] Other commenters argued that wider spreads would only help market professionals at the expense of investors.[58]

Generally, commenters opposing the Tick Size Pilot were concerned about its costs to investors and the complexity of its design.[59] For example one commentator estimated "that the

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53 See ECFTF Letter at 1.

54 See BenBrahim Letter; Richardson Letter; Ling Letter; Blecha Letter; Sosnoff Letter; Choffy Letter; Runsdorf Letter; Greenblatt Letter; Bangura Letter; Ricker Letter; DFA Letter; Vanguard Letter; CFA Letter; MFA Letter II; Wells Fargo Letter; ICI Letter; Schwab Letter; Fidelity Letter; TD Ameritrade Letter; and Citadel Letter II. See also IAC Recommendations.

55 See Vanguard Letter at 1; CFA Letter at 4; MFA Letter II at 6 (stating more than 20% of all U.S. listed companies will be impacted by the Tick Size Pilot); Wells Fargo Letter at 4; and ICI Letter at 5. See also IAC Recommendations.

56 See Ling Letter; Blecha Letter; and Runsdorf Letter.

57 See Richardson Letter.

58 See Richardson Letter; Ling Letter; Sosnoff Letter; Choffy Letter; and Bangura Letter. See also Greenblatt Letter (stating that expanding the tick sizes will only help market makers become wealthy).

59 See DFA Letter at 2 (raising concerns that U.S. companies would incur a higher cost of capital); Vanguard Letter at 4 (stating that "any program that increases the minimum quoting or trading increments will necessarily result in increased transaction costs to long-term investors"); MFA Letter II at 3 (expressing concern that the Tick Size Pilot would harm investors by creating unnecessary market complexities and systems risks) ; Wells Fargo Letter at 9 (expressing concerns about both costs to investors and complexity); Fidelity Letter at 3-4 (citing concerns both about increased trading costs for retail investors and complexity and implementation costs); TD Ameritrade Letter at 2;

[Tick] Pilot could cost investors hundreds of millions of dollars."[60] Other commenters stated the Tick Size Pilot would "make it more expensive for investors to buy and sell [P]ilot [S]ecurities."[61] Commenters also opined that the Tick Size Pilot would increase operational risk, and heighten market complexity which would require "a whole redesign of trading systems and algorithms."[62] Another commenter stated that, "while the purported benefits of the [Tick Size Pilot] are questionable, the costs are real and significant."[63]

Additionally, Tick Size Pilot opponents indicated that the underlying goals of the Tick Size Pilot were not properly defined and tenuous.[64] For example, one commenter stated that the Tick Size Pilot's "goal seems simply to find ways to drive higher profits to exchanges and some of their favored clients."[65]

Seventeen commenters, while providing substantive analysis and opinion, did not specifically express support for, or, opposition to, the Tick Size Pilot.[66] While the commenters

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and Citadel Letter II at 5 (citing concerns about implementation costs, systems risks, and investor costs). See also IAC Recommendations.

60 See TD Ameritrade Letter at 2.

61 See BenBrahim Letter; Greenblatt Letter; Bangura Letter; Wells Fargo Letter at 2 (expressing opposition to increased tick sizes and increased transaction costs); and MFA Letter II at 3 (stating that artificially widening spreads and increasing trading costs would make it expensive for investors to buy and sell securities).

62 See MFA Letter II at 3. See also infra note 74 and accompanying text.

63 See Vanguard Letter at 4.

64 See Vanguard Letter at 1; Wells Fargo Letter at 6; Schwab Letter at 9; and Citadel Letter II at 2. See also IAC Recommendations.

65 See Schwab Letter at 9.

66 See Leary Letter; Adorney Letter; RGM Letter; CCMC Letter I; Wellington Shields Letter; ModernNetworks Letter (noting its agreement with the premise behind wider ticks, such as discouraging arbitrage, encouraging market making and longer holding periods); CoreOne Letter; JonesTrading Letter; CMR Letter II; Liquidnet Letter; FIF Letter; CCMC Letter II; Ye Letter; Angel Letter; Birch Bay Letter; ITG Letter; Albert

generally focused on issues related to the proposed Tick Size Pilot, some also raised tangential or alternative market-based solutions such as those relating to access fees, maker-taker fee models, payment-for-order-flow, and high frequency trading.[67] For instance, nine commenters stated that the Commission should test the elimination of exchange access fees, either independently or in conjunction with the Trade-At Prohibition;[68] two commenters suggested the Commission

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Letter and Saito Letter.

67 See Wellington Shields Letter at 2 (subpenny pricing should be eliminated and quotes should have a time-in-force); Virtu Letter at 2 (recommending the Commission study and establish specific market maker obligations through an NMS plan and eliminate access fees); Liquidnet Letter at 1-2 (asserting that Commission should pass Rule 10b-18 prior to the Tick Size Pilot and should conduct a simplified version of the Trade-At Prohibition independently along with other market structure issues such as removing access fees, and eliminating maker-taker pricing); BIO Letter at 5 (suggesting other measures to assist small capitalization companies such as an increase in the qualifying cap for accelerated filers and as well as an exception from XBRL reporting requirements); CFA Institute at 6; ICI Letter at 6 (stating other market initiatives, such as maker-taker, should be addressed prior to the Tick Size Pilot); Birch Bay Letter at 1 (asserting all orders should have a minimum lifespan of at least one-second); Schwab Letter at 5 (stating that if the Commission wants to test order flow migration, it should reduce exchange access fees and liquidity rebates);; Bright Trading Letter at 3 (suggesting that OTC market makers should be required to provide "meaningful" price improvement); Bloomberg Letter at 15 (suggesting that reduced access fees should be the subject of a pilot); Ye Letter at 1 (suggesting that the maker-taker fees should be analyzed); Angel Letter at 11 (suggesting that a maker-taker pilot should be conducted); and KOR Letter II at 2.

68 See Virtu Letter at 2; CFA Institute at 6; Liquidnet Letter at 2 (asserting a simplified version of the Trade-At Prohibition should be tested independently along with other market structure issues such as removing access fees, and eliminating maker-taker pricing); Schwab Letter at 5; Fidelity Letter at 5 (suggesting that a trade-at prohibition should also contemplate access fees, maker-take, internalization, but noted that these were properly excluded from the Tick Size Pilot); Bright Trading Letter at 3; Bloomberg Letter at 15; Ye Letter at 1; Angel Letter at 11; and KOR Letter II at 5 (suggesting that the Trade-At Prohibition should be coupled with access fee reform or the elimination of rebates).

implement a stand-alone trade-at pilot;[69] and three commenters suggested that subpenny pricing should be explored and studied.[70]

Several commenters supported the Commission's use of "data-driven" research to formulate market structure changes.[71] Additionally, some commenters believed that, while the Tick Size Pilot may not achieve the goal of improved liquidity for small-capitalization securities, it nonetheless should be tested.[72] For example, one commenter stated, "we believe it is worth the effort, time and money to test these ideas in the real world . . . as an important step in helping to improve the market for small capitalization companies in the future."[73]

A. Costs and Complexity of the Tick Size Pilot

Several commenters expressed concerns related to the costs and complexity of the Tick Size Pilot.[74] Some commenters expressed concern that trading costs of the wider tick size would be borne either by investors[75] or the brokers and institutions representing customer interest.[76]

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69 See Vanguard Letter at 2 and ICI Letter at 4.

70 See Greenblatt Letter; RGM Letter at 1; and MFA Letter II at 3. But see Wellington Shields Letter at 5 (stating subpenny pricing causes the front running of trades); Ye Letter at 2; and ModernNetworks Letter at 3 (arguing against studying subpenny pricing).

71 See RGM Letter at 1; ABC Letter at 3; ECFTF Letter at 1; Two Sigma Letter at 1; KCG Letter at 6; Virtu Letter at 2; BIO Letter at 4; CFA Institute Letter at 6; BlackRock Letter at 1; STANY Letter at 2; Bloomberg Letter at 3; Angel Letter at 2; KOR Letter II at 2; IMC Letter at 2; Nasdaq Letter at 4; and OTC Markets Letter at 2.

72 See Tabb Letter at 1; Angel Letter at 1-2 (arguing that corporate issuers should set their trading increments and supporting a data-driven approach); KOR Letter II at 4; and IMC Letter at 1.

73 See CFA Institute Letter at 2.

74 See Duffy Letter at 2; DFA Letter at 2; Vanguard Letter at 4; Fidelity Letter at 3-4; TD Ameritrade Letter at 2; MFA Letter II at 3; Wells Fargo Letter at 9; ITG Letter at 4-6; and Citadel Letter II at 5.

75 See BenBrahim Letter; DFA Letter at 2; Vanguard Letter at 1; KCG Letter at 2-3; Wells Fargo Letter at 5; and Citadel Letter II at 5.

Two commenters suggested that investor costs related to the Tick Size Pilot would be at least $200 million annually.[77] Certain commenters expressed concern that the Tick Size Pilot would inflate the cost of capital for the issuers of Pilot Securities.[78]

Other commenters were concerned with the costs associated with the complexity of the Tick Size Pilot. Some commenters thought that the three Test Group design of the Tick Size Pilot would drive costs upward,[79] but several commenters more directly attributed the potential costs to the complexity caused by the inclusion of Test Group Three and its Trade-At Prohibition.[80] Some commenters opined that eliminating Test Group Three would eliminate much of the complexity related to the Tick Size Pilot.[81] In particular, certain commenters stated that the complexity and costs of the Trade-At Prohibition result from the changes to technology and programming that would be necessary for effective implementation.[82] Some commenters

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76 See DFA Letter at 1; Two Sigma Letter at 2; and TD Ameritrade Letter at 2.

77 See Two Sigma Letter at 2 (estimating excess trading costs of implementing Test Group Two and Three of $200 million annually) and TD Ameritrade Letter at 2 (utilizing optimistic assumptions would be $273,149,484 annually).

78 See DFA Letter at 2 and NVCA Letter at 7.

79 See DFA Letter at 2 (arguing that the Tick Size Pilot's four group design where each group has its own rules and exemptions increases both the risk and costs); MFA Letter II at 7-8 (asserting that the Tick Size Pilot "will greatly increase complexity by creating four different trading schemes that will need to be implemented by trading centers and institutional investors…The financial cost for such significant systems development, coding, reprogramming and testing are likely to be meaningful."); and Wells Fargo Letter at 9 (stating "the costs and risks of the [Tick] Pilot would be lessened in a study involving only one control group and one test group without exceptions).

80 See Tabb Letter at 1; ECFTF Letter at 2; CMR Letter II at 7; KCG Letter at 14; FIF Letter at 3; and TD Ameritrade Letter at 2.

81 See Tabb Letter at 1; Two Sigma Letter at 3; Vanguard Letter at 5; MFA Letter II at 6; and Wells Fargo Letter at 8.

82 See Tabb Letter at 5-6 (stating "[t]he programing for this . . . will be challenging, significant, and require massive testing."); CoreOne Letter at 7; Wells Fargo Letter at 8; FIF Letter at 3; and ITG Letter at 5.

expressed concern that the Tick Size Pilot would lead to increased operational risks.[83] However some commenters, while acknowledging that there would be costs associated with the Tick Size Pilot, believed the Commission should move forward because of the importance of testing the impact of wider tick increments on the liquidity and market quality of securities with smaller capitalization.[84]

Certain commenters believed that the Tick Size Pilot should be subject to a cost benefit analysis pursuant to the Commission rulemaking process.[85] Some of these commenters questioned whether the costs of the Tick Size Pilot outweighed its benefits. Others commenters posited that a cost-benefit analysis, focused on the implementation costs of the Tick Size Pilot, should be completed.[86] Other commenters suggested that an assessment of investor costs should be completed prior to the implementation of the Tick Size Pilot.[87]

B. Duration of the Tick Size Pilot

Twenty-three commenters discussed whether the Pilot Period should be extended, remain as proposed, or implemented on a provisional basis.[88] Seventeen commenters opined that the

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83 See SIFMA Letter II at 5; Wells Fargo Letter at 3; ICI Letter at 5; and Citadel Letter II at 6 (stating "it would be unfortunate if the Commission approved a pilot that imposed such an extraordinary degree of operational risk on the markets.").

84 See Tabb Letter at 8; CFA Institute Letter at 2; CHX Letter at 17 (this commenter provided an estimate of potential implementation costs for all three Test Groups of approximately $140,000 and suggested that such costs for all market centers could be in excess of $8.0 million); Nasdaq Letter at 5-6; and NYSE Letter at 3.

85 See Duffy Letter at 2; KCG Letter at 8-9; SIFMA Letter II at 7; MFA Letter II at 8; Wells Fargo Letter at 3; Citigroup Letter at 5; Schwab Letter at 8-9; STANY Letter at 9-10; Bloomberg Letter at 21-22; TD Ameritrade Letter at 4; ITG Letter at 4; Citadel Letter II at 3-4; Nasdaq Letter at 7; and OTC Markets Letter at 9.

86 See BlackRock Letter at 4; FIF Letter at 6; and Citadel Letter II at 5.

87 See Wells Fargo Letter at 9; SIFMA Letter II at 8; and Citadel Letter II at 5.

88 See Duffy Letter at 1; Galinskie Letter at 2; IssuWorks Letter at 3; Tabb Letter at 1; ABC

Pilot Period should be longer than one-year.[89] Some of these commenters indicated that the Pilot Period should be extended to justify the associated implementation costs.[90] Others indicated that better data could be gathered with a longer Pilot Period.[91] In particular, some of these commenters opined that the data generated from a longer Pilot Period would be less likely to be skewed by short-term or aberrational events.[92] One commenter suggested that the one-year time period would make it easy to manipulate the data to produce negative outcomes.[93] Other commenters stated that additional time is necessary to allow for market participants to adjust their behavior.[94]

Letter at 2; ECFTF Letter at 1-2; Themis Letter at 6; CoreOne Letter at 2; CMR Letter II at 2; STA Letter II at 7; BIO Letter at 7; CFA Letter at 6; NVCA Letter at 3-5; CFA Institute Letter at 3; BlackRock Letter at 6; Liquidnet Letter at 1; CCMC Letter II at 2; ICI Letter at 5; STANY Letter at 9; Angel Letter at 7; KOR Letter II at 3; CHX Letter at 6; and Warner-Toomey Letter at 1. See also IAC Recommendations.

89 See Duffy Letter at 1; Galinskie Letter at 2; IssuWorks Letter at 3; Tabb Letter at 5-6; ABC Letter at 2; ECFTF Letter at 1-2; Themis Letter at 6; CoreOne Letter at 2; CMR Letter II at 2; BIO Letter at 3; NVCA Letter at 3-5; CFA Institute Letter at 3; Liquidnet Letter at 1; STANY Letter at 9; KOR Letter II at 3; Warner-Toomey Letter at 1; and Vargas Letter at 1.

90 See Duffy Letter at 1; IssuWorks Letter at 3; ABC Letter at 3; NVCA Letter at 3; Liquidnet Letter at 3; STANY Letter at 9; Warner-Toomey Letter at 1; and Vargas Letter at 1. See also Tabb Letter at 8 (while not suggesting a longer duration, asserting that the one-year duration, which would require extensive technology development, may not be the best use of industry resources).

91 See ECFTF Letter at 1 (arguing that "[a] significantly longer time period is required to gather meaningful data around whether the changes to the market structure are having the desired effects"); CoreOne Letter at 2 (stating "it remains unclear if the [Tick] Pilot could generate meaningful data . . . given the [Tick] Pilot's length among other things."); NVCA Letter at 4; and STANY Letter at 9.

92 See ECFTF Letter at 1-2; CMR Letter II at 2; NVCA Letter at 4-5; and Vargas Letter at 1.

93 See Duffy Letter at 1.

94 See Duffy Letter at 2; ECFTF Letter at 1-2; Themis Letter at 6; CMR Letter II at 2; BIO Letter at 3; SIFMA Letter II at 5-6; CFA Institute Letter at 3; and KOR Letter II at 3.

Some commenters also indicated that the relatively short Pilot Period could have a negative impact on participation. Several commenters indicated that due to, among other things, the complexity and cost relative to the short duration of the Pilot Period, some market participants would avoid trading Pilot Securities during the Tick Size Pilot.[95] A number of commenters expressed concern that if market participants avoided trading Pilot Securities the assessment of the Tick Size Pilot would be frustrated by skewed data.[96]

The recommended duration for the Tick Size Pilot varied among commenters advocating for a longer Pilot Period. Four commenters stated that the Pilot Period should be extended to five-years,[97] while other commenters suggested either a two-[98] or three-year duration.[99] Some commenters opined that the Pilot Period should be longer, but did not provide a specific time period.[100] Instead of a specific time period, others suggested a range of eighteen months to five years.[101]

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95 See IssuWorks Letter at 4; ECFTF Letter at 2; CMR Letter II at 7; STA Letter II at 11; NVCA Letter at 5; BATS Letter at 4; SIFMA Letter II at 6-7; FIF Letter at 6; ICI Letter at 6; Schwab Letter at 5; STANY Letter at 9; Fidelity Letter at 4; Bloomberg Letter at 13; TD Ameritrade Letter at 3; CHX Letter at 7; Citadel Letter II at 6; Warner-Toomey Letter at 4; and Vargas Letter at 1.

96 See IssuWorks Letter at 4; CoreOne Letter at 7; BATS Letter at 5; SIFMA Letter II at 6; Warner-Toomey Letter at 1; and Vargas Letter at 1.

97 See Duffy Letter at 1; Galinskie Letter at 2; IssuWorks Letter at 3; and Themis Letter at 6.

98 See KOR Letter II at 3.

99 See ECFTF Letter at 1-2 and Liquidnet Letter at 1. See also Vargas Letter at 1 (advocating for a longer Tick Size Pilot and stating that many experts suggested a three-year duration.).

100 See Tabb Letter at 1; ABC Letter at 2; CMR Letter II at 2 (believing the Tick Size Pilot should be extended by one to two years); and CFA Institute Letter at 3.

101 See CMR Letter II at 2; BIO Letter at 3 (stating a range of three to five years); NVCA Letter at 3-5 (stating the Pilot should last greater than three-years); and STANY Letter at 9 (indicating a Pilot duration of eighteen months to five-years).

Six commenters stated that the Pilot Period of the Tick Size Pilot should be one-year as proposed.[102] One commenter, who advocated for a Tick Size Pilot with a one-year Pilot Period, asserted that sufficient data to analyze the effects of wider ticks could be generated within that timeframe.[103] Another commenter stated that there would need to be greater confidence in the benefits of Tick Size Pilot in order to justify a longer Pilot Period.[104]

Among the commenters advocating for a one-year Pilot Period, there was variance on whether the Tick Size Pilot should be cut off immediately after one-year[105] or remain in operation while the results are assessed.[106] One commenter stated that the Tick Size Pilot should be assessed following the first six months of the Pilot Period but that the Tick Size Pilot should still only operate for the one-year Pilot Period.[107] Five commenters offered that the Pilot Period should initially operate for one-year with the possibility of an extension if such action is supported by the data.[108] Five commenters stated that the Tick Size Pilot should continue during the final assessment of the data in order to mitigate unnecessary changes in the market.[109]

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102 See CCMC Letter II at 2; STA Letter II at 7; CFA Letter at 6; BlackRock Letter at 6; ICI Letter at 5; and CHX Letter at 6.

103 See CFA Letter at 6.

104 See BlackRock Letter at 6. See also IAC Recommendations.

105 See CCMC Letter II at 2 (asserting the Pilot should end completely following a year). See also BlackRock Letter at 6 (asserting that the Tick Size Pilot should have a "finite duration and clear end date").

106 See STA Letter II at 7; FIF Letter at 6 (advocating for a preliminary assessment during the Tick Size Pilot to avoid unnecessary disruption); STANY Letter at 9 (noting that ending the Tick Size Pilot and possibly reintroducing it after the assessment would result in unnecessary risks and costs); KOR Letter II at 3; and CHX Letter at 6.

107 See STA Letter II at 7.

108 See STA Letter II at 7; ICI Letter at 5 (asserting that the Tick Size Pilot could only be extended for one-year if necessary); Angel Letter at 7; KOR Letter II at 3; and CHX Letter at 6.

Another commenter stated that the Pilot Period should be at least one-year to gather preliminary results and, if deemed appropriate, extended for a "full economic cycle" thereafter to determine its impact on capital formation.[110]

C. Criteria for Pilot Securities

The Commission received many comments with respect to the selection criteria for Pilot Securities. The commenters raised concerns about the proposed selection criteria, especially the market capitalization threshold, and suggested other criteria to be considered.[111]

1. Market Capitalization of Pilot Securities

Sixteen commenters argued that a $5 billion market capitalization threshold is too high.[112] Commenters argued that the market capitalization threshold should be decreased because the $5 billion threshold would capture securities not traditionally considered small capitalization securities, which are the focus of the Tick Size Pilot.[113] Two commenters believed

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109 See supra note 106 and accompanying text.

110 See Angel Letter at 7.

111 One commenter stated that the proposed Measurement Period should be extended to the previous twelve months to verify whether any unique circumstances created any unintentional biases. See CFA Institute Letter at 4. See also FIF Letter at 1 (suggesting that the Measurement Period should be redefined to conclude seven months before the effective date of the Tick Size Pilot). Another commenter argued that consideration be given to securities that are priced under $5.00 per share. See IssuWorks Letter at 4.

112 See ECFTF Letter at 2; Themis Letter at 3; Vanguard Letter at 6; CMR Letter II at 5; CFA Letter at 3; NVCA Letter at 6; BATS Letter at 2-3; SIFMA Letter II at 8; MFA Letter II at 5-6; Wells Fargo Letter at 8; ICI Letter at 4; Schwab at 10-11; STANY Letter at 7; Fidelity Letter at 3; Warner-Toomey Letter at 2; and OTC Markets Letter at 3-4.

113 See MFA Letter II at 4; Wells Fargo Letter at 8; ICI Letter at 4; and Warner-Toomey Letter at 2 (stating "re-examine…[the capitalization threshold] to remain consistent with goals of the Pilot"). Commenters stated the directive from Congress in the JOBS Act and also echoed by the Commission in the June 2014 Order was to address concerns of small capitalization securities. See MFA Letter II at 5-6 and KCG Letter at 10. One commenter also argued that small capitalization stocks would benefit the most from the Tick Size Pilot. See ECFTF Letter at 2.

that the $5 billion market capitalization threshold would include stocks that do not have the liquidity and market quality concerns that the Tick Size Pilot seeks to address.[114] Various commenters recommended that the market capitalization threshold for Pilot Securities be lowered from $5 billion to a range of $250 million to $2 billion.[115]

2. Other Comments on the Selection Criteria

Some commenters stated that the current volume threshold of CADV of one million shares should be altered. For example, one commenter suggested that the volume threshold should range from 300,000 shares to 500,000 shares for illiquid securities.[116] Another commenter stated that the volume threshold should be based upon the daily dollar trading value to focus on small capitalization securities.[117] One commenter opined that the volume threshold should be based upon the volume relative to the public float.[118]

3. Suggestions for Additional Selection Criteria

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114 See Vanguard Letter at 6 and STA Letter II at 5.

115 See ECFTF Letter at 2 (recommending lowering the threshold to $750 million); Themis Letter at 3 (recommending lowering the threshold to $2 billion); Vanguard Letter at 6 (recommending lowering the threshold to $500 million); CMR Letter II at 5 (recommending lowering the threshold to $750 million); CFA Letter at 3 (recommending lowering the threshold to $2 billion); NVCA Letter at 6 (recommending lowering the threshold to less than $1 billion); BATS Letter at 2-3 (recommending lowering the threshold to less than $1 billion); SIFMA Letter II at 8 (recommending lowering the threshold to less than $1 billion); MFA Letter II at 6 (recommending lowering the threshold to $750 million); Wells Fargo Letter at 8 (recommending lowering the threshold to $1 billion); STANY Letter at 7 (recommending lowering the threshold to $750 million); Fidelity Letter at 3 (recommending lowering the threshold to $750 million to $1 billion); and OTC Markets Letter at 3-4 (recommending lowering the threshold to $250 million).

116 See CFA Letter at 3.

117 See NVCA Letter at 6 (stating an appropriate average daily dollar trading value for small capitalization stocks is less than $10 million).

118 See Virtu Letter at 2.

A number of commenters recommended that additional selection criteria should be required and recommended additional thresholds for the selection of Pilot Securities. Nine commenters opined that an average weighted daily spread of five cents or greater should be a qualifying factor to avoid artificially widening the spread and increasing transaction costs for investors.[119] Other commenters stated that securities with an average spread of less than five cents would not benefit from the Tick Size Pilot because they are already very liquid.[120] Finally, two commenters suggested that including the daily turnover of a security would be a useful qualifying criterion to help determine liquidity.[121]

4. Securities Excluded from the Tick Size Pilot

Two commenters raised the possibility of regulatory arbitrage and asserted that cross-listed securities from Canada should not be eligible for the Tick Size Pilot.[122] Another commenter suggested that any security that trades below $1.00 during the Measurement Period should be eliminated from consideration as a Pilot Security. Further, the commenter stated that if a Pilot Security during the Pilot Period trades below $1.00 then its data should be removed from the Tick Size Pilot.[123] Two commenters supported the exclusion of ETFs.[124]

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119 See CoreOne Letter at 3 (advocating for using the average displayed spread for the Measurement Period); Two Sigma Letter at 2 (stating the securities meeting this criteria are approximately 25% of the NMS common stocks and would therefore be a large enough universe while minimizing the risk of increasing transaction costs to investors); CFA Letter at 3; MFA Letter II at 7 (asserting that the spread on some qualifying securities could increase by 500%); CFA Institute Letter at 4; Wells Fargo Letter at 9; Schwab Letter at 10-11; and OTC Markets Letter at 3-4. See also KCG Letter at 10 (arguing that artificially wider spreads will increase transaction costs).

120 See CFA Letter at 3 (stating that "securities with $0.01 spreads are already highly liquid and actively traded"); MFA Letter II at 7; and Schwab Letter at 10-11.

121 See CMR Letter II at 3-4 and STA Letter II at 4-5.

122 See STA Letter II at 9 and SIFMA Letter II at 10.

123 See CHX Letter at 2.

D. Control Group, Test Groups, and Trade-At Prohibition

A number of commenters discussed the design of the Tick Size Pilot. Two commenters opined that there were too many Pilot Securities included in each Test Group.[125] Some commenters indicated there were too many test groups, which would make the Tick Size Pilot complex to implement and difficult to assess.[126] One commenter supported the Tick Size Pilot design opining that it represented "logical steps" by comparing the trading environments of the test groups, and adding that "[i]f there is an incremental effect that each change has on various quality of markets metrics, it should be apparent from the [Tick] Pilot data."[127] Another commenter supported the inclusion of all three Test Groups in order to "deepen [the] understanding of the various factors impacting liquidity in [today's] fragmented market."[128]

Commenters suggested testing tick sizes other than the proposed $0.05 increment. Some commenters suggested that various tick size increments, both larger[129] and smaller[130] than the

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124 See CFA Institute at 4 (stating that the exclusion recognizes their different shareholder base) and ICI Letter at 4.

125 See STA Letter II at 5-6 and BATS Letter at 3 (arguing that the number of Pilot Securities per Test Group should be reduced to 100 securities). But see CFA Institute at 4 (asserting that 400 securities per Test Group are appropriate for "more robust analysis").

126 See STA Letter II at 5 (arguing that the Tick Size Pilot should have only one test group); KCG Letter at 3 (asserting the Tick Size Pilot should include only Test Group One, but generally supports Test Groups One and Two); MFA Letter II at 6 (arguing that the Tick Size Pilot's "broader scope will likely frustrate the Commission's ability to assess the impact of increased tick sizes on liquidity for small-cap[italization] stocks"). See also supra note 81 and accompanying text (advocating for the elimination of Test Group Three). See also infra note 136 and accompanying text (asserting Test Group One should be eliminated).

127 See CHX Letter at 11.

128 See NYSE Letter at 3.

129 See IssuWorks Letter at 3 (advocating to study $0.10 or larger trade increments); CoreOne Letter at 3 (suggesting testing $0.02 and $0.10 trade increments); and OTC

proposed $0.05 increment, be concurrently tested. Other commenters suggested that subpenny increments should be tested.[131] One commenter believed the $0.05 trade increment should apply to the opening and closing auctions and asked for this issue to be directly addressed in the Tick Size Pilot.[132] Conversely, another commenter suggested that the opening and closing auctions should be exempt from the Tick Size Pilot.[133]

One commenter asserted that, in order to avoid logistical and operational problems of rejecting non-conforming orders for brokers and customers, the Tick Size Pilot should permit orders that are received but not priced in $0.05 increments to be re-priced for display purposes to a permissible $0.05 increment.[134] Another commenter requested clarification on the handling of orders and quotes that are not in a proper tick increment.[135]

1. Test Group One: Widened Quote Increment

One commenter suggested that Test Group One should be eliminated in order to reduce the Tick Size Pilot's complexity.[136] Four commenters theorized that Test Group One "probably

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Markets Letter at 4 (stating the Commission should review trade increments of $0.10 and $0.25).

130 See CoreOne Letter at 3.

131 See Greenblatt Letter; RGM Letter at 2 (suggesting the Commission look into subpenny trade increments); and MFA Letter II at 3 (asserting that the Commission should test half-penny increments for highly liquid securities).

132 See FIF Letter at 2.

133 See Citigroup Letter at 6.

134 See ITG Letter at 6-7 (noting that for purposes of order display and regulatory compliance, "price-sliding" is permissible in the context of Rule 201 of Regulation SHO).

135 See FIF Letter at 2.

136 See KOR Letter II at 3.

will drive more volume to the dark pools" because the trade increment is less than $0.05.[137] For example, one commenter stated, "[w]ith no controls around trading increments, we will see a deterioration in market quality as more trading moves off-exchange, and lit market making is further disadvantaged."[138] One commenter suggested that market participants should be permitted in Test Group One to accept or rank orders in penny increments because exchanges and agency ATSs would be at a competitive disadvantage vis-à-vis broker-owned proprietary execution systems that could trade, accept and rank orders at otherwise impermissible increments.[139] One commenter stated that Test Group One should be eliminated because "we should not be engaging in experiments that actively increase undisplayed liquidity."[140]

2. Test Group Two: Widened Quote and Trade Increment

The comments on Test Group Two were mainly directed at the exception for Retail Investor Orders, which is also applicable to Test Group Three. Two commenters argued that the definition of Retail Investor Order should be broadened so that it would be less burdensome to implement and applicable to more individuals.[141] Five commenters stated that an attestation

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137 See Wellington Shields Letter at 4 (arguing that market participants may be hesitant to display liquidity in instances where the quoting increment is changed without corresponding changes to the minimum trading increment); Tabb Letter at 3 (forecasting that off-exchange volume to rise to between 60-70% from its current range of lower to mid-40%); CFA Letter at 4; and KOR Letter II at 3 (stating that "as constructed, [Trade Group One] will simply divert flow from lit markets to dark pools and internalizers.").

138 See KOR Letter II at 3.

139 See BATS Letter at 3.

140 See CFA Letter at 4.

141 See Wells Fargo Letter at 5 and FIF Letter at 2.

should not be required, as it would be unwieldy for trading centers to surveil and attest that substantially all trades entered into the system originated from an individual.[142]

Other commenters requested clarification of the Retail Investor Order definition.[143] One commenter questioned whether the definition of Retail Investor Order in the Tick Size Pilot was consistent with that of the Retail Liquidity Programs at various exchanges.[144] Another commenter suggested that the Retail Investor Order definition should be based on the "individual customer" account type definition used by FINRA's OATS.[145]

Other commenters supported the Tick Size Pilot's proposed exception for Retail Investor Orders.[146] Two other commenters thought the exception for Retail Investor Orders should apply generally to all orders, including institutional orders.[147] One commenter opined that the exception should be broadened to alleviate the implementation burden.[148]

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142 See Tabb Letter at 5; Two Sigma Letter at 2; KCG Letter at 9 (noting that the definition of Retail Investor Order was too complex and ambiguous and would lead to many of the largest retail firms to not sign the required attestations); STANY Letter at 6; and TD Ameritrade at 5.

143 See Two Sigma Letter at 2; KCG Letter at 9; STANY Letter at 6; Fidelity Letter at 7 (seeking clarification on whether there is a restriction on who the contra party may be for a Retail Investor Order); and TD Ameritrade Letter at 5-6.

144 See TD Ameritrade Letter at 7-8.

145 FINRA's Order Audit Trail System ("OATS") is a FINRA owned automated reporting system that captures order information in NMS stocks and OTC equity securities that is required for all FINRA members. See FINRA Rule 7410(k). OATS defines an individual customer account type as "an account that does not meet the definition of FINRA Rule 4512(c) and is also not a proprietary account." See FIF Letter at 2.

146 See Virtu Letter at 2 (supporting the mid-point, retail, block size, and single-priced transactions exceptions in the Tick Size Pilot) and CHX Letter at 13.

147 See SIFMA Letter II at 9 and Citadel Letter II at 8-9.

148 See SIFMA Letter II at 9.

Seven commenters opposed the Retail Investor Order exception because the minimum price improvement required by the exception was not large enough.[149] Some of these commenters were concerned that the relatively low level of required price improvement needed to qualify for the exception would encourage internalization.[150] Some of these commenters also believed that the wider spread warranted a more significant amount of price improvement relative to the spread.[151]

Some commenters opposed the exception for Retail Investor Orders for other reasons.[152] For instance, one commenter believed that all Tick Size Pilot pricing should be in $0.05 increments to effectively attract liquidity and market makers and thus the Retail Investor Order exception could undermine the validity of the Tick Size Pilot.[153] Another commenter argued that in light of the highly desirable nature of retail order flow, the elimination of the exception would

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149 See Galinskie Letter at 2; CFA Letter at 5; Weaver Letter at 2; CFA Institute Letter at 6; STANY Letter at 6; IMC Letter at 2; and Birch Bay Letter at 1.

150 See IMC Letter at 2 and Birch Bay Letter at 1 (asserting that the exception would also undermine the Trade-At Prohibition of Test Group 3). See also Wells Fargo Letter at note 19 (asserting that the number of exceptions, especially the retail price improvement exception, would render the data inconclusive).

151 See Galinskie Letter at 2 (arguing for "meaningful" price improvement); CFA Letter at 5; IMC Letter at 2 (advocating for price improvement of fifty-percent of the tick size); and Birch Bay Letter at 1 (arguing that price improvement should be a full five-cent improvement).

152 See Wellington Shields Letter at 4; IssuWorks Letter at 5; and KOR Letter II at 4. See also Galinskie Letter at 2 (arguing that subpenny trading should be eliminated across all markets).

153 See Wellington Shields Letter at 4 (arguing that the midpoint exception should be eliminated because it provides price improvement to the liquidity taker but prevents public order interaction with a liquidity provider, which the commenter suggests is not necessarily a market benefit.). See also Bright Trading Letter at 2 (opining that the Retail Order exception will increase the toxicity of the order flow, which will result in market makers widening their quote spreads or not quoting at all).

encourage more displayed liquidity.[154] Another commenter was concerned that the Retail Investor Order exception would cause price competition to be prioritized, and negatively impact the Tick Size Pilot because of its view that markets that compete mostly on price are generally unable to compete on the value provided by, for instance, research, sales, and capital commitment.[155] This commenter stated that the tick size must have "integrity" in order to attract investor interest, and did not think, among other things, that the Retail Investor Order exception made "economic sense."[156]

3. Test Group Three: Widened Quote and Trade Increment with a Trade-At Prohibition

The Commission received many comments on Test Group Three, and in particular, on the Trade-At Prohibition. Twenty-seven commenters opposed the Trade-At Prohibition.[157] These commenters generally believed that the Trade-At Prohibition was overly complex[158] and would

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[154] See KOR Letter II at 4. This commenter also opined that the retail price improvement exception would increase payment-for-order-flow stating, "With tick sizes at a penny, internalizers had little leeway in how much they could pay for orders, as they are generally only profiting at a fraction of the spread. By blowing out spreads but excluding retail trades at the midpoint, the result will be a dramatic increase in PFOF rates."

[155] This commenter believes that pure price competition would not attract more liquidity. See IssuWorks Letter at 5.

[156] See IssuWorks Letter at 5.

[157] See STA Letter I at 3; Tabb Letter at 5-6; ECFTF Letter at 2; Two Sigma Letter at 2-3; Vanguard Letter at 5 (stating that while it is opposed to including the Trade-At Prohibition in the Tick Size Pilot, it supports a trade-at prohibition for the overall market if it is coupled with the elimination of maker-taker pricing); CoreOne Letter at 7; JonesTrading Letter at 1 (stating that Trade-At Prohibition is not related to the purpose of the Tick Size Pilot); CMR Letter II 5-8; STA Letter II at 6; KCG Letter at 11-17; NVCA Letter at 7; BATS Letter at 4-6; SIFMA Letter II at 4; MFA Letter II at 7-8; Wells Fargo Letter at 5-6; Citigroup Letter at 2; BlackRock Letter 2-3; Liquidnet Letter at 2; ICI Letter at 3-4; Schwab Letter at 4; STANY Letter at 5-6; Fidelity Letter at 5; Bloomberg Letter at 16; TD Ameritrade Letter 2-4; KOR Letter II at 4-5; ITG Letter at 4-5; Citadel Letter II at 6; and OTC Markets Letter at 7-9.

[158] See Tabb Letter at 5 (noting that the Trade-At Prohibition would introduce significant

be costly to implement and operate,[159] and could induce market participants to opt-out of quoting and trading in Test Group Three Pilot Securities.[160] Some of these commenters opined that the Tick Size Pilot data could be distorted if a number of market participants were to forego quoting and trading in the Test Group Three Pilot Securities because of the Trade-At Prohibition.[161] Other commenters argued that the Trade-At Prohibition would increase costs for investors.[162] One commenter pointed to Australian and Canadian rules[163] as evidence that market quality would be adversely affected and as a justification to not implement trade-at domestically.[164]

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market structure complexity); ECFTF Letter at 2 (stating the belief that Trade-At Prohibition introduces an unnecessary layer of complexity); STA Letter II at 6; ICI Letter at 4; ITG Letter at 3 (noting that the Trade-At Prohibition introduces unnecessary levels of complexity and associated unintended consequences); and Citadel Letter II at 6-7.

159 See MFA Letter II at 7 (expressing concerns that Test Group Three would exponentially increase the complexity and cost of the Tick Size Pilot) and Citigroup Letter at 4 (noting that overwhelming majority of the cost of the Tick Size Pilot can be attributed to the Trade-At Prohibition).

160 See CoreOne Letter at 7 (noting that an unintended consequence of Trade-At Prohibition is that a number of market participants will elect to trade using third parties or not trade at all in Test Group Three in order to avoid the cost of implementation).

161 See Two Sigma Letter at 3 and CoreOne Letter at 7 (noting that opting-out would potentially compromise the validity of the results and cast doubt on whether the results could be extrapolated to a broader based, final rule).

162 See CMR Letter II at 3 (noting that the inclusion of a Trade-At Prohibition without also addressing related issues like exchange access fees and backup systems could harm investors and increase the likelihood of extreme adverse market events); Schwab Letter at 2 (noting concerns that the Trade-At Prohibition will have on execution quality and cost for retail investors); and Citadel Letter II at 5.

163 See Australian Securities and Investment Commission Market Integrity Rule 4.1.1 and Investment Industry Regulatory Organization of Canada Universal Market Integrity Notice 12-0130.

164 See BlackRock Letter at 2. But see CFA Institute Letter at 2-3 (asserting that despite the negative market quality effects of trade-at rules internationally, the NMS plan should be implemented domestically as it could lead to valuable information).

Finally, three commenters supported testing the Trade-At Prohibition and encouraged the Commission to simultaneously reduce the market access fee cap.[165]

Ten commenters that opposed the Trade-At Prohibition nevertheless recommended modifications related to the provision should the Commission approve the Tick Size Pilot with the Trade-At Prohibition.[166] These other commenters' recommendations included, among other things, changing the scope of the Trade-At Prohibition,[167] and changing the retail price improvement exception.[168]

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165 See Virtu Letter at 2; CFA Institute Letter at 6; and Bright Trading Letter at 3. See also KOR Letter II at 5.

166 See KCG Letter at 11-17; NVCA Letter at 7; BATS Letter at 5-6 (noting that Trade-At Prohibition should only apply to protected NBBO, not protected quotes and executing against nondisplayed orders when the market is crossed); SIFMA Letter II at 4; BlackRock Letter at 2-3; Liquidnet Letter at 2 (noting that the thirteen exceptions are too complex); STANY Letter at 5-6; Bloomberg Letter at 15 (opining that there are less burdensome alternatives to the proposed Trade-At Prohibition, including reduced access fees, permitting issuers enter into contracts with market makers to set their own spreads, and implementing a trade-at prohibition that is more consistent with the June 2014 Order); KOR Letter II at 4-5; and Citadel Letter II at 7.

167 See BATS Letter at 5 (noting that Trade-At Prohibition should only apply to protected NBBO, not protected quotes); SIFMA Letter II at 7 (noting that broker-dealers should be able to internalize without any size limitation if they are quoting at the NBBO); BlackRock Letter at 2 (stating that non-displayed liquidity at NBBO should be allowed to execute); KOR Letter II at 5 (supporting a simplified Trade-At Prohibition independently); and Citadel Letter II at 7 (noting that the Trade-At Prohibition should not prohibit a trading center from executing more than displayed size).

168 See KCG Letter at 9 (stating the proposed Retail Investor Order definition is too complex); STANY Letter at 6 (stating that the price improvement of the Retail Investor Order exception needs to be greater and the attestation should be amended); KOR Letter II at 4 (stating that the Retail Investor Order exception would offset the purpose of the Trade-At Prohibition to promote the execution of displayed liquidity and should be eliminated); and Citadel Letter II at 8-9 (noting that all orders should have price improvement exception and exchange retail programs should not receive special treatment).

Fourteen commenters supported testing the Trade-At Prohibition.[169] Five commenters supported the Trade-At Prohibition as proposed.[170] Certain commenters expressed their belief that the Trade-At Prohibition could enhance displayed liquidity[171] and provide valuable information to the Commission.[172] Several commenters argued that the Trade-At Prohibition should apply to all securities not just Pilot Securities.[173] One commenter suggested that interested parties should not prejudge the efficacy of the Trade-At Prohibition and stated that "studying the impact of tick increments and display priority will benefit emerging growth companies regardless of whether the [Tick Size Pilot] leads to the permanent adoption of five-cent tick increments, national display priority, a Trade-At rule, or any other rule." [174] Another commenter, while skeptical about the benefits of the Trade-At Prohibition, supported its inclusion in the Tick Size Pilot in order to "gather hard evidence to help make the case . . . whether trade-at is a good idea."[175] Several commenters believed that the Trade-At Prohibition would support the price discovery mechanism and mitigate the migration of displayed interest to

169 See Adorney Letter; Wellington Shields Letter at 5; Themis Letter at 2 (expressing concerns for the exceptions to Trade-At Prohibition as overly complex); Virtu Letter at 2; BIO Letter at 4; CFA Letter at 5-6; CFA Institute Letter at 5 (stating the Tick Size Pilot as well as the Trade-At Prohibition would be a "useful exercise"); Bright Trading Letter at 2; Angel Letter at 10-11; CHX Letter at 17; IMC Letter at 2; Birch Bay Letter at 1 (stating strong support for the Trade-At Prohibition to curtail internalization); Nasdaq Letter at 4; and NYSE Letter at 3.

170 See Adorney Letter; Wellington Shields Letter at 3; BIO Letter at 4; CHX Letter at 17; IMC Letter at 1; and Nasdaq Letter at 4.

171 See Wellington Shields Letter at 5; CHX Letter at 17; and IMC Letter at 2.

172 See BIO Letter at 4.

173 See Adorney Letter ("every time an order is executed away in a dark pool at the same price (or some cruel di minimis price like $15.997), it is 100% trading ahead of potential orders. . .") and Vanguard Letter at 2.

174 See Nasdaq Letter at 4.

175 See Angel Letter at 10-11.

off-exchange trading venues.[176] Many of these commenters argued that the Trade-At Prohibition should be included in the Tick Size Pilot in order to mitigate this potential migration of trading.[177]

a. Protected Quotations Standard

Several commenters discussed the use of the protected quotation standard rather than the NBBO for the Trade-At Prohibition. Some commenters were concerned that using the protected quotation standard would protect less competitive prices and undermine price competition[178] or would be too onerous.[179] While other commenters favored using the protected quotation standard as a means to encourage posting lit quotations.[180] Two commenters requested that the protected quotation standard be clarified.[181]

b. SRO Quotation Feed

One commenter supported the use of an SRO Quotation Feed to post and execute trades

176 See CHX Letter at 17 (expressing concern that "if left unchecked migration could rise to a level where the price discovery mechanism provided by 'lit' venues could be compromised."); IMC Letter at 2; Nasdaq Letter at 5; and NYSE Letter at 3 (acknowledging speculation that larger ticks could lead to more internalization and harm liquidity, but believes the outcome is uncertain and it is important for the data to decide).

177 See CHX Letter at 17; IMC Letter at 2; and NYSE Letter at 3.

178 See CMR Letter II at 6.

179 See CMR Letter a 6; BATS Letter at 5 (stating that use of protected quotes at the NBBO properly balances the goal of rewarding those who set lit prices while also preserving trading center competition); and Citigroup Letter at 2.

180 See CFA Institute Letter 3 and CHX Letter at 18 (stating the protected quotation standard "supports price discovery" and is analogous to Rule 611 of Regulation NMS that would make it "simple to understand and implement").

181 See FIF Letter at 3 (requesting clarification on what quotes would be subject to the Trade-At Prohibition – protected quotations or NBBO) and Bloomberg Letter at 21 (inquiring whether a matching engine could use the protected quotation standard for routing while using the NBBO standard for matching).

at the protected quote.[182] This commenter stated that this feature would assist trading centers which cannot publish their own protected quotation.

c. Size Limitation

Several commenters discussed the Tick Size Pilot's Size Limitation.[183] Commenters specifically took issue with the restriction prohibiting a trading center from immediately accessing its hidden, reserve interest that is at a protected price.[184] Several commenters were concerned the Size Limitation would inhibit execution quality and create risks of information leakage.[185] Other commenters were concerned that the Size Limitation would add

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182 See CHX Letter at 18.

183 See Tabb Letter at 5; CMR Letter II at 6; STA Letter II at 10; KCG Letter at 15 (stating that the Size Limitation is beyond the scope of the Commission's June 2014 Order); BATS Letter at 5-6; SIFMA Letter II at 7; Citigroup Letter at 2; BlackRock Letter at 3; Bloomberg Letter at 13; CHX Letter at 19; Citadel Letter II at 7; and NYSE Letter at 3.

184 See STA Letter II at 10 (noting that the change in execution logic is highly complex and recommends that hidden orders be provided an exemption to satisfy incoming orders); SIFMA Letter II at 7 (stating that broker-dealers should be allowed to internalize order flow without a limitation on size if they are displaying a quote at the price of the NBB or NBO and execution quality of large orders primarily from institutions could be harmed); Bloomberg Letter at 13 (expressing lack of support for trading with all display before trading with reserve); and Citadel Letter II at 7 (noting that there is substantial un-displayed liquidity at exchanges through iceberg orders and other non-displayed orders, and tapping this additional liquidity is very important to institutional and retail investors).

185 See Tabb Letter at 5 (noting that execution certainty would be reduced); CMR Letter II at 6 (noting that information leakage risk would increase as investors with large orders would have to simultaneously execute against the BBO at multiple venues, thereby exposing the orders to significant signaling risk and market impact); BATS Letter at 5-6 (noting that not allowing execution of non-displayed order at a price equal to a protected quotation may disincent trading centers from quoting in the lit markets); SIFMA Letter II at 7 (stating that broker-dealers should be allowed to internalize order flow without a limitation on size if they are displaying a quote at the price of the NBB or NBO and execution quality of large orders primarily from institutions could be harmed); and BlackRock Letter at 3 (stating that the Size Limitation creates excessive delay in execution and sub-optimally broadcasts order flow in illiquid names to multiple venues when there might have been sufficient reserve or non-displayed interest to accommodate the order).

implementation complexity, among other things, due to additional routing obligations.[186] Two commenters supported the Size Limitation arguing that without it the Trade-At Prohibition would do very little to promote displayed liquidity.[187]

d. Venue Limitation

Commenters generally opposed the Venue Limitation because it would restrict market makers' execution of incoming orders to lit exchanges.[188] Commenters opined that the Venue Limitation offered little, if any, market quality enhancement, and was anti-competitive.[189] One commenter stated; "[T]here is no real benefit to price discovery and no real benefit to the displayed order; therefore, there is no incentive for market participants to display additional liquidity. It is simply a way to subsidize the for-profit exchanges by forcing more orders to be

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186 See CMR Letter II at 6; STA Letter II at 10 (noting that the change in execution logic is highly complex and recommends that hidden orders be provided an exemption to satisfy incoming orders); Citigroup Letter at 2 (noting that the Size Limitation and Venue Limitation are more onerous than any version of trade-at and there is no real benefit to price discovery and to displayed order); and BlackRock Letter at 3.

187 See CHX Letter at 19 (stating that without the Size Limitation, the Trade-At Prohibition would do little if anything to promote displayed liquidity and that it would reinforce the price discovery mechanism) and NYSE Letter at 3.

188 See CMR Letter II at 7 (noting that the Venue Limitation would increase message traffic between exchanges and other trading centers, which may cause additional failures of systems); KCG Letter at 16; SIFMA Letter II at 7 (stating that broker-dealers should be allowed to internalize order flow without a limitation on size if they are displaying a quote at the price of the NBB or NBO); Citigroup Letter at 2; Citadel Letter II at 7; and OTC Markets Letter at 8.

189 See KCG Letter at 16 (stating that the Venue Limitation is beyond the scope of the Commission's June 2014 Order and "anti-competitive on its face"); Citigroup Letter at 2 (noting that the Size Limitation and Venue Limitation are more onerous than any version of trade-at and there is no real benefit to price discovery and to displayed order); Citadel Letter II at 7 (stating that market makers should not be forced to route all of their orders to the exchanges who would then reap the full benefit of their unnecessarily high, but permitted, "take" fees); and OTC Markets Letter at 8 (stating that the Venue Limitation violates the most basic principles of competition and capitalism, under which a variety of venues should be able to compete to offer the best package of price and services to investors).

routed to them."[190] Two of the Participants, however, asserted that the Venue Limitation was an analog to the Size Limitation and is necessary to gauge the market impact of wider tick sizes.[191]

e. Block Size Orders

Several commenters suggested that the Block Size definition be altered to more accurately reflect block size transactions of small capitalization securities.[192] Two commenters recommended that the Block Size exception should be included in all Test Groups to help maintain institutional trading in Pilot Securities,[193] while another commenter stated that block trades should have the same execution increments as Retail Investor Orders.[194]

f. Other Test Group Three Exceptions

Seven commenters, while supporting the Trade-At Prohibition, recommended that its exceptions be modified.[195] Two commenters opined that the Trade-At Prohibition should not

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190 See Citigroup Letter at 2.

191 See CHX Letter at 20 (stating that the Venue Limitation is necessary for the same reason as the Size Limitation) and NYSE Letter at 3 (supporting the Venue Limitation to protect displayed quotes, strengthen the incentive for market makers to quote aggressively, and allow the ability to analyze the impact of a protected quote requirement on a wider tick size).

192 See SIFMA Letter II at 7 (stating that the block size definition should be decreased); BlackRock Letter at 3-4 (noting that "[n]early a third of equities eligible for the [Tick] [P]ilot have average daily trading volumes which are lower than 50,000 shares. A block of 10,000 shares would be incommensurate with the volume profile for these stocks as it represents a substantial percentage of the daily trading volume."); and Fidelity Letter at 7.

193 See JonesTrading Letter at 2 (asserting that the Negotiated Trade Exception should also apply to all Test Groups to preserve institutional anonymity) and Citadel Letter II at 8 (advocating for the exemption to preserve execution quality).

194 See Liquidnet Letter at 2 (noting that block execution is important to institutional investors and that block orders should be allowed to execute at half-penny increments).

195 See Themis Letter at 4-5; CFA Letter; CFA Institute Letter; Bright Trading Letter; IMC Letter; Birch Bay Letter; and NYSE Letter (supporting certain limited exceptions to the Trade-At Prohibition in circumstances where the end customer is benefited by the exception). See also IssuWorks Letter at 5 (while not expressing support or opposition to

contain exceptions similar to Rule 611 of Regulation NMS because the Trade-At Prohibition would then replicate the complexity of Regulation NMS.[196] Other commenters opined that the Retail Investor Order exception should be modified or eliminated.[197] One commenter stated that the fractional shares exception to the Trade-At Prohibition was reasonable because fractional shares cannot be displayed and this exception would have a minimal effect on the market.[198]

g. Odd Lots

Finally, several commenters made suggestions regarding odd lots. One commenter suggested that odd lots should be subject to the Trade-At Prohibition because current trading practices create a large number of odd lot trades that would circumvent the Tick Size Pilot.[199] Another commenter, however, suggested that odd lot orders be excepted from the Trade-At

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the Trade-At Prohibition, the commenter suggested that odd-lot trades should be subject to the Trade-At Prohibition). But see CHX Letter at 18 (supporting the exceptions as proposed).

196 See Themis Letter at 4-5 and CFA Letter at 5-6 (arguing that the exceptions should be eliminated and the price improvement for retail investors should be increased). But see FIF Letter at 3 (while not expressing support or opposition to the Trade-At Prohibition, the commenter stated that it approved of mirroring the Regulation NMS exceptions).

197 See CFA Letter at 5; CFA Institute Letter at 5-6 (objecting to the retail price improvement amount as not sufficient to prevent market participants from stepping in front of displayed limit orders); Bright Trading Letter at 2 (objecting strongly to the retail exception because retail order flow would be more valuable on the exchanges); IMC Letter at 2 (noting that $0.005 hardly qualifies as meaningful price improvement and recommends at least half of the applicable tick); and Birch Bay Letter at 1 (believing that price improvement should be the full five cent tick increment for retail orders).

198 See CHX Letter at 20.

199 See IssuWorks Letter at 5 (citing O'Hara, Yao, and Ye paper, What's Not There, The Odd-Lot Bias in TAQ Data, that asserted 19% of trades are missing from the consolidated tape).

Prohibition, as odd lots historically are often excluded from regulatory requirements.[200] One commenter requested clarity on the treatment of odd lots.[201]

E. Collection and Assessment of Tick Size Pilot Data

1. Trading Center Data

Several commenters stated that the Tick Size Pilot should leverage existing reporting requirements to ease the implementation burden.[202] Commenters suggested that existing data, such as data available through MIDAS,[203] Rule 605,[204] the SIPs,[205] and OATS,[206] could be used to lessen the burden of collection.[207] One commenter stated the collected data should focus only on data that allows for centralized comparisons and analysis.[208] This commenter also suggested

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200 See SIFMA Letter at 9 (asserting that larger orders divided up to create odd lots should not qualify for the exemption).

201 See BATS Letter at 6.

202 See CoreOne Letter at 6; STA Letter II at 3 (recommending a widely used quantitative market metrics to measure improvements and degradations in overall liquidity available); FIF Letter 3-4; SIFMA Letter II at 8; STANY Letter at 8-9; Nasdaq Letter at 6-7; and NYSE Letter at 2-3.

203 Market Information Data and Analytics System ("MIDAS") collects and processes data from the consolidated tapes as well as from separate proprietary feeds made individually available by each equity exchange. See http://www.sec.gov/marketstructure/midas.html.

204 Rule 605, Disclosure of Order Execution Information ("Rule 605") is a trading center monthly reporting requirement regarding covered orders in NMS stocks. See 17 CFR 242.605.

205 Securities Information Processor ("SIP") is any person engaged in the business of collecting, processing, or preparing for distribution information with respect to transactions or quotations. See 15 U.S.C. 78c(22).

206 See supra note 145 and accompanying text.

207 See CoreOne Letter at 6; STA Letter II at 4 (advocating for additional categories of data that can be obtained through MIDAS); SIFMA Letter II at 8; STANY Letter at 8-9; CHX Letter at 2; Nasdaq Letter at 6-7; and NYSE Letter at 2-3.

208 See FIF Letter at 3.

that only data relevant to increased liquidity of Pilot Securities should be collected.[209] Some commenters believed certain additional data metrics should be included to better facilitate the assessment of the Tick Size Pilot.[210]

Several commenters supported the public availability of data for potential analysis by academics and other interested parties.[211]

2. Market Maker Profitability Data

Thirteen commenters discussed whether the Market Maker Profitability Data should be collected.[212] Ten commenters opposed collecting the Market Maker Profitability Data[213] because they believe gathering such data would be costly.[214] One commenter noted that profitability

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209 See FIF Letter at 3-4 (suggesting sixteen specific data requirements that would be relevant to assessing liquidity).

210 See Bloomberg Letter at 17 (suggesting the NMS plan data include order type usage statistics, off-exchange trading information, and research coverage metrics); Weaver Letter at 2 (requiring brokers to report the number of shares internalized). See also IAC Recommendations.

211 See BIO Letter at 4 (stating an interest in reviewing the Tick Size Pilot results on an industry-by-industry basis); CFA Institute Letter at 6 (asserting that "[p]ublic release ensures accountability and peer review of the data by enabling independent researchers to look for unique and potentially valuable bits of information within the data."); Bloomberg Letter at 17; and KOR Letter II at 5-6 (urging the Commission to provide free and open access to Tick Size Pilot data to ensure broadened analysis from varied perspectives). Two commenters suggested that the data should be available in a downloadable format. See CFA Letter at 6; and FIF Letter at 2.

212 See Duffy Letter at 2; CoreOne Letter at 2 (noting that it is going to be very difficult to measure the impact on research coverage from market maker profitability); STA Letter II at 10; KCG Letter at 18; CFA Letter at 7; SIFMA Letter II at 9; Citigroup Letter at 4-5; FIF Letter at 5-6; STANY Letter at 8; TD Ameritrade Letter at 5; Angel Letter at 8; CHX Letter at 21-22; and NYSE Letter at 2.

213 See Duffy Letter at 2; STA Letter II at 10; KCG Letter at 18; SIFMA Letter II at 9; Citigroup Letter at 4-5; FIF Letter at 5-6; STANY Letter at 8; TD Ameritrade Letter at 5; CHX Letter at 21-22; and NYSE Letter at 2.

214 See SIFMA Letter II at 8 (arguing the collection of market maker profitability unnecessarily increases the burden on market makers) and FIF Letter at 5-6 (asserting

information is highly confidential and proprietary.[215] This commenter stated that profitability information is not currently disclosed except in a public company context, and requiring market makers to disclose their profitability to competitors (i.e., the exchanges) is anti-competitive. This commenter posited that market makers may opt-out of trading in Pilot Securities rather than disclose the profitability information.

Additionally, two commenters stated that Market Maker Profitability Data is difficult to calculate and attribute to a specific activity.[216] Other commenters argued that the Market Maker Profitability Data is not necessary or useful to the goals of the Tick Size Pilot and therefore should not be collected.[217] Some commenters suggested that this data element was unnecessary and would provide the Participants with a competitive insight and advantage on market maker operations.[218]

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that the collection of market maker profitability would involve significant implementation). See also STANY Letter at 8 and NYSE Letter at 2 (stating eliminating the collection of market maker profitability would reduce the cost of the Tick Size Pilot).

215 See STANY Letter at 8.

216 See Citigroup Letter at 4 (arguing it is not feasible, nor accurate, to measure market maker profitability on a symbol-by-symbol basis) and FIF Letter at 6 (calculating profit includes access fees and rebates that are computed monthly and not on a trade-by-trade basis at the time of execution).

217 See STA Letter II at 10; KCG Letter at 18; TD Ameritrade Letter at 5; and CHX Letter at 27. See also CoreOne Letter at 2 (asserting the correlation between market maker profitability and research would be difficult to determine).

218 See KCG Letter at 18 (stating that "[e]xchanges compete directly with market makers for order flow and should not collect, review and interpret their competitors' profitability data" and it would also place market makers at a disadvantage when negotiating for services provided by exchanges); Citigroup Letter at 5 (arguing that market maker profitability should not be published to a primary competitor); and STANY Letter at 8 (asserting that the collection of market maker profitability is "anti-competitive and extremely disadvantageous to market makers").

Three commenters supported the collection of the Market Maker Profitability Data.[219] One commenter stated that the collection of this data would help to identify the effect of the Tick-Size Pilot on market maker business practices.[220] Another commenter stated that Market Maker Profitability Data has analytical value for the Tick Size Pilot and indicated that the dissemination of the data on an aggregated basis would alleviate confidentiality concerns.[221]

One commenter stated the collection of the Market Maker Profitability Data should only be done if it is absolutely necessary for the Tick Size Pilot and, if so, then it should also be collected from ATSs and exchanges.[222] As a potential alternative to Market Maker Profitability Data, one commenter suggested the use of a "Market Maker/Investment Bank" scorecard that includes metrics or important drivers of liquidity.[223]

Two commenters expressed concerns related to the confidentiality of Market Maker Profitability Data because of the potential for such data to be reverse engineered and attributed to specific market participants after becoming publicly available.[224]

3. Assessment of Tick Size Pilot Data

Many commenters stated that the NMS plan should clearly define what would constitute a successful Tick Size Pilot and warrant implementation on a permanent basis.[225] Some

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219 See CFA Letter at 6-7; CFA Institute Letter at 6; and Angel Letter at 8.

220 See CFA Letter at 6-7.

221 See Angel Letter at 8.

222 See TD Ameritrade at 5.

223 See Fidelity Letter at 8.

224 See FIF Letter at 4 and STANY Letter at 8.

225 See ECFTF Letter at 3; CMR Letter II at 2; STA Letter II at 2; KCG Letter at 7; BATS Letter at 6; BlackRock Letter at 6; Schwab Letter at 10; STANY Letter at 4-5; Fidelity Letter at 5-6; and TD Ameritrade Letter at 5.

commenters stated that it is important to quantify, within the metrics, specific data ranges that would be considered successful.[226] Another commenter noted that "liquidity" should be defined in order to facilitate the assessment of the Tick Size Pilot's impact on liquidity.[227]

Other commenters suggested specific data that would indicate the Tick Size Pilot's success or failure.[228] One commenter, focused on issuers of small capitalization securities, stated that capital formation criteria should be used to gauge the success of the Tick Size Pilot.[229] Another commenter, however, was concerned that the Tick Size Pilot would be prejudged if success metrics were defined before empirical data was gathered.[230]

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226 See STA Letter II at 2 (stating the Tick Size Pilot's goals should be prioritized from the onset in the event a conflict among the specific goals developed.); KCG Letter at 8 (arguing that "the 200+ data collection items are susceptible to post-[Tick Size Pilot] use to build a story of "success" based on whatever criteria a given reviewer decides at that time"); BATS Letter at 6; BlackRock Letter at 6 (asserting that due to the associated costs of the Tick Size Pilot "criteria for success should also be unambiguous"); Schwab Letter at 10; STANY Letter at 4-5 (stating that without a clear metrics to determine success "[e]ach of the various business models will be able to lay a credible claim to success."); and Fidelity Letter at 5 (asserting that success metrics need to be clearly defined from the onset "to avoid post hoc justifications and arguments about success and failure.").

227 See Warner-Toomey Letter at 2.

228 See ModernNetworks Letter at 2 (stating increasing the number of committed market-makers, more market participants, larger trade sizes and deeper displayed buy-sell interest should determine the success of the Tick Size Pilot); Tabb Letter at 2 (providing six metrics that indicate success: market efficiency, greater liquidity, larger transaction size, increased certainty of execution, less off-exchange activity and greater price discovery, more market-making firms other than high-frequency firms); ECFTF Letter at 3 (indicating that Tick Size Pilot success should be determined by increase in relative level of trading liquidity, increase in change of institutional ownership, higher rate of equity capital issuance); and STA Letter II at 3-4. See also IAC Recommendations.

229 See ECFTF Letter at 3 (advocating for using higher rate of equity capital issuance as a metric for success).

230 See Nasdaq Letter at 4.

Three commenters stated that the Tick Size Pilot data should be analyzed on a more frequent periodic basis until the final assessment is conducted.[231]

F. Use of an NMS Plan

Fourteen commenters indicated that the Tick Size Pilot should not be the subject of an NMS plan, but instead should be presented as, and adhere to the procedural requirements of, a formal Commission rulemaking that includes additional cost-benefit analysis.[232] Some commenters believed that the Tick Size Pilot is a market structure initiative that is too significant and impactful to be delegated to the Participants through an NMS plan.[233] A number of commenters questioned whether it was appropriate to have Participants formulate an NMS plan that would affect their competitors.[234] Commenters were also concerned that not all affected market participants, such as market makers, broker-dealers, and institutional investors, were

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231 See FIF Letter at 6; KOR Letter II at 3; and CHX Letter at 6. See also STANY Letter at 9 (requesting the Tick Size Pilot continue while its final assessment is conducted to avoid unnecessary costs, potential confusion, and greater risks of system errors).

232 See Duffy Letter at 2; KCG Letter at 8-9; SIFMA Letter II at 7; MFA Letter II at 8; Wells Fargo Letter at 3; Citigroup Letter at 5; Schwab Letter at 8-9; STANY Letter at 9-10; Bloomberg Letter at 21-22; TD Ameritrade Letter at 4; ITG Letter at 4; Citadel Letter II at 3-4; Nasdaq Letter at 7; and OTC Markets Letter at 9.

233 See Schwab Letter at Letter 8-9; Bloomberg Letter at 22 (stating the Commission should not defer to Participants for such major policy decisions); ITG Letter at 4 (opining that the Tick Size Pilot would modify certain obligations under Regulation NMS, and that NMS plans should implement the Commission's policy directives but not amend existing regulations established under federal securities laws); and Citadel Letter II at 3 (asserting that the temporary nature of a significant pilot should not exempt it from traditional rulemaking).

234 See SIFMA Letter II at 2-3 (asserting the NMS plan benefits Participants more than others); TD Ameritrade Letter at 4 (stating the NMS plan unfairly gives more control of the Tick Size Pilot to one set of market participants over others); ITG Letter at 4 (stating that the SROs devising the NMS plan have potential conflicts of interests with ATSs and market makers); and Citadel Letter II at 4 (claiming that exchanges are able implement an NMS plan while excluding broker-dealers, issuers, investment funds, and the general investing public from the process).

included in the process of establishing the terms of the Tick Size Pilot and the NMS plan.[235] Additionally, some commenters intimated that a conflict of interest may exist by highlighting that the Participants who devised the NMS plan are now for-profit entities.[236]

G. Issuer Participation

A few commenters suggested that Pilot Security issuers should have discretion to set their own minimum increments.[237] One commenter stated that companies should be empowered to determine their increments by contract with market makers.[238] Another commenter stated there should be an "Issuer Committee" formed to advocate for the interests of issuers in the process.[239] Another commenter suggested the formation of a "Tick Size Pilot Advisory Committee" that would be able to provide input after the completion of the Tick Size Pilot comment period.[240]

Three commenters favored allowing issuers of Pilot Securities to opt-out of participating in the Tick Size Pilot.[241] One commenter stated that the decision to participate in the Tick Size Pilot should be determined by the Board of Directors or current shareholders of the company.[242]

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235 See Schwab Letter at 7 (asserting that "it is unacceptable for exchanges to design the [NMS] [p]lan without any input from other parts of the industry."); TD Ameritrade Letter at 4; and Citadel Letter II at 4.

236 See KCG Letter at 8-9; Schwab Letter at 7; TD Ameritrade Letter 1; and Citadel Letter II at 5.

237 See Bloomberg Letter at 16 and Angel Letter at 4.

238 See Bloomberg Letter at 16 (citing certain European markets that allow for issuers to contract with market makers to determine the spread).

239 See ModernNetworks Letter at 2.

240 See NYSE Letter at 3.

241 See DFA Letter at 3; Themis Letter at 2; and CCMC Letter II at 3.

242 See DFA Letter at 3.

Three commenters opposed the idea of allowing a Pilot Security issuer to opt-out of the Tick Size Pilot because it could skew the data.[243]

H. Implementation of Tick Size Pilot

Several commenters offered suggestions on how the Tick Size Pilot should be implemented. Two commenters suggested that the implementation period should be at least one-year, but could be reduced if the Tick Size Pilot was simplified.[244] One commenter indicated that in order to adequately assess the burden and time necessary to implement the Tick Size Pilot, the requirements needed to be finalized prior to developing an implementation schedule.[245] Other commenters stated that either the Commission, or the Participants, should release detailed frequently-asked-questions to assist implementation of the Tick Size Pilot to help alleviate confusion.[246] One commenter requested that the list of securities be finalized prior to determining the implementation schedule.[247]

V. Discussion and Commission Findings

In 1975, Congress directed the Commission, through the enactment of Section 11A of the Act,[248] to facilitate the establishment of a national market system to link together the individual

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243 See STA Letter II at 9; ICI Letter at 4; and CHX Letter at 9 (stating that an opt-out provision should be allowed only if there is also an opt-in provision; but either would be premature without data). See also IAC Recommendations.

244 See SIFMA Letter II at 10 (citing the rollout period required for other Commission actions and indicating that if the Trade-At Prohibition is removed a shorter time would be sufficient) and FIF Letter at 6 (asserting a twenty month implementation would be necessary for the current NMS plan, but if it was simplified only a twelve month period would be necessary).

245 See CHX Letter at 1.

246 See KCG Letter at 17; Liquidnet Letter at 2; and Bloomberg Letter at 20.

247 See Bloomberg Letter at 20.

248 15 U.S.C. 78k-1.

markets that trade securities. Congress found the development of a national market system to be in the public interest and appropriate for the protection of investors and the maintenance of fair and orderly markets to assure fair competition among brokers and dealers, among exchange markets, and between exchange markets and markets other than exchange markets.[249] Section 11A(a)(3)(B) of the Act authorizes the Commission, "by rule or order, to authorize or require self-regulatory organizations to act jointly with respect to matters as to which they share authority under this title in planning, developing, operating, or regulating a national market system (or a subsystem thereof) or one or more facilities."[250] Rule 608 under Regulation NMS provides that the Commission's approval of a NMS plan is required to be based upon a finding that the plan is "necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanism of, a national market system, or otherwise in furtherance of the purposes of the Act."[251] Further, Rule 608 provides the Commission with the authority to approve a NMS plan, "with such changes or subject to such conditions as the Commission may deem necessary or appropriate."[252]

While the Commission has reviewed certain aspects of decimalization and tick sizes over the years, the Commission has not tested whether a wider tick size for small capitalization stocks improves the market quality for these stocks.[253] As noted above, the JOBS Act directed the

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249 15 U.S.C. 78k-1(a)(1)(C)(ii).

250 15 U.S.C. 78k-1(a)(3)(B).

251 17 CFR 242.608(b)(2). See also 15 U.S.C. 78k-1(a).

252 17 CFR 242.608(b)(2).

253 See supra note 56 and accompanying text. These commenters suggested that the Commission had already studied the impact of tick sizes. While the Commission staff did prepare the Decimalization Report, which summarized academic literature related to

Commission to conduct a study, which resulted in the Decimalization Report. The Decimalization Report further recommended a public roundtable, which in turn produced broad support among its panelists for a pilot program. Since issuing the June 2014 Order, the Commission has received 77 comment letters that relate to, among other things, the development, costs, and complexity of the Tick Size Pilot, and the Commission has carefully considered the comments and the issues raised. The Commission has conducted significant analysis relating to the development, costs, and complexity of the Tick Size Pilot. As noted in the June 2014 Order and reflected in several comment letters,[254] it has been suggested that the minimum one penny tick size has had a detrimental impact on incentives for underwriters to pursue public offerings of smaller capitalization stocks, the production of sell-side research, and the incentives for broker-dealers to make markets in the securities of smaller capitalization companies. The Commission believes that it is in the public interest to gather objective evidence on the impact of the minimum tick size, and study a minimum of $0.05 tick size, on the trading, liquidity and market quality of securities of smaller capitalization companies.

The Commission believes that the Tick Size Pilot set forth in the NMS plan is reasonably designed to provide measurable data that should facilitate the ability of the Commission, the public, and market participants to review and analyze the effect of tick size on the trading, liquidity, and market quality of securities of smaller capitalization companies. The Tick Size Pilot should provide a data-driven approach to evaluate whether certain changes to

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the impact of decimalization, the Commission has not studied the impact of wider ticks on small capitalization stocks. See Decimalization Report, supra note 14.

254 See June 2014 Order, supra note 4. See also IssuWorks Letter at 2; ECFTF Letter at 1; BIO Letter at 2 ("The one-size-fits-all tick size imposed by decimalization has hampered small company growth since it was implemented in 2000."); BlackRock Letter at 1; and CCMC Letter II at 2.

the market structure for Pilot Securities would be consistent with the Commission's mission to protect investors, maintain fair, orderly and efficient markets and facilitate capital formation.

As described in detail below, the Commission, consistent with Rule 608, is modifying certain aspects of the NMS plan and the Tick Size Pilot. Specifically, the Commission is making the following changes to the NMS plan: (1) extending the Pilot Period to two years; (2) lowering the market capitalization threshold criteria for identifying Pilot Securities to $3 billion or less; (3) modifying the Trade-At Prohibition by: (i) amending the definition of trade-at to clarify that the provision would only be operative during Regular Trading Hours; (ii) removing the Venue Limitation, and (iii) lowering the thresholds in the Block Size definition; (4) modifying the data elements related to Market Maker Profitability Data by: (i) removing the data element that would have required realized trading profits to be calculated net of fees and rebates, and (ii) requiring further aggregation of the Market Maker Profitability Data made publically available; (5) requiring Participants to provide an assessment on the impact of the Tick Size Pilot on market maker profitability; and (6) modifying the time when Participants must submit their assessments to the Commission.

The Commission received comments on market structure issues other than the Tick Size Pilot, such as maker-taker fee structures, access fees, payment for order flow, high frequency trading, and subpenny quoting.[255] The Tick Size Pilot is a targeted, limited-term pilot that is directed at analyzing discrete issues related to a segment of the equity markets. While the Commission appreciates market participants' views and opinions on these matters, the Commission believes that there would be substantial additional costs and complexity if the Tick Size Pilot were expanded to address these additional issues, and that they are broader than what

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[255] See supra notes 67-70 and accompanying text.

the Commission wants to study in connection with the Tick Size Pilot. Therefore, the Commission is not expanding the Tick Size Pilot to assess these other market structure issues.

A. Costs and Complexity of the Tick Size Pilot

The Commission received numerous comments related to the costs and complexity of implementing and complying with the Tick Size Pilot in general, and Test Group Three in particular.[256] Commenters also expressed concerns about the potential increased costs that might be incurred by market participants, investors, and issuers as a result of the wider minimum tick size mandated by the Tick Size Pilot.[257]

With respect to market participants, such as trading centers and routing brokers, commenters believed that those market participants would incur substantial costs to reprogram and/or implement and operate as brand new, their trading, order routing, compliance, and other systems to implement the Tick Size Pilot. Such reprogramming or new implementation of systems would also include additional testing and compliance costs. Concerns were particularly pronounced with respect to the costs and complexity of implementing Test Group Three and its Trade-At Prohibition and, as noted above, some commenters believed market participants might cease trading Test Group Three securities for the proposed one-year duration of the Tick Size Pilot rather than incur those implementation costs.[258] Other commenters expressed concerns that the complexity of the Tick Size Pilot would lead to increased operational risks for market

256 See supra Section IV.A. See also infra Section V.D.4. for the discussion on Test Group Three and the Trade-At Prohibition.

257 See supra Section IV.A.

258 For a full discussion of the change in the Pilot Period to two years to address these concerns, see infra Section V.B.

participants and the market as a whole. One commenter believed that the Tick Size Pilot would impede its ability to trade efficiently in Pilot Securities.

The Tick Size Pilot, by design, is an objective, data-driven test intended to evaluate how a wider tick size would impact trading, liquidity, and market quality of securities of smaller capitalization companies. As noted above, the Commission cannot know in advance the full effects, whether positive or negative, of a wider tick size on the behavior of market participants in response to the Tick Size Pilot. While the effects of wider tick sizes for small capitalization stocks on trading, liquidity, and market quality are not clear, the Commission believes that the Tick Size Pilot will generate data to help inform whether significant benefits, such as improved liquidity and market quality, could be realized by investors, issuers, and other market participants. The Tick Size Pilot will provide the Commission and interested parties with real-world data regarding the effects of wider tick sizes on trading, liquidity and market quality for small-capitalization companies, and this empirical data will inform analyses and may serve as a basis for potential future regulatory actions to, among other things, capture any benefits from wider tick sizes on a permanent basis. The Commission, therefore, believes that the potential magnitude of the benefits that could be revealed by the Tick Size Pilot justify the costs of the Tick Size Pilot.

The Commission acknowledges that implementation of the Tick Size Pilot would create costs for market participants and potential operational risks. The Commission has taken seriously the concerns about costs, complexity, and operational risks, and has tried to carefully balance those concerns with the objectives and goals of the Tick Size Pilot. As a result, in response to comments, the Commission has decided to exercise its authority under Rule

608(b)(2)[259] to modify the Tick Size Pilot, as described below and elsewhere in this order. As noted by a one commenter, "[a]ny systems change, no matter how thoroughly prepared and tested, creates a risk of error and negative impact to the market."[260] The Commission acknowledges that implementation of the Tick Size Pilot may involve operational risks, but believes that the Tick Size Pilot's design will permit market participants to leverage the use of existing compliance systems, which have been tested and currently are in use, and that this should serve to mitigate operational risks. In addition, certain of the Commission modifications to the Tick Size Pilot will further align the Tick Size Pilot requirements with existing systems which should further mitigate operational risks. The Commission believes that these Tick Size Pilot modifications should lessen the costs, complexity, and operational risks of its implementation and compliance without impairing the quality and relevance of the data to be collected. The Commission also notes that it is approving a one-year implementation period, which should provide market participants with adequate time for the careful development and rigorous testing of their compliance systems for the Tick Size Pilot.

Trading centers (i.e., exchanges, alternative trading systems, and market makers and other internalizing broker-dealers), as well as non-trading center broker-dealers that route orders for customers or themselves and certain institutional and other investors, would incur costs to implement and comply with the Tick Size Pilot. Market participants would need to modify systems to comply with the minimum $0.05 quoting and/or trading increment and applicable exceptions for all three Test Groups. While some systems changes would be required for the purposes of the Tick Size Pilot, market participants already have systems in place to comply with

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259 17 CFR 242.608(b)(2).

260 See SIFMA Letter at 6.

the existing minimum $0.01 quoting increment and applicable exemptions under Rule 612 of Regulation NMS.[261] Rule 612 ("Subpenny Rule") prohibits trading centers, among other things, from accepting, ranking or displaying an order priced greater than $1.00 per share in an increment smaller than $0.01, absent an applicable exemption. Consequently, the Commission believes that compliance with the quoting restrictions of the Tick Size Pilot would be implemented in a manner similar to the Subpenny Rule, so that trading centers and other market participants would be able to leverage existing Subpenny Rule compliance systems by, for example, adjusting their parameters from $0.01 to $0.05 as applicable. Nonetheless, the costs to market centers to implement the Tick Size Pilot could be substantial.[262]

As noted above, many commenters expressed concerns about the costs and complexity of implementing and complying with Test Group Three, and the Commission acknowledges the particular complexity of implementing and complying with the Trade-At Prohibition.[263] Among other things, trading centers would need to monitor protected quotations on other trading centers and prevent an execution that would match the price of any such quotation unless the trading center itself was displaying a protected quotation at that price, and of at least that size, absent an applicable exception. While compliance with the Trade-At Prohibition would require systems changes by trading centers, the Commission believes that, as with the minimum quoting increment, trading centers should be able to leverage existing compliance systems when

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261 17 CFR 242.612.

262 See CHX Letter at 17 (Estimating that its potential implementation costs for all three Test Groups would be approximately $140,000, and suggesting that such costs for approximately 60 market centers could be in excess of $8.0 million). See also supra note84.

263 See supra Section IV.A. See also infra Section V.D.4. for the discussion on Test Group Three and the Trade-At Prohibition.

implementing this aspect of the Tick Size Pilot. Trading centers today already have systems in place to comply with the provisions of Rule 611 under Regulation NMS ("Trade-Through Rule")[264] and applicable exceptions, which operates in a manner similar to the Trade-At Prohibition. In addition, as discussed below, the Trade-At Prohibition has been designed to closely parallel the operation of Rule 611 (e.g., by using protected quotations as the compliance benchmark rather than the NBBO, by mirroring most of the Rule 611 exceptions into the Trade-At Prohibition, and, as modified by the Commission, by eliminating the Venue Limitation). Accordingly, the Commission believes that trading centers should be able to efficiently build upon their existing Rule 611 compliance systems, which today monitor protected quotations on other trading centers and prevent an execution at a price worse than such quotations absent an applicable exception, to comply with the Trade-At Prohibition. In addition, the Commission acknowledges that certain non-trading center broker-dealers that desire to control the routing of their orders today monitor protected quotations and use "intermarket sweep orders" to allow trading centers to rely on an exception from Rule 611. These broker-dealers also would need to make adjustments to their compliance systems if they desire to use the comparable intermarket sweep order exception to the Trade-At Prohibition but, as with trading centers, the Commission believes they should be able to efficiently leverage their existing Rule 611 compliance systems to do so. Because compliance with the Trade-At Prohibition would be implemented in a manner similar to compliance with Regulation NMS, and by leveraging those longstanding systems, the Commission does not believe that compliance with the Trade-At Prohibition would create material additional operational risks or materially reduce the efficiency of trading in Pilot Securities as market participants already are complying with Regulation NMS.

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264 17 CFR 242.611.

The Commission also acknowledges that trading centers would be required to produce specified data in connection with the Tick Size Pilot and there would be some associated costs and burdens.[265] Among other things, trading centers would have to produce certain data on market quality, orders, and market maker participation, and market makers additionally would be required to produce certain profitability data. The Commission believes that trading centers should be able to leverage existing systems for collecting and reporting execution quality data under Rule 605 of Regulation NMS for certain of the data relating to market quality and order information.[266] With respect to producing Market Maker Profitability Data, the Commission notes that market makers may capture trading profit data for internal business purposes. As discussed further below, the Commission believes that the design of the Trading Center Data already mitigates concerns about confidentiality and has further modified the Market Maker Profitability Data requirements to address concerns regarding the confidentiality of that data.[267]

The Commission recognizes that trading centers and market makers would be required to incur some additional costs to produce the specific data called for by the Tick Size Pilot. In particular, the Commission recognizes that trading centers and market makers would need to make changes to their systems to compile the data and that transmitting the data would entail costs as well. However, as discussed below, the Trading Center Data and Market Maker Profitability Data are necessary to examine specific components of the Tick Size Pilot. As such,

265 See, e.g., FIF Letter at 5-6; SIFMA Letter at 8 ("the data collections specified in Appendices B and C of the Proposed Plan are extremely burdensome on broker-dealers and should be eliminated . . . The proposed collections of order and profitability data unnecessarily increase the burden on all trading centers, especially market makers who would be subject to both Appendix B and C."); Nasdaq Letter at 6; and Citadel Letter at 8.

266 17 CFR 242.605.

267 See infra Section V.E.2

the Tick Size Pilot will provide the Commission and interested parties with real-world data regarding the effects of wider tick sizes on trading, liquidity, and market quality for securities of small capitalization companies, and this empirical data will inform analyses and potential future regulatory actions to, among other things, capture any benefits from wider tick sizes on a permanent basis.

As discussed below in Section V.E.2, the Commission is modifying certain aspects of the Tick Size Pilot to reduce the data production burdens and related concerns about the confidentiality thereof (e.g., by eliminating the requirement for market makers to report realized trading profits net of fees and rebates, and by requiring Market Maker Profitability Data that is made publicly available to be further aggregated).[268] The Commission is not modifying the Trading Center Data to address confidentiality concerns. First, the order data and the market quality data would be available on a significant lag, mitigating potential risks about confidentiality. One concern is that order data and market quality data may reveal the trading intentions of market participants. However, this concern is mitigated if the data is disseminated with a significant lag because market participants may have completed their trades, rendering this information less sensitive. Second, the Commission does not believe that the order data would be sufficiently detailed to identify particular investors or their trading strategies. Further, current market quality data identifies the trading center producing the data, so any increases in risks regarding confidentiality are unlikely to be significant. The collection and analysis of relevant data, however, is the central purpose of the Tick Size Pilot. The effects of wider tick sizes for small capitalization stocks on trading, liquidity, and market quality are not clear and the

268 The Commission also notes that data production costs should also be reduced as a result of the modification of the market capitalization threshold which will reduce the universe of potential Pilot Securities. See infra Table 1 in Section V.C.1.

Tick Size Pilot will provide data to allow the Commission to effectively test for the potential benefits and costs of permanently changed tick sizes. The Commission believes that the potential magnitude of the benefits that could be revealed by the Tick Size Pilot justify the costs of running the Tick Size Pilot.

Finally, the Commission acknowledges the concerns expressed by commenters about the potential increased costs that might be incurred by investors and issuers as a result of the wider minimum tick size mandated by the Tick Size Pilot.[269] As noted above, several commenters expressed concern that the Tick Size Pilot would help market professionals at the expense of investors. In fact, two commenters believed that the increased costs to investors could exceed $200 million per year. Other commenters expressed the view that the Tick Size Pilot could raise the cost of capital for issuers.[270] Other commenters suggested that an assessment of investor costs should be completed prior to the implementation of the Tick Size Pilot.

The Commission notes that the central purpose of the Tick Size Pilot is to assess the market quality impact of an increase in the tick size for the securities of smaller capitalization companies, which is comparable to assessing the impact of the Tick Size Pilot on investors. Notwithstanding the opinions of the commenters, whether an increased tick size would improve market quality, or increase or reduce execution costs for some or all investors, in some or all Pilot Securities, is not known at this time. As further discussed in Section V.C.1, the number of potential Pilot Securities that currently trade with a spread of greater than $0.05, and less than

269 See supra note 59 and accompanying text. See also IAC Recommendations (expressing concern that a pilot would disproportionately harm retail investors because their trading costs would rise). The Commission has carefully considered the IAC Recommendations from January 2014. After careful deliberation and considering the IAC Recommendations, the Commission is approving the NMS plan, as modified.

270 See supra note 78 and accompanying text.

$0.05, is approximately equal. For Pilot Securities that currently trade with less than $0.05 spread, the costs for investors to trade smaller orders, typically placed by retail investors, at the quote may increase while the costs for investors to trade small orders in general may or may not increase, depending on the degree to which trades execute between the bid and the offer. The impact on larger orders, typically placed by institutional investors, however, is not clear. The impact on Pilot Securities that currently trade with a spread of greater than $0.05 similarly is not clear, as spreads in these securities may change as well depending on the impact of an increase in the tick size on market making incentives. The Commission notes that the exception for Retail Investor Orders was proposed by the Participants as a means to reduce the risk of the Tick Size Pilot having a detrimental impact on retail investor execution quality, and further, the Commission has made modifications to the proposal submitted by the Participants (e.g., lowering the market capitalization threshold to exclude securities that tend to have narrower spreads and, with respect to the Trade-At Prohibition, removing the Venue Limitation[271] and liberalizing the Block Size definition).[272]

With respect to the specific cost estimates, the Commission appreciates the efforts of commenters to quantify costs and has carefully assessed the estimates. These estimates rely on historical trading data and reasonable assumptions on how retail execution quality may change with wider tick sizes. The Commission cannot know, however, the full impact of wider tick

271 The removal of the Venue Limitation should reduce the potential costs and complexity associated with the proposed Tick Size Pilot by not requiring liquidity that would have been affected by the Trade-At Prohibition to be routed from off exchange venues to lit venues. See infra Section V.D.4.d.

272 The modification to liberalize the Block Size definition should serve to mitigate disruptions to the institutional trading of securities with smaller market capitalization. See infra Section V.D.4.e.

sizes on investors, before the Tick Size Pilot is underway. With the exception of the modifications and consideration for retail investors in the original design of the Tick Size Pilot, the Commission does not believe it can further reduce these costs without sacrificing the utility of the Tick Size Pilot. Specifically, the Commission would need to focus the Tick Size Pilot exclusively on stocks with higher transaction costs, which are determined by spreads. As noted in Section V.C.3. below, if the tick size mechanically affects a criterion for inclusion, then the Tick Size Pilot would be severely limited in its ability to inform any future rulemaking by the Commission. While the effects of wider tick sizes for small capitalization stocks on trading, liquidity, and market quality are not clear, the Commission believes that the Tick Size Pilot will generate data to help inform whether the significant benefits, such as improved liquidity and market quality, could be realized by investors, issuers, and other market participants. The Tick Size Pilot will provide the Commission and interested parties with real-world data regarding the effect of wider tick sizes on trading, liquidity, and market quality for small-capitalization companies and this empirical data will inform analyses and potential future regulatory actions to, among other things, capture any benefits from wider tick sizes on a permanent basis. The Commission, therefore, believes that the potential magnitude of the benefits that would be revealed by the Tick Size Pilot justify the costs of the Tick Size Pilot.

Similarly, while the Commission recognizes the potential connection between tick size, liquidity, and cost of capital, the impact of an increased tick size on the costs and ability of issuers to raise capital, if any, is not known at this time. As noted above, the Commission believes that altering tick sizes could result in significant market-wide benefits and improvements to capital formation. In particular, if a wider tick size leads to more active market making and attracts more investors to small capitalization stocks, positive effects on trading, liquidity, and market quality as measured by metrics such as trading volume, displayed depth, effective spreads, or execution costs for small and large trades could be observed. Indeed, some advocates for a tick size pilot argue that a wider tick size would benefit issuer's capital formation and cost of capital.[273] Nonetheless, the Commission recognizes that these benefits may not manifest in the manner or to the extent anticipated. Further, the Commission believes that the design of the Tick Size Pilot and the data in the Appendices will facilitate robust analyses to help assess the benefits and costs of wider tick sizes. Nevertheless, the Commission intends to carefully monitor implementation of the Tick Size Pilot and, should it appear that the protection of investors is compromised, the Tick Size Pilot can be modified or terminated early to protect them and integrity of the market.

Some commenters expressed the view that the Tick Size Pilot should have been implemented through Commission rulemaking that includes a cost-benefit analysis or that the Commission should have conducted a cost-benefit analysis as part of the NMS plan process. The Commission reasonably concluded that proceeding with the Tick Size Pilot through an NMS plan was an appropriate way to gather information necessary to assess whether changes should ultimately be made through rulemaking or otherwise. As discussed in detail in the June 2014 Order, and noted above, consideration of issues related to minimum tick sizes has been ongoing for years.[274] That history of study led the Commission to conclude that it could not adequately evaluate the need for additional regulatory action without empirical data that would be generated from a pilot implemented through an NMS plan. The Commission is modifying the NMS plan in response to comments, including comments with respect to the costs and benefits. Consideration

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273 See, e.g., BIO Letter at 5.

274 See supra Section II. See also June 2014 Order, supra note 4 for a further discussion on the history of decimalization and tick sizes.

of the potential costs and benefits of the Tick Size Pilot is reflected in the June 2014 Order, the Notice and this order which also addresses comments about the potential competitive impact and other economic consequences of the NMS plan.

The Commission's approval of the NMS plan is designed and intended to produce measurable data to study the impact of a wider tick size on the liquidity and trading in the securities of smaller capitalization companies, which should support an objective data-driven review of this important policy issue. Legitimate questions have been raised about the impact of decimalization on the market for small capitalization securities.[275] The Tick Size Pilot, as modified, should produce valuable data to allow the Commission, the public, and market participants to assess the impact of a wider tick size on the trading, liquidity, and market quality of smaller company stocks. Notwithstanding, the Commission would, and expects the Participants to, actively monitor the operation of the Tick Size Pilot[276] and, if necessary, the Tick Size Pilot can be modified or terminated early to ensure the protection of investors and integrity of the market.

In addition, the Commission emphasizes that it welcomes the submission of additional comments and empirical evidence during the Pilot Period with respect to, among other things, the operation of the Tick Size Pilot, in particular the three Test Groups, and the costs associated therewith. The Commission would take such comments into account in its consideration of related future regulatory actions.

B. Tick Size Pilot Duration

275 See supra note 9 and accompanying text.

276 See June 2014 Order, 79 FR at note 50, supra note 4. As noted in the June 2014 Order, during the Pilot Period, the Commission believes that Participants should notify the Commission if they detect any broadly negative impact of the Tick Size Pilot on market quality.

As proposed, consistent with the June 2014 Order, the Pilot Period would be for one year. In the June 2014 Order, the Commission noted that it preliminarily believed that a one-year Pilot Period would be sufficient to generate data to reliably analyze the effects and impact of wider tick sizes. Several commenters argued that the Pilot Period should be longer than one-year.[277] Commenters suggested that the Tick Size Pilot would be too complex and costly to implement for a one-year Pilot Period, which could lead market participants to opt-out of quoting and trading in the Pilot Securities, especially in Test Group Three Pilot Securities.[278] As noted by several commenters, the one-year Pilot Period could lead some market participants to decide not to participate in the Tick Size Pilot.[279] For example, one commenter suggested that a one-year Pilot Period would not be "enough time to warrant start-up costs and other investments to participate."[280] Another commenter suggested that a longer Pilot Period would "provide a better incentive for investments that market participants will need to make in order to increase their exposure to the small cap[italization] market."[281] Some commenters suggested that a longer Pilot Period could also help justify its up-front implementation costs. Commenters noted that if market participants did not participate in the Tick Size Pilot, the reliability of the data could be compromised.

The Commission recognizes that there would be start-up costs and other investments associated with participating in the Tick Size Pilot, and does not want the Pilot Period to be a disincentive to participate. The Commission believes that extending the Pilot Period to two

277 See supra note 89 and accompanying text.

278 See supra note 90 and accompanying text.

279 See supra notes 95-96 and accompanying text.

280 See Duffy Letter at 1. See also ABC letter at 3.

281 See ABC Letter at 3.

years would help address some of those concerns in part by having those costs spread out over a longer period. The Commission expects that a longer Pilot Period should encourage wider participation (or remove incentives to opt-out of participation) and therefore help make the data more reliable, richer, and useful.[282] Accordingly, after carefully considering the comments, the Commission is modifying the NMS plan by lengthening the Pilot Period from one-year to two-years.

The Commission does not think it is necessary to extend the Tick Size Pilot beyond two years. As noted above, several commenters suggested a Pilot Period longer than two years.[283] In the Order, the Commission noted its preliminary belief that a one-year period would generate sufficient data to reliably analyze the effects and impact of the wider tick size. The Commission continues to believe that meaningful data could be generated in a relatively short time period but believes that extending the Pilot Period for one additional year could encourage participation in the Tick Size Pilot, which further supports the goal of generating sufficient data. If a number of market participants decided to refrain from participating in the Tick Size Pilot, the ability to generate and collect data sufficient to study the impact of wider tick sizes would be frustrated. The Commission also notes that a longer Pilot Period should help to mitigate concerns that the data generated from the Tick Size Pilot could be susceptible to short term fluctuations as suggested by commenters. Therefore, the longer Pilot Period should also support

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282 The Commission notes that market makers not trading in Pilot Securities would forgo the profits they could earn from trading in those securities. Those foregone potential profits would be larger over a longer time period. In addition, the larger potential profits that could be earned by market makers over the longer time period should help to offset any implementation and compliance costs associated with trading in the Pilot Securities.

283 See supra Section IV.B.

representational faithfulness.[284] The Commission understands that some commenters supported the one-year Pilot Period.[285] However, the Commission believes that the longer Pilot Period is necessary for the reasons discussed above.

The Commission received comments on whether the Tick Size Pilot should cease at the end of the Pilot Period or continue to operate while the data are assessed.[286] As described below, the Participants will be required to submit their assessment 18 months after the start of the Tick Size Pilot, based on data generated during the first 12 months.[287] This timing is consistent with the timing set forth in the June 2014 Order,[288] but would provide the Commission and the public with valuable information about the Tick Size Pilot's impact during the Pilot Period. In addition, the Trading Center Data and Market Maker Profitability Data would be publically available during the Pilot Period, which would allow market participants and the public to conduct analysis during the Pilot Period.

The Commission, however, is only approving a Pilot Period of two years in this order. Any proposal to extend the Tick Size Pilot beyond the two-year term would be considered and

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284 In this respect, the Commission notes that the costs of implementing the Tick Size Pilot should be justified not by a longer duration per se, but by the benefits that a longer Tick Size Pilot would bring in generating useful data that could guide potential future tick size rulemaking. The Commission notes that one commenter suggested that the proposed one-year time period would make the data easy to manipulate. See Duffy Letter at 1. As noted, the Commission believes that the longer Pilot Period should support data integrity.

285 See supra Section IV.B.

286 See supra notes 105-108.

287 Therefore, the modification to the Pilot Period will not delay assessment of the Tick Size Pilot.

288 The June 2014 Order and proposed NMS plan provided that Participants should submit their assessment six months after the end of the Tick Size Pilot, which would have been 18-months after the start of the Tick Size Pilot.

evaluated at a later date. Therefore, the modification to the Pilot Period of the Tick Size Pilot, extending its duration to two-years, is appropriate.

C. Criteria for Pilot Securities

The Tick Size Pilot sets forth five criteria for determining which NMS common stocks would be included: (1) market capitalization of $5 billion or less; (2) Closing Price of at least $2.00 on the last day of the Measurement Period; (3) Closing Price of at least $1.50 on every trading day during the Measurement Period; (4) CADV of one million shares or less; and (5) VWAP of at least $2.00.

1. Market Capitalization for Pilot Securities

Many commenters noted that the market capitalization threshold was too high and recommended that the threshold be lowered.[289] Commenters expressed views that the $5 billion market capitalization threshold would include many securities not considered as small capitalization stocks. Certain comments recommended that the market capitalization threshold be as low as $250 million to $2 billion. After carefully considering the comments and reviewing prior staff analysis,[290] the Commission deems it appropriate to change the NMS plan by lowering the market capitalization threshold for Pilot Securities from $5 billion or less to $3 billion or less. In the June 2014 Order, the Commission preliminary believed that a market capitalization of $5 billion or less would capture the securities of smaller and middle capitalization companies with low liquidity and trading activity, and would provide the Tick Size Pilot with a broad sample. However, in response to the comments received, the Commission

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289 See supra Section IV.C.1.

290 See June 2014 Order, supra note 4.

staff reviewed its analysis of stocks from a period of July 1, 2013 to August 31, 2013,[291] and found that lowering the market capitalization threshold from $5 billion or less to $3 billion or less should ensure that there would be a sufficient sampling of stocks to support the analysis of the Tick Size Pilot, including as it relates to a variability in effective spreads, particularly effective spreads greater than 5 cents per share for Pilot Securities. Table 1 reflects staff's analysis.

Table 1: Effective Spread Distribution[292]

Market Capitalization Categories	Number of Stocks	Effective Spreads (in cents) 90th Percentile	10th Percentile	Percent of Stocks with Effective Spread > $0.05
Less than $1 billion	1,979	25.33	1.42	53.97
Less than $2 billion	2,376	23.10	1.43	50.04
Less than $3 billion	2,574	22.31	1.43	48.10
Less than $5 billion	2,758	21.93	1.43	46.63

Overall, Table 1 provides evidence that the selection of a market capitalization threshold involves trading-off potential sample size, which affects statistical power,[293] and the potential negative impact of the Tick Size Pilot on stocks with low current effective spreads. The analysis in Table 1 shows that no single threshold can produce a clear-cut sample of securities for the Tick Size Pilot. In particular, for each potential market capitalization threshold in the table, approximately 10% of stocks have effective spreads of 1.43¢ or less. Further, for stocks in the

291 See June 2014 Order, supra note 4.

292 Data in this table covers common stocks with average price greater than $2 per share and average daily trading volume smaller or equal than one million shares during the period of July 1, 2013 - August 31, 2013. Data comes from the NYSE's Trade and Quote Data.

293 Statistical power is the ability to detect an effect, if the effect actually exists.

lower thresholds, more stocks have higher effective spreads. This shows that the range of effective spreads is greater for lower market capitalization stocks. However, the number of stocks in the potential sample declines with market capitalization as well. Table 1 also shows that lowering the market capitalization threshold from $5 billion or less to $3 billion or less would reduce the universe of potential Pilot Securities by only 184 stocks, which suggests that the threshold of $3 billion or less would restrict the Tick Size Pilot to smaller stocks while still assuring a sufficiently large sample.

Therefore, the Commission believes that it is necessary and appropriate to change the NMS plan by lowering the market capitalization threshold to $3 billion or less. The Commission notes that this change would result in fewer securities eligible to be included in the Tick Size Pilot, but this reduction should not materially impact the Tick Size Pilot's goal of generating useful data. Further, the lowered threshold should lessen the impact of the Tick Size Pilot on the overall market, in that stocks included in the Test Groups would be smaller and less liquid; and their combined trading volume as a proportion of the overall market volume would also be lowered.

Many commenters recommended lowering the market capitalization threshold to $1 billion or less (or to an even lower threshold).[294] However, Table 1 shows that further reducing the market capitalization threshold from $3 billion or less to $1 billion or less would reduce the number of Pilot Securities by additional 595 stocks. The Commission believes that such a reduction in market capitalization would result in a sample size that is too small (1,979 stocks, including the Control Group), significantly reducing the power of a statistical analysis of the Tick Size Pilot. Moreover, the threshold of $1 billion or less would limit the ability to assess the

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294 See supra note 115 and accompanying text.

impact of the widened ticks on stocks with different market capitalizations and hence the utility of the Tick Size Pilot in assessing possible market capitalization thresholds for a potential future tick size rulemaking.[295]

2. Other Proposed Selection Criteria for Pilot Securities

The Commission received a few comments on the other proposed selection criteria.[296] For example, one commenter suggested that the volume threshold should range from 300,000 to 500,000 for illiquid shares. The Commission has considered these comments but does not believe it is necessary to modify the Tick Size Pilot any further in response. First, by having a floor of 300,000 shares, many small capitalization firms would be excluded from the Tick Size Pilot. Second, the upper threshold of 500,000 would reduce the sample size and limit the variation in stock characteristics in the Tick Size Pilot. The goal of the Tick Size Pilot is to study the effect of tick size on the liquidity and trading of small capitalization stocks. Therefore, the Commission believes that the universe of Pilot Securities should include a variety of stock characteristics in the sample to facilitate the ability to conduct fulsome assessments.

Other commenters suggested that the CADV be lowered or that it should be based on the dollar trading value or that it should be based relative to public float. The Commission has considered these comments but does not believe it is necessary to modify the Tick Size Pilot any further in response. In particular, it is widely known that these volume measures are highly

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295 Two commenters recommended lowering the market capitalization threshold to $2 billion or less see supra note 115 and accompanying text. That threshold would suffer from the same disadvantages as the threshold of $1 billion or less, although to a lesser extent. In particular, Table 1 shows that reducing the market capitalization threshold from $3 billion or less to $2 billion or less would reduce the number of Pilot Securities by additional 198 stocks. See supra Table 1 in Section V.C.1. The threshold of $2 billion or less would also limit the ability to assess the impact of the widened ticks on stocks with different market capitalizations.

296 See supra Section IV.C.2.

correlated with each other and therefore would most likely produce similar samples of Pilot Securities. Further, share volume is less correlated with market capitalization than other volume measures, so it would add the most as a separate criterion.

3. Additional Criteria for Pilot Securities

Commenters also suggested additional criteria for selecting the Pilot Securities.[297] For example, several commenters suggested that the average weighted daily spread of five cents or greater should be a criterion because some securities with spreads less than five cents would not benefit from the Tick Size Pilot. After careful review, the Commission believes that the selection criteria as proposed in the NMS plan, and modified by the Commission, are appropriate. In particular, the Commission believes that the selection criteria should provide an appropriate number of securities to test while also minimizing potential concerns about costs to investors and issuers. Further, tick size does not mechanically affect the approved criteria set forth in the Tick Size Pilot, making it more informative for any potential future tick size rulemaking.

The Commission does not believe that a spread criterion should be included. Tick size mechanically affects alternative criteria such as bid-ask spreads and effective spreads, such that using such criteria to determine Pilot Securities would make the Tick Size Pilot less informative on when the tick size in a stock should be smaller. In addition, researchers should be better positioned, without spread criteria that is set forth by the NMS plan, to use Tick Size Pilot data to independently suggest tick size criteria for securities with smaller capitalization

4. Securities Excluded from the Tick Size Pilot

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297 See supra Section IV.C.3.

The Tick Size Pilot, as proposed, excludes securities that have had an IPO within six months of the start of the Pilot Period. Commenters expressed views on other securities that should be excluded from the Tick Size Pilot, including securities that are cross-listed in Canada and securities that trade below $1.00 per share during the Pilot Period. The Commission notes that securities that are cross-listed in Canada are included in other NMS provisions and plans; accordingly the Commission believes that such securities should also be included in the Tick Size Pilot. The Commission also notes that researchers may choose not to include all securities in the Test Groups when they undertake their analyses. In particular, researchers may choose not to include securities that are cross-listed with Canada if they think the results of their analyses may be significantly affected.

The Commission believes that the exclusion of securities that have participated in a recent IPO is necessary because such stocks would not have a full data set prior the start of the Tick Size Pilot, which would limit the ability of the Commission and the public to analyze the effects of the Tick Size Pilot against a sufficient baseline.

One commenter suggested that the NMS plan specifically eliminate Pilot Securities that trade at $1.00 or less during the Pilot Period. The Commission notes that the Participants proposed additional selection criteria to minimize the likelihood that securities that trade with a share price of $1.00 or less would be included in the Tick Size Pilot. Specifically, there are three criteria that seek to evaluate the share price of potential Pilot Securities: (1) a closing price of at least $2.00 on the last day of the Measurement Period; (2) a closing price on every U.S. trading day during the Measurement Period that is not less than $1.50; and (3) a Measurement Period VWAP of at least $2.00 per share. The Participants stated that these criteria were designed to avoid having securities priced $1.00 or less selected as Pilot Securities but the Participants state that Pilot Securities would not be excluded from the Tick Size Pilot if their share price falls to $1.00 or less during the Pilot Period. The commenter has not suggested that these criteria are not sufficient for this purpose but states that it is "reasonable to expect a small number of Pilot Securities to trade below $1.00 during the Pilot." The Commission believes that once established, the universe of Pilot Securities should stay as consistent as possible so that the analysis and data can be accurate throughout the Pilot Period.

Finally, the Commission received a few comments supporting the exclusion of ETFs from the Tick Size Pilot. The Commission agrees that these securities should be excluded because their pricing is derivative of the value of their component securities.

5. Assignment of Pilot Securities

The NMS plan contains procedures for stratified random sampling in which the Participants would assign the Pilot Securities into 27 categories, and then randomly assign Pilot Securities into the Tick Size Pilot groups (Control Group and three Test Groups), based on the percentages of Pilot Securities in each category. The Commission did not receive comments with respect to this aspect of the NMS plan.

In the June 2014 Order, the Commission stated that the assignment of Pilot Securities into each test group should involve stratified sampling by market capitalization and price. The Participants proposed to add the CADV to the market capitalization and price. The Commission believes that the addition of CADV should ensure that each test group contains a representative of the total universe of Pilot Securities. Specifically, this should help ensure that the four groups of securities are comparable to each other in terms of stock characteristics and therefore should provide an ideal experimental setting for robust analysis of the Tick Size Pilot.[298]

D. Control Group and Test Groups

The Tick Size Pilot would have a Control Group and three Test Groups, comprised of 400 Pilot Securities per test group. Test Group One Pilot Securities would quote in $0.05 per share increments and would trade at any currently permitted increments. Test Group Two Pilot Securities would quote in $0.05 per share increments like those in Test Group One, but would only be permitted to trade in $0.05 per share increments, subject to three exceptions. Finally, Test Group Three Pilot Securities would quote in $0.05 per share increments and trade at $0.05 per share increments consistent with Test Group Two, and be subject to the Trade-At Prohibition. Pilot Securities in the Control Group would continue to quote and trade at the pricing increments that are currently permitted.

Several commenters opined about the design of the Tick Size Pilot. For example, some commenters suggested that the Tick Size Pilot should be narrower, with only one or two test groups which would lessen the cost and complexity of the Tick Size Pilot.[299] Other commenters supported the incremental design of the Tick Size Pilot.

The Commission notes that the NMS plan has been designed to incrementally assess potential changes to the Tick Size Pilot, such that Test Group One would only add a wider quoting increment, while Test Group Two would also add a wider trading increment, and finally Test Group Three would add the Trade-At Prohibition. The Commission believes that

298 Ideally, researchers would want to have identical stocks in each group to isolate the effects of the different treatments in the four groups. However, because this is not possible, researchers employ techniques to make the stocks in the four groups as similar as possible. The SROs have proposed such a technique.

299 See supra note 126 and accompanying text.

constructing the Tick Size Pilot in this manner should generate the most meaningful and measurable data that should allow the Commission and other interested parties to conduct studies.

Commenters also expressed their views that other tick sizes, both larger and smaller than the proposed $0.05 tick size increment, should be included and tested concurrently within the Tick Size Pilot.[300] In the June 2014 Order, the Commission stated its preliminary belief that $0.05 is an appropriate minimum increment, due to the significant percentage of Pilot Securities with a bid-ask spread of greater than $0.05. As noted above, the Commission modified and analyzed potential Pilot Securities based on the $3 billion market capitalization threshold, for a period of July 1, 2013 to August 31, 2013 and found that 48.1 percent of these securities had effective spreads greater than $0.05.[301] For these securities, the impact on costs to investors of an increase of the minimum price increment to $0.05 is not clear, as effective spreads in these securities may change as well depending on the impact of an increase in the tick size on market making incentives. For securities with effective spreads smaller than $0.05, the effective spread may or may not rise due to the increase in the minimum increment, depending on the degree to which trades execute between the bid and the offer. Increased effective spreads, holding everything else equal, would represent increased costs to investors. However, the Tick Size Pilot will be able to address whether the increased minimum increment will lead to more market maker participation and ultimately, to more liquidity in small capitalization stocks, which may counteract increased costs due to higher effective spreads. The Commission believes that the data supports the conclusion that, on balance, the $0.05 increment is appropriate for the Tick

300 See supra notes 129-131 and accompanying text.

301 See supra Table 1 in Section V.C.1.

Size Pilot because it should mitigate cost increases to investors while supporting a robust test. While commenters suggested additional increments to test along with the $0.05 increment, the Commission believes that additional increments could increase the Tick Size Pilot's complexity by, for example, increasing the number of test groups in the Tick Size Pilot, which in turn would require more programming development and system changes by market participants.[302]

In the NMS plan, the Participants proposed 400 Pilot Securities per Test Group positing that the increased size of each Test Group would help to ensure a sufficient data yield for the completion of required assessments even in the event of the removal or exclusion of Pilot Securities. The Commission received three comments on this aspect of the Tick Size Pilot, two of which said the Test Groups should be smaller and one who thought 400 was appropriate.[303] The Commission believes 400 Pilot Securities per Test Group should be large enough to generate data to reliably test for the effects of larger tick size, and should make the Tick Size Pilot more resilient in the event of the unforeseen removal or exclusion of Pilot Securities. Therefore, the Commission believes that assigning 400 Pilot Securities to each Test Group is appropriate.

The Commission received a few other comments related to the operation of the Tick Size Pilot. Specifically, two commenters offered differing opinions with respect to whether the Tick Size Pilot should operate during opening and closing auctions.[304] The Commission notes that the

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302 While additional increments would provide additional data and would allow for additional tests, the Commission believes that the Tick Size Pilot with one increment will allow for a comprehensive analysis of the effects of an increased tick size and the added complexity would not be justified. In addition, the added complexity of additional increments may not only make analyses more complicated, but rather may even reduce the statistical power of such analyses and increase the operational risk of implementing the Tick Size Pilot.

303 See supra note 125 and accompanying text.

304 See supra notes 132-133 and accompanying text.

NMS plan provides that the Tick Size Pilot would be operational during and outside of Regular Trading Hours, which is defined in the NMS plan as consistent with Rule 600(b)(64) of Regulation NMS.[305] If the Participants find that further clarification or modification is needed to address the opening and closing auctions, they may utilize the procedures set forth in Rule 608 to amend the NMS plan. However, the Commission notes that switching to penny increments during these auctions may cause additional complexity and would be different than how these auctions are currently run. Specifically, opening and closing auctions typically do not operate with increments different than the increments used during Regular Trading Hours.

In addition, two commenters requested clarification on how to handle orders that do not conform to the quoting increments.[306] The Commission notes that the Participants, as required under the NMS plan, would be required to adopt rules that are needed for compliance by the Participants and their members with the provisions of the Tick Size Pilot.[307] In addition, the Participants, as required under the NMS plan would be required to develop written policies and procedures that are reasonably designed to comply with the quoting and trading requirements of the Tick Size Pilot. Therefore, the Participants should ensure that they address issues and questions related to the operation of the Tick Size Pilot during the implementation period.

1. Control Group

The Pilot Securities in the Control Group would be quoted and traded in any increment currently permitted. Any Pilot Securities that are not selected to be included in a test group

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[305] See NMS plan Section I(CC) and 17 CFR 242.600(b)(64) defines Regular Trading Hours as the time between 9:30 a.m. and 4:00 p.m. Eastern Time.

[306] See supra notes 134-135 and accompanying text.

[307] Any new rules or changes to existing rules of the Participants would be subject to Section 19 of the Act. See 15 U.S.C. 78s.

would be placed in the Control Group. The Commission believes that the Control Group should provide a baseline for the analysis of the effect of the Tick Size Pilot on liquidity and market quality data.

2. Test Group One: Widened Quote Increment

As discussed above, Pilot Securities in Test Group One would have a quoting increment restriction of $0.05 but could continue to trade at any currently permitted price increment. The Participants would be required to adopt rules that would prohibit the Participants or any member of a Participant from displaying, ranking, or accepting from any person any displayable or non-displayable bids or offers, orders, or indications of interest in increments other than $0.05. Orders priced to execute pegged to the midpoint of the NBBO and orders entered in a Participant's retail liquidity program could be quoted at less than the $0.05 increment. The Commission notes that Test Group One would be different from the Control Group in only one manner—the quoting increment would be widened.

Several commenters argued that Test Group One should be eliminated because trading for Test Group One Pilot Securities would migrate to non-displaying trading centers.[308] One commenter also suggested eliminating Test Group One to reduce the complexity of the Tick Size Pilot.[309] This commenter believed that eliminating Test Group One would reduce the costs of implementing the Tick Size Pilot and posited that "there is little disagreement" that Test Group One would divert order flow to unlit markets.[310]

308 See supra Section IV.D.1.

309 See supra note 136 and accompanying text.

310 The Commenter did however acknowledge that removing Test Group One from the Tick Size Pilot would be a significant change. See KOR Letter II at 3.

The Commission, however, believes, as noted above, that Test Group One is necessary as an initial incremental change to test the impact of the Tick Size Pilot on market quality and liquidity of this market segment. The Commission believes that Test Group One is reasonably designed to generate data on how trading characteristics and liquidity would change if the quoting increment alone is widened. One commenter suggested that exchanges and agency ATSs would be at a competitive disadvantage vis-à-vis broker-owned proprietary execution systems which can execute orders at any increment without accepting or ranking an order at an impermissible increment. This commenter recommended that market participants be permitted to accept and rank, but not display, orders in one penny increments for Test Group One.[311] The Commission notes the quoting restrictions of Test Group One would be implemented in a manner similar to Rule 612, the Subpenny Rule.[312] Further, the Commission notes that the issue raised by the commenter is present in the current trading environment with Rule 612, where brokers may execute trades in increments finer than $0.01 so long as they do not accept, rank, or display orders in such increments. The Commission believes it is important to test and evaluate Test Group One with a design that is similar to the current trading environment and within the context of the Tick Size Pilot's incremental design that should permit qualitative comparison with Test Group Two and Test Group Three. Accordingly, the Commission does not believe it is necessary to modify the Tick Plan to address the distinction raised by the commenter.

While commenters have raised counterpoints, the Commission believes that it is necessary to initially test this incremental change to generate data to analyze the impact, if any, on market quality for the Pilot Securities in Test Group One. The Commission notes that Test

311 See BATS Letter at 3.

312 17 CFR 242.612.

Group One would only test how a wider quoting increment implemented using the current regulatory framework, reflected in Rule 612, could impact the liquidity and trading of smaller capitalization securities. Test Group One is not designed to favor one group of market participants over other groups of market participants any more than the existing regulatory framework. In particular, including Test Group One would allow the Tick Size Pilot to examine each change incrementally to identify the changes that are economically most important. Further, the Commission recognizes that the design of the Test Groups create differing incentives for the display and execution of orders which may result in the migration of order flow,[313] which is why the inclusion of Test Group One is vital. This Test Group could potentially generate data on the degree to which widening the quoting increment alone results in a migration to non-displaying trading centers.

Specifically, Test Group One should enhance the ability of the Tick Size Pilot to generate data on the effects of wider ticks and any resulting order flow migration on liquidity, execution quality, volatility, market maker profitability, competition, and transparency.

3. Test Group Two: Widened Quote and Trade Increment

Pilot Securities in Test Group Two would be required to be quoted in a $0.05 increment, like Test Group One, but trading would be limited to the $0.05 increment subject to three exceptions. Specifically, executions could occur at a price other than a $0.05 increment in the following circumstances: (1) midpoint executions at the NBBO or best protected bid and best

313 For example, if a larger minimum quoting increment leads to wider bid-ask spreads, but the trading increment remains unchanged, it would produce an incentive to internalize order flow and execute off-exchange because price improvement would be relatively cheaper to provide.

protected offer; (2) retail price improvement of at least $0.005 better than the best protected bid or offer; and (3) Negotiated Trades.

After carefully weighing comments, the Commission believes that Test Group Two and the exceptions, including the exception for retail price improvement, are reasonably designed to generate data on how trading characteristics and liquidity would incrementally change relative to Test Group One if the trading increment is widened. The Commission believes it is important to measure the incremental impact of a trading increment on market quality for small capitalization stocks and it would be useful to compare the data generated by this Test Group against the data in Test Group One. As the Commission noted in the June 2014 Order, if the minimum quoting increment is changed without corresponding changes to the minimum trading increment, market participants may be hesitant to display liquidity in larger $0.05 increments if other market participants could easily trade ahead of them in smaller increments.

As noted above, commenters raised concerns with respect to the retail price improvement exception.[314] Some commenters argued that the exception should be broadened to include all orders as a means to alleviate implementation burdens. Some commenters argued that the level of price improvement should be increased to more than the proposed $0.005. Another commenter expressed its opposition to the retail exception because it believes that the exception would undermine the Tick Size Pilot.[315]

By allowing Retail Investor Orders to trade at certain prices other than the $0.05 trading increment and receive price improvement, the Commission believes that some of concerns related to costs for retail investors could be minimized. As noted earlier in Section V.A., retail

314 See supra Section IV.D.2.

315 See supra notes 155-156 and accompanying text.

investors may incur costs due to the Tick Size Pilot in the form of wider bid-ask spreads, which imply less favorable prices and high transaction costs if retail investors were required to trade only at the displayed quotation. As noted above, many potential Pilot Securities would have bid-ask spreads of greater than $0.05, although an equal number may have spreads less than $0.05. Therefore, the Tick Size Pilot could potentially widen bid-ask spreads of some Pilot Securities, which could increase costs for retail investors. The ability to receive price improvement, therefore, should reduce some retail investor costs. Further, the Commission does not believe that the exception for Retail Investor Orders would undermine the Tick Size Pilot and believes it is appropriate to provide this exception for retail investors.

The Commission, however, does not believe that it is necessary or appropriate to expand the price improvement exception to all orders. The Commission believes that such a modification could undermine the purpose of Test Group Two, which is to assess the impact of a trading increment on trading and liquidity. As noted above, this exception was designed to mitigate cost concerns for retail investors that typically receive price improvement under current trading conditions.[316]

Commenters stated that the attestation should not be required because it would be unwieldy for trading centers to conduct surveillance to ensure that only bona fide retail orders qualify.[317] The Commission notes that certain Participants have approved retail liquidity programs that require market participants to submit an attestation. Thus, many market

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316 See June 2014 Order supra note 4.

317 See supra Section IV.D.2. See also Tabb Letter at 5; Two Sigma Letter at 2 ("It is unclear how a trading center receiving order flow from large numbers of natural persons can design surveillance programs that would allow them to confidently make this attestation."); KCG Letter at 9 (noting that the definition of Retail Investor Order was too complex and ambiguous and would lead to many of the largest retail firms to not sign the required attestations); STANY Letter at 6; and TD Ameritrade at 5.

participants must currently comply with an attestation requirement, and should already have the appropriate policies and procedures in place. While it should not be unwieldy for these trading centers to conduct surveillance for the attestation requirement, the Commission acknowledges that there would be additional costs for trading centers and their market participants that are not currently required to comply with the attestation requirements. However, the Commission believes that the attestation requirement is necessary to promote the integrity and goals of the Tick Size Pilot by helping to ensure that only bona fide retail orders entered by market participants are eligible for the retail price improvement exception.

The Commission acknowledges that there are potential downsides to widening the quoting and trade increment to $0.05 but believes that the Tick Size Pilot is designed to reasonably balance the need to generate data and the potential higher costs for investors. The Commission also recognizes that the $0.05 quoting and trading increment for Test Group Two could have an effect on competition between exchanges and non-exchange trading centers, including the potential migration of order flow. The extent of any such potential order flow migration or other competitive impact is not known at this time. The Commission believes that the data analysis from the results of Test Group Two should provide information on the potential competitive impact and the incremental economic effects of a wider trading increment, including any incremental effects on the incentives for the display and execution of orders that may result in the migration of order flow relative to the other Test Groups and the Control Group. This should better inform the Commission and interested parties of the impact of a wider tick increment.

4. <u>Test Group Three: Widened Quote and Trade Increment with a Trade-At Prohibition</u>

Pilot Securities in Test Group Three would be quoted and traded in $0.05 increment like Test Group Two and provided with the same trading exceptions. In addition, Test Group Three would introduce another incremental change—the Trade-At Prohibition. In the June 2014 Order, the Commission described a trade-at prohibition as requiring a trading center that was not displaying at the NBBO at the time the trading center received an incoming marketable order to either: (1) execute the order with significant price improvement ($0.05 or the midpoint of the NBBO); (2) execute the order at the NBBO if the size of the incoming order is of block size; or (3) route intermarket sweep orders to execute against the full displayed size of the protected quotations at the NBBO and the execute the balance of the order at the NBBO price. In the Notice, the Commission noted that, in the context of the Tick Size Pilot, an important purpose of a trade-at requirement would be to test whether, in a wider tick environment, the ability of market participants to match displayed quotes, without quoting, would negatively affect market makers' quoting practices. The Commission further noted that if quoting practices were affected negatively, then it could undermine one of the central purposes of the Tick Size Pilot, namely to determine whether wider tick sizes positively affect market maker participation and pre-trade transparency. For example, if the results of Test Groups One and Two were to show an improvement in liquidity with wider tick increments but a loss to transparency because of an order flow migration to the OTC market, perhaps Test Group Three would show similar improvements to liquidity but without the loss to transparency.

The Participants proposed to define "trade-at" in the NMS plan as "the execution by a trading center of a sell order for a Pilot Security at the price of a protected bid or the execution of a buy order for a Pilot Security at the price of a protected offer."[318] The Commission notes that the proposed definition of trade-at set forth in the NMS plan would require compliance with the Trade-At Prohibition outside of Regular Trading Hours. In particular, the NMS plan states that the Tick Size Pilot would be applicable during and outside of Regular Trading Hours.[319] The application of the Trade-At Prohibition outside of Regular Trading Hours would extend its application beyond what is currently required for the Trade-Through Rule under Regulation NMS.[320] As noted above, the Commission expects that market participants would be able to leverage existing Rule 611 systems for implementing and complying with the Tick Size Pilot, which currently do not apply outside of Regular Trading Hours. The application of the Trade-At Prohibition outside of Regular Trading Hours would be broader than what the Commission envisioned for trade-at and could increase implementation and compliance burdens for market participants. Therefore, the Commission has deemed it necessary to modify the definition of trade-at under the NMS plan to provide that it is only applicable during Regular Trading Hours.

Under the proposed Trade-At Prohibition, trading centers that are not quoting cannot match protected quotations and a trading center quoting at the protected quotation can execute orders but only up to the size of its displayed quotation. The Tick Size Pilot included thirteen exceptions to the Trade-At Prohibition, when trading centers may trade at a protected quotation or price match.

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318 See NMS plan Section (I)(LL).

319 See NMS plan Section (IX).

320 The definition of "trade-through" in Rule 600(b)(77) of Regulation NMS provides that it is applicable during Regular Trading Hours. See 17 CFR 242.600(b)(77).

The Commission received several comments that opposed the inclusion of the Trade-At Prohibition.[321] Commenters raised concerns about the complexity and costs of implementing Test Group Three which they concluded could lead market participants to forego participation in Test Group Three and distort the resulting data. Other commenters suggested that the Trade-At Prohibition would increase operational risks. Several commenters suggested that Test Group Three should be eliminated to reduce the complexity related to the Tick Size Pilot. Other commenters suggested that the Trade-At Prohibition would increase investor costs if off-exchange venues are restricted in their ability to compete for executions. One commenter pointed to Australian and Canadian rules as evidence that market quality would be adversely affected and as a justification to not implement trade-at domestically.

Several commenters, however, supported the inclusion of the Trade-At Prohibition.[322] Commenters raised concerns that Test Group One and Test Group Two could provide less incentive for market participants to display liquidity and result in trades migrating to dark venues. As noted by several commenters, wider spreads, and the potential increased profits derived therefrom, could incentivize market participants to execute more transactions in Pilot Securities on dark venues.[323] Some commenters, therefore, supported including the Trade-At Prohibition to test its impact on displayed liquidity and market quality.

The data generated by this test group should inform the Commission, the public, and market participants on the incremental impact of the Trade-At Prohibition on trading characteristics and liquidity of Pilot Securities when the quoting and trading increments are

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321 See supra note 157 and accompanying text. See also Section IV.A.

322 See supra note 169 and accompanying text.

323 See supra note 176 and accompanying text.

widened. The Trade-At Prohibition should test whether market participants are incentivized to display more liquidity in a wider tick environment. Therefore, the Commission believes that the inclusion of the Trade-At Prohibition should enhance the utility of the Tick Size Pilot. Further, the data generated by Test Group Three would allow the Commission and the public to test the incremental impact on displayed liquidity and market quality in a wider tick environment when compared to Test Group One and Test Group Two. As noted, several commenters stated that trading in Test Groups One and Two could migrate to non-displayed venues. As a control measure, the Commission believes that it is important to test whether given larger quoting and trading increments, market quality could be enhanced by an incentive to display liquidity such as the Trade-At Prohibition.[324]

However, the Commission acknowledges commenters' concerns about the cost and complexity of the Trade-At Prohibition. The Commission is therefore modifying the Trade-At Prohibition, as described below, to mitigate and address some of these concerns. The Commission believes that the modifications to the Trade-At Prohibition should reduce the complexity of the provision while maintaining its utility in the Tick Size Pilot. The modified Trade-At Prohibition, as well as the modification to extend the Tick Size Pilot's duration, should work in tandem to ensure that there is wider participation in the Tick Size Pilot.

The Commission recognizes that the Trade-At Prohibition may have some effect on competition between exchanges and non-exchange trading centers. However, the Commission does not believe that this modified Trade-At Prohibition should have significant effects on this competition. Non-exchange trading centers should continue to be able to compete with

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324 The Commission notes that the inclusion of Test Group Three would not necessarily provide data that could examine whether a broader trade-at prohibition, applied to all securities with all tick sizes and fewer exceptions, would benefit investors.

exchanges for order flow, albeit either in a displayed manner or by providing price improvement. Further, the Commission believes that the exceptions to the modified Trade-At Prohibition, such as the exception for Retail Investor Orders and Block Size orders, should exclude the types of transactions that occur primarily off-exchange.[325] As a result, the Trade-At Prohibition should not result in a migration to exchanges of transactions not likely to occur on exchanges in the Control Group. In addition, the Tick Size Pilot data should facilitate tests on the effect of a conditional Trade-At Prohibition on investors and the effect on competition of any resulting migration to exchanges. Finally, the Commission notes that the market structure and regulatory framework in Australia and Canada are very different from the U.S. market structure and regulatory framework. For example, the U.S. equity market structure includes higher levels of off-exchange trading and trading is dispersed among a large number of market centers.[326] Accordingly, the Commission believes the experiences of those jurisdictions with a trade-at prohibition are not clearly relevant when considering a trade-at prohibition in the context of the Tick Size Pilot. As discussed above, the Commission believes that the Trade-At Prohibition is necessary to fully study the impact on the liquidity and trading of smaller capitalization securities.

The Participants proposed deviations from, or additions to, the trade-at prohibition set forth in the June 2014 Order, as follows: (1) the proposed Trade-At Prohibition would apply to any protected bid or protected offer, rather than just the NBBO; (2) trading centers displaying a quote at the price of a protected quote on an SRO proprietary quote feed could execute an

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325 See Laura Tuttle, SEC Staff Paper, OTC Trading: Description of Non-ATS Trading in National Market System Stocks, (March 2014) available at http://www.sec.gov/marketstructure/research/otc_trading_march_2014.pdf.

326 See Securities Exchange Act Release No. 61358 (January 14, 2010), 75 FR 3593 (January 21, 2010) ("Concept Release on Equity Market Structure").

incoming order at that displayed price; (3) a trading center could only execute up to its displayed size (i.e., Size Limitation); (4) a trading center must execute where the protected quotation is displayed (i.e., Venue Limitation); (5) nine exceptions to the Trade-at Prohibition modeled after the exceptions found in Rule 611 of Regulation NMS; and (6) an exception for fractional shares.

a. Protected Quotations Standard

The Participants proposed to use a protected quotation standard rather than the NBBO for the Trade-At Prohibition. As described in the Notice, the protected quotation standard would give broader protection to aggressively displayed quotes because the protected quotation standard encompasses the aggregate of the most aggressively priced displayed liquidity on all trading centers, while the NBBO standard is limited to the single best order in the market.[327]

A few commenters opposed expanding the Trade-At Prohibition to protected quotations. One commenter suggested that protecting less competitive prices than the NBBO would undermine price competition and increase complexity,[328] while other commenters supported the protected quotation standard because it would encourage more aggressive quoting on multiple trading centers.[329]

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327 See 17 CFR. 242.600(b)(42). When two or more market centers transmit to the plan processor identical bids or offers for an NMS security, the best bid or best offer is determined by ranking the identical bids or offers by size and then time. As a result, while two market centers may display identical prices, only one market center will display the national best bid or national best offer. Moreover, the Commission notes that the NBBO could contain manual quotations.

328 See supra Section IV.D.3.a.

329 Two other commenters requested clarification related to the protected quotation standard. The Commission notes that specific clarification questions should be addressed by the Participants during the implementation period. See supra note 181 and accompanying text.

After careful consideration, the Commission believes that using protected quotations as the basis for the Trade-At Prohibition is appropriate. The protected quotations standard should further enhance displayed liquidity by providing incentives for market participants and trading centers to display additional liquidity. The Commission does not believe that using protected quotations for the Trade-At Prohibition would necessarily result in less price competition. The Commission expects that market participants would continue to compete to provide liquidity via the best priced orders under the Tick Size Pilot.[330] Further, the Commission believes that using the protected quotations standard should help to alleviate concerns that the Tick Size Pilot is complex and costly to implement, as it would allow more displaying trading centers to execute orders at their displayed price and because market participants currently use the same standard to comply with Rule 611 of Regulation NMS.

b. <u>SRO Quotation Feed</u>

The Participants proposed to allow price matching by trading centers that have displayed a quote at the price of a protected quote through an SRO proprietary data feed. One commenter stated this feature would assist a trading center that cannot publish its own protected quotation.[331] The Commission believes that the use of an SRO proprietary data feed is appropriate. Trading centers displaying a quote on an SRO proprietary data feed have contributed to displayed liquidity, and therefore should be able to trade at these displayed prices, subject to the Size Limitation.

c. <u>Size Limitation</u>

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330 The Commission notes that Rule 611 of Regulation NMS would apply to transactions executed under the Tick Size Pilot.

331 <u>See supra</u> Section IV.D.3.b.

The Participants proposed to limit the price matching by trading centers that have displayed a protected quote with the Size Limitation. Under the Size Limitation, displaying trading centers would only be permitted to execute an incoming order up to the size of its protected quotation, and executions against undisplayed interest at that price level could not occur unless other protected quotations at that price are satisfied. Several commenters opposed the Size Limitation.[332] Commenters suggested that hidden reserve orders at the protected quotation price level should be allowed to execute without satisfying the other protected quotations. A few commenters believed that the Size Limitation would reduce execution certainty or cause delays in executions. Other commenters stated that the Size Limitation would lead to information leakage for larger sized orders because of the need to route to multiple venues to execute against protected quotes. Further, commenters stated that undisplayed liquidity, both on- and off-exchange, is important to retail and institutional investors.

While the June 2014 Order did not specify the Size Limitation, the Commission believes that it supports one of the reasons for testing trade-at in the Tick Size Pilot—to determine its impact on displayed liquidity and market quality in a wider tick environment. As one commenter noted, the Size Limitation should create a strong incentive to display liquidity.[333] The Commission notes that some commenters suggested that allowing hidden reserve orders to execute before same-priced protected quotations could incentivize market participants to display a quote for a nominal size. The Trade-At Prohibition is intended to test whether a trade-at is needed to encourage the display of limit orders with depth greater than a nominal size in a wider tick environment. During the Tick Size Pilot, Test Group Three should allow researchers to

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332 See supra Section IV.D.3.c.

333 See CHX Letter at 19. See also supra note 187 and accompanying text.

measure whether this structure results in increases in displayed liquidity, and if so, whether it has a positive impact on market quality. The Commission believes that without the Size Limitation, the incentive to display liquidity could be reduced, which in turn would undermine a primary rationale for testing trade-at in a wider tick environment. Commenters also raised concerns with respect to execution certainty and execution delay. The Commission believes that the Size Limitation could potentially increase execution certainty by providing incentives to display additional liquidity. The Commission believes that the Size Limitation's effect on execution delay is uncertain due to the potential increase in routing to execute against protected quotations, and would monitor results of the Tick Size Pilot to determine if there is significant execution delay.

The Commission also notes that the modification to the Block Size definition should mitigate and address some commenter concerns related to execution certainty and information leakage that some commenters believe could occur as a result of the Size Limitation. The reduced threshold for Block Size orders should lower the risk of market exposure for investors trading with size. The liberalized Block Size definition should permit more orders to trade without being restricted by the Trade-At Prohibition.

d. Venue Limitation

The Participants proposed the Venue Limitation that would restrict where a trading center that is displaying a quotation at the price of a protected quotation could execute incoming orders. Commenters stated that the inclusion of the Venue Limitation would protect displayed quotations, strengthen incentives for market making and gauge the impact of tick size increments.[334] Several other commenters, however, expressed concern that the Venue Limitation would increase the implementation costs and burdens for Test Group Three.[335] For example, one commenter noted that the Venue Limitation would increase message traffic and potentially cause systems failures.[336] Commenters also argued that the Venue Limitation was anti-competitive.[337] In particular, commenters stated that off-exchange trading centers should not be forced to route orders to the exchanges.

After carefully considering the comments, the Commission is modifying the Trade-At Prohibition to remove the Venue Limitation. The Commission notes that the Venue Limitation was not prescribed in the June 2014 Order. The Commission believes that the Venue Limitation would have unnecessarily restricted the ability of off-exchange market participants to execute orders in the Pilot Securities of Test Group Three.[338] Further, the Commission believes that the Venue Limitation would not have created additional incentives to display liquidity and thus is not necessary to support the purposes of the Trade-At Prohibition.[339] The Commission believes that the Size Limitation, as discussed above, should be sufficient to incentivize displayed liquidity because price matching generally would be permitted only if the market participant

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334 See supra Section IV.D.3.d.

335 See supra Section IV.D.3.d.

336 See CMR Letter II at 7.

337 See supra note 189 and accompanying text.

338 A potential cost of the Venue Limitation would have been that a broker-dealer would need to connect to the ADF to display off-exchange, thereby incurring initial set-up costs for connectivity and costs to maintain that connectivity. In addition, each quote displayed on the ADF, in addition to an exchange, would result in costs to the broker-dealer related to message and recordkeeping capacity and fees and associated quoting activity costs to be paid to FINRA.

339 The incremental effect of the Venue Limitation would be to encourage those who display on an exchange to display off-exchange.

otherwise was publicly displaying an order in a size at least as large as the size of the matching transaction. The Commission does not believe the Venue Limitation would incentivize any material amount of additional displayed liquidity, and thus would not have provided additional economic information for the Tick Size Pilot.

Further, the Commission believes that removing the Venue Limitation should mitigate commenter concerns about the complexity and cost of implementing the Trade-At Prohibition by reducing the need for off-exchange trading centers to route orders to the exchanges. Therefore, the Commission deems it appropriate to change the NMS plan by removing the Venue Limitation.[340]

e. Modifying the Definition of Block Size

The Trade-At Prohibition proposed by the Participants included a Block Size order exception whereby the price matching of orders of a "block size" would be permitted. The Participants, consistent with the June 2014 Order, proposed to use the "block size" definition set forth in Regulation NMS, which is an order (1) of at least 10,000 shares or (2) with a market value of at least $200,000.[341] Several commenters explained that a block size order for small capitalization stocks is generally considered to be substantially smaller than that for large capitalization stocks, and thus the Trade-At Prohibition included in the proposed Tick Size Pilot would unduly restrict institutional trading.[342]

340 The Commission notes that the NMS plan includes three examples for how the Trade-At Prohibition would operate. Those examples do not implicate the Venue Limitation and therefore the Commission is not modifying the examples. See NMS plan supra note 3.

341 17 CFR 242.600(a)(9).

342 See supra Section IV.D.3.e.

In light of the views expressed by the commenters and after supplemental staff analysis, the Commission deems it is appropriate to modify the definition of "block size," for purposes of the Tick Size Pilot. Specifically, an order (1) of at least 5,000 shares or (2) with a market value of at least $100,000 will be considered a block size for purposes of the Tick Size Pilot. This block size adjustment aligns with commenters' request for a smaller block size to reflect trading characteristics for potential Pilot Securities, and is consistent with the Commission staff analysis which indicates that, based on the modified selection criteria, the potential Pilot Securities, on average, trade at comparatively smaller sizes than securities with larger market capitalization. The following table reflects staff analysis:

Table 2:[343] Trade Size Distribution Statistics

Shares/Dollars	Percent of trades	Percent of share volume	Percent of $ volume
Panel A: All NMS securities			
≥10,000 shares or ≥$200,000	0.24	13.04	16.27
Panel B: Stocks eligible for the Tick Size Pilot			
≥1,000 shares or ≥$20,000	2.08	26.61	23.37
≥3,000 shares or ≥$60,000	0.38	15.44	13.91
≥5,000 shares or ≥$100,000	**0.18**	**12.03**	**11.24**
≥10,000 shares or ≥$200,000	0.07	8.68	8.61

In particular, Table 2 indicates that among all NMS securities, trades with at least 10,000 shares or with a market value of at least $200,000 constitute 0.24 percent of all trades, 13.04

343 Data in Panel A covers all securities in the NYSE's Trade and Quote database, which consists of all NMS securities except options. Data in Panel B covers common stocks with average price greater than $2 per share, average daily trading volume smaller or equal than one million shares, and market capitalization smaller or equal than $3 billion. All data covers the period of July 1, 2013 - August 31, 2013 and comes from the NYSE's Trade and Quote Data.

percent of traded share volume, and 16.27 percent of traded dollar volume. In contrast, among stocks eligible for the Tick Size Pilot, trades with at least 10,000 shares or with a market value of at least $200,000 constitute only 0.07 percent of all trades, 8.68 percent of traded share volume, and 8.61 percent of traded dollar volume.

The Commission received one comment suggesting that Block Size orders should be able to execute in subpenny increments in a manner similar to Retail Investor Orders that receive price improvement.[344] However, to avoid undermining the incremental design of the Tick Size Pilot, the Commission does not believe that Block Size orders in the Tick Size Pilot should have the same execution increments as Retail Investor Orders.

The Commission also notes that the modified Block Size definition should ease some of the burden related to the Trade-At Prohibition. Specifically, the modified Block Size definition should mitigate any potential disruption to the institutional trading of Pilot Securities by allowing more of such orders to match protected quotes. Therefore, the Commission deems it appropriate to modify the definition of Block Size to lower the thresholds.

f. Addressing Other Test Group Three Exceptions

The Participants proposed nine exceptions (numbers 4 through 12) to the Trade-At Prohibition that were not specified in the June 2014 Order. These exceptions were based on the exceptions to Rule 611.[345] Commenters raised concerns that the exceptions were too numerous

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344 See supra note 194 and accompanying text.

345 17 CFR 242.611(b)(2).

and added to the complexity of the Tick Size Pilot.[346] One commenter, however, agreed with the rationale for using the Rule 611 exceptions.[347]

The Commission believes that these exceptions are appropriate. The Commission notes that market participants currently have rules, procedures, and systems in place to comply with Rule 611. Therefore, the Commission believes that the consistency with Rule 611 should alleviate concerns regarding the costs and burdens of implementing the Tick Size Pilot because market participants should be able to leverage existing systems.

The Commission recognizes the concerns related to modeling the Trade-At Prohibition exceptions on the Rule 611 exceptions. Specifically, the Commission notes that two commenters argued that the rationale for the Rule 611 exceptions should not be necessarily applied to the Trade-At Prohibition.[348] The Commission notes that approval of the Trade-At Prohibition is limited solely to the instant NMS plan and the Tick Size Pilot, and believes that utilizing current rules, procedures and systems should facilitate the implementation of the Tick Size Pilot.

The Participants also proposed an exception to the Trade-At Prohibition for fractional shares where fractional shares do not the result from dividing an order for one or more whole shares. One commenter supported this exception.[349] The Commission notes that there could be potential difficulty in the routing and executing of fractional shares and believes that such a limited exception is appropriate.

g. Odd Lots

346 See supra Section IV.D.3.f.

347 See CHX Letter at 18 (supporting the exceptions as proposed).

348 See supra note 196 and accompanying text.

349 See supra Section IV.D.3.f.

The Commission notes that several commenters requested clarification on how odd lot orders would be treated under the Trade-At Prohibition.[350] Under Regulation NMS, odd lot orders are not considered protected quotations.[351] Since the Trade-At Prohibition only applies to protected quotations, odd lot orders and the odd lot portion of mixed lot orders would therefore not be covered by the Trade-At Prohibition. On the other hand, if a trading center that is not displaying a quotation at the price equal to the traded-at protected quotation and then receives an odd lot order or the odd lot portion of a mixed lot order, the trading center would be prevented from executing the odd lot order at the price of the protected quotation unless an exception applies.[352]

E. Collection and Assessment of Tick Size Pilot Data

The Participants proposed Trading Center Data and Market Maker Profitability Data elements that were consistent with the June 2014 Order. Several commenters suggested that the data elements should be based solely on currently available data, such as the data reported to the processors, SRO proprietary data feeds, or under Rule 605, which would ease reporting burdens

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350 See supra Section IV.D.3.g.

351 See Rule 600(b)(8) defines a bid or offer as the bid price or offer price communicated by a member of a national securities exchange or member of a national securities association to any broker or dealer, or to any customer, at which it is willing to buy or sell one or more round lots of any NMS security, as either principal or agent, but shall not include indications of interest. This definition of bid or offer is embedded in the definition of "quotation" in Rule 600(b)(62), as well as the definition of "protected bid" or "protected offer" in Rule 600(b)(57). See "Frequently Asked Questions Concerning Rule 611 and Rule 610, Question 7.03", available at https://www.sec.gov/divisions/marketreg/nmsfaq610-11.htm#sec7.

352 See Data Highlight 2014-01: Odd Lot Rates in a Post-Transparency World, (January 9, 2014), available at http://www.sec.gov/marketstructure/research/sec_data_highlight_2014-01.pdf.

and costs.[353] However, as discussed below, the Commission believes that the Trading Center Data and Market Maker Profitability Data are necessary to provide the Commission and the public with measurable data on which to assess the Tick Size Pilot's impact.

1. Trading Center Data

The Tick Size Pilot would require the Participants to collect market quality statistics, data on specific orders, and data on market makers. The data would be publicly available on a monthly basis. Some commenters suggested that the Commission should rely on currently available data as this would reduce the implementation costs while still providing sufficient information to study the effects of the Tick Size Pilot.[354] However, the Commission believes that it is necessary to collect the Trading Center Data in order to fully analyze the Tick Size Pilot. These new data elements are important for assessing the Tick Size Pilot's impact on liquidity, execution quality, market maker activity, competition, and transparency and are not included currently in the publicly available data.[355]

In particular, the market quality statistics in the Trading Center Data expand in several important ways on the data reported under Rule 605. For example, compared to Rule 605 data, the market structure statistics are daily instead of monthly and will be publicly available more centrally, contain a broader set of orders, contain additional information on cancelations and hidden orders, and contain additional categories on order size and time to execution. As

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353 See supra Section IV.E.1.

354 Id.

355 Some commenters suggested that the data-collection requirements should be limited to data elements needed to assess the impact of the Tick Size Pilot on liquidity. While recognizing the importance of liquidity, as discussed throughout this order, measuring changes in liquidity is not the only goal of the Tick Size Pilot. Therefore, a broader range of data elements needs to be available for a full analysis of the Tick Size Pilot.

described in more detail below, the Trading Center Data are intended to build on an infrastructure that already exists for the collection of Rule 605 data and tailors the data from that infrastructure to the purposes of the Tick Size Pilot.

Requiring daily data and making it available more centrally should improve the feasibility of studying the Tick Size Pilot. Many liquidity and execution quality statistics using SIP data can be calculated, but these statistics are imperfect because they focus on trades instead of orders. For the purposes of assessing the Tick Size Pilot, execution quality of orders is more relevant. Rule 605 data, on the other hand, focuses on orders, but are available on a monthly aggregated basis and are from each of hundreds of trading centers. The daily frequency of the market quality statistics should allow for the study of the time series of metrics in a manner that provides a greater ability to statistically detect changes in market quality resulting from the Tick Size Pilot because it allows for the analysis of effects on a daily basis.[356] Requesting data that can be collected using existing Rule 605 infrastructure should reduce the incidence of data errors that result from creating a dataset from scratch which should increase the reliability of the data and reduce costs.

Including additional orders and reducing duplication could help to tailor the market quality statistics to the purposes of the Tick Size Pilot. The market quality statistics include a broader set of orders than Rule 605 statistics, with reduced double counting. In particular, the Tick Size Pilot requires producing market quality statistics on all orders regardless of inclusion in Rule 605 statistics, but includes only statistics on orders that the execution venue executes in part or full. The market quality statistics categorize some of the orders not included in Rule 605

356 Statistically, a daily time series provides greater ability for tests to detect changes resulting from the Tick Size Pilot.

data. In particular, the market quality statistics include categories for resting intermarket sweep orders, retail liquidity providing orders and midpoint passive liquidity orders and separates statistics by whether the statistics are for orders included in Rule 605 data or not. In addition, the market quality statistics include an order size category to capture orders of 10,000 shares or more, which are excluded from Rule 605. Because the purpose of Rule 605 differs from that of the Tick Size Pilot, studies of the Tick Size Pilot necessarily benefit from the inclusion of all orders that could be impacted by wider tick sizes. The Trading Center Data does not include the Rule 605 data on orders that are routed away in their entirety. The Rule 605 data for a particular trading center includes orders that a trading center routed away in their entirety. If this data was aggregated, it would produce double counting of these orders. Because Commission staff intends to aggregate the Trading Center Data across the trading centers, the Commission has decided to not require this information to prevent the likely double counting that could occur when such orders are routed in their entirety.[357]

Including additional data elements and categories in market quality statistics compared to Rule 605 allows for the study of key issues and helps to supplement other existing public data such as the data on the Commission's Market Structure website.[358] The additional market quality statistics include information on displayed or hidden order status, which would provide a more fulsome view of transparency than other sources of information on hidden orders including

357 In addition, such orders would be attributed to the market center that routed them away and execution quality metrics for that market center would contain such orders that were not executed on the market center.

358 The Commission's Market Structure Website (http://www.sec.gov/marketstructure/) allows the public access to data derived from the Commission's MIDAS, which several commenters suggested as an alternative to the Trading Center Data. See supra Section IV.E.1.

those on the Commission's Market Structure website.[359] The market structure statistics include significantly more refined time interval categories (starting with microseconds rather than seconds) to measure speed of order executions and additional order categories. These changes allow for comparability to the statistics available on the Commission's Market Structure website. The Trading Center Data adds information on speed of order cancellations.[360] Because the Tick Size Pilot may affect investors' behavior regarding cancellations, the ability to observe those changes would help to better understand the effects of the Tick Size Pilot.

The Trading Center Data on specific orders provides disaggregated execution, cancellation and routing statistics for individual market and marketable limit orders. This type of information is not available from any public source or from any raw data source that, as a practical matter, is available in an easily and publicly accessible manner to meet the needs of the Tick Size Pilot. As noted above, order information is more relevant for studies of the Tick Size Pilot than SIP data because order information can consider the full order size. The data on specific orders improves on the market quality statistics by allowing researchers to more directly test hypotheses on the effect of the Tick Size Pilot on quote competition and transparency, for example. Researchers can also supplement statistics they derive from this data with statistics on limit orders from the Commission's Market Structure website.

Finally, the Trading Center Data includes daily statistics on registration and participation of market makers. Information on market maker registration and participation is necessary to

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359 The Commission's Market Structure website provides data on hidden orders for only a subset of exchanges because not all exchanges provide hidden order information in their proprietary data feeds, which supply data to MIDAS.

360 A wider tick size may change the composition of the market participants for a given stock and it may also change their behavior. For example, "pinging" the market, which results in frequent and fast cancellations, becomes more expensive and therefore less attractive. As a result, the practice may be used less in stocks with a wider tick size.

test the hypothesis that widening the tick size could encourage market making in such a way to improve the liquidity and trading of small capitalization stocks, which could potentially allow such issuers to raise capital more easily. Such data is not available publicly, except from a few exchanges.

Because of these enhancements, the Commission believes that collections of Trading Center Data should facilitate a significantly richer analysis than the public data of the effects of the Tick Size Pilot on liquidity (e.g., transaction costs by order size), execution quality (e.g., speed of order executions), market maker activity, competition between trading venues (e.g., routing frequency of market orders), transparency (e.g., choice between displayed and hidden orders), and market dynamics (e.g., rates and speed of order cancellations), and thus is necessary to fully assess the impact of the Tick Size Pilot.

2. Market Maker Profitability Data

The Tick Size Pilot would require market makers to produce the Market Maker Profitability Data, which relates to daily trading profits on the Pilot Securities. Several commenters opposed the collection of Market Maker Profitability Data.[361] Commenters raised concerns about the costs of collecting the data as well as concerns related to the confidentiality and the competitive impact of the data. Commenters suggested that market makers would forego participation in the Tick Size Pilot if they were required to submit their Market Maker Profitability Data.

The Commission notes that one of the premises behind the Tick Size Pilot is that a widened tick increment could increase market maker profits and that the increased profits could foster a more robust secondary market for small capitalization stocks (and ultimately a more

361 See supra Section IV.E.2.

robust primary market) by, for example, increasing liquidity, enhancing the attractiveness of acting as a market maker, and possibly increasing the provision of sell-side research. Without the Market Maker Profitability Data, the Commission and the public would not be able to test this hypothesis. In light of the comments on the costs of producing the Market Maker Profitability Data and the confidentiality of the data, however, the Commission deems it necessary to modify this data-collection requirement in two ways.

First, the Commission is eliminating the data element which required realized trading profits net of fees and rebates from the list of the required market maker profitability statistics and the data element that would have required the DEA to calculate the volume-weighted average of market maker realized traded profits net of fees and rebates. Some commenters expressed concern that because fees and rebates are charged monthly and in an aggregate form, the fees and rebates could be difficult to assign to daily trades in specific securities. As a result, data on market maker realized trading profits net of fees and rebates could be difficult to produce accurately and in a cost effective manner.

After carefully considering these comments, the Commission is eliminating these data elements from the list of the required Market Maker Profitability Data because of the difficulties in calculating the data and the concerns about the costs related to the calculation. Eliminating this data element should ease the implementation burdens and costs to produce the data. Further, the Commission recognizes that changes in raw realized trading profits may be more relevant for the economic relation the Tick Size Pilot is addressing. The Commission believes that the data on realized raw trading profits and unrealized raw trading profits should be sufficient to support robust analysis.[362]

Second, to address confidentiality concerns the Commission is modifying the NMS plan to require further aggregation of all Market Maker Profitability Data for public dissemination. Some commenters expressed concern about dissemination of Market Maker Profitability Data (even in aggregate form for each security) and opined that some designated market makers could deregister from Pilot Securities to avoid providing profitability data. The Commission recognizes that some Pilot Securities may have a relatively small number of designated market makers, and that in these cases aggregating profitability data across market makers may be insufficient to fully protect the confidentiality of profits of individual market makers. For example, some smaller market makers may be able to use aggregate data to infer the profitability

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362 The Commission believes that the costs of producing the modified Market Maker Data may not be high and the Commission understands that market makers may capture trading profit data for internal business purposes. One commenter suggested that measuring market maker profitability for each security may be difficult because "costs [of market making] are typically allocated to trading across the board, rather than on a symbol-by-symbol basis." In response to this comment, the Commission notes that the modified Market Maker Data is limited to measures of gross trading profitability, which do not require information on general operating costs (or allocation of these costs to specific securities). Another commenter mentioned that some market makers may not currently compute their profits on a LIFO basis. However, the Commission believes that even for these market makers it should be fairly easy to implement a LIFO-like method for computing their profits as required by the Tick Size Pilot. Independent of which specific method, e.g., LIFO, FIFO, or average cost basis, is used to compute profits, the same information has to be collected, processed, and stored. The only difference is the formula for computation. The Commission recognizes that there will be costs associated with computing profits in a manner different than current profit calculations. However, the requirement to produce profitability figures for the Tick Size Pilot does not mean that market makers are required to change how they currently compute trading profits for internal business purposes. For example, a market maker may continue to use a FIFO-like method for internal profit computations and only report profits on a LIFO basis for the purpose of the Tick Size Pilot. This would alleviate the risk for disruptions due to a change in their practices.

of their larger competitors, which could give them an unfair competitive advantage. To address the confidentiality concerns raised by commenters and to ensure that public dissemination of the Market Maker Data does not adversely impact competition between market makers, the Commission has determined that the DEA should further aggregate the Market Maker Profitability Data by each Test Group and Control Group such that the public data will not contain profitability measures for each security. The Commission notes that the data available to Participants and the Commission would continue to identify the market maker profits in individual stocks.[363] As a result of this change, the public would not have the ability to match individual stocks in the Test Groups with stocks from the Control Group and compare changes in profitability between stocks from the Test Groups and the matched stocks. The Commission, however, believes this modification should adequately address confidentiality concerns related the dissemination of detailed Market Maker Profitability Data. Therefore, the Commission deems it appropriate to modify the Market Maker Profitability Data as described above.

Some commenters suggested that the disclosure of Market Maker Profitability Data to DEAs may be anti-competitive, as market makers would essentially have to disclose sensitive, proprietary information to their exchange competitors. In response to these comments, the Commission notes that many market makers are already required to provide profitability information to their DEAs as part of their registration requirements and by virtue of their membership with a national securities exchange or association. Thus, the Commission believes that the additional impact of the disclosing Market Maker Data is not likely to be significant.

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363 The Commission notes that it will keep this information confidential, subject to the provisions of applicable law. Additionally, as noted below, because the Participants will have data that is more detailed than the public, the Commission has determined that the SROs should provide an assessment of Market Maker Profitability Data. See infra Section V.E.3.

Moreover, the Commission emphasizes that the Participants are expected to collect and use Tick Size Pilot data, including Market Maker Profitability Data, for legitimate regulatory purposes, and not for inappropriate, anti-competitive purposes.

3. Assessment of Tick Size Pilot Data

The Tick Size Pilot would require the Participants to provide a joint assessment on the impact of the Tick Size Pilot, no later than six months after the end of the Pilot Period. In the June 2014 Order, the Commission identified certain assessments that the Participants were to conduct and to submit to the Commission. However, the Participants did not include the assessment related to the impact of quoting and trading increments on the profitability of market makers in the proposed Tick Size Pilot because, in their view, the market makers would be better positioned, compared to the Participants, to analyze such data.[364]

As previously noted, the impact of a wider tick size on market maker profitability is an important assessment to be conducted. In addition, the Commission has modified the Market Maker Profitability Data to require further aggregation of publically released data. While the public will still be able to study this aggregated profitability data, the public is limited in its ability to conduct an independent assessment based on the more granular profitability data available to the Participants and the Commission. Therefore, the Commission is modifying the NMS plan to reflect that the Participants are required to conduct and submit this assessment. The Commission deems it appropriate to modify the NMS plan to require this assessment.

The Commission is also modifying the timing when the impact assessments should be prepared by the Participants and submitted to the Commission. In particular, the Commission is modifying the NMS plan to require the Participants to submit their assessments 18-months after

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[364] See Notice, 79 FR at 66428, supra note 5.

the Tick Size Pilot begins based on data generated during the first year of the Tick Size Pilot or a subset of which that represents the impact of the Tick Size Pilot. The Commission notes that the timing for when the assessments are due to the Commission has not changed. As proposed, the Participants would have submitted their assessment six months after the end of the Pilot Period (which would have been 18-months after the Tick Size Pilot was implemented). This modification has been made in relation to the modified Pilot Period. As a result, the Commission will receive the impact assessment of the Tick Size Pilot six months prior to its completion. The Commission is not modifying the NMS plan to require the Participants to conduct more frequent periodic impact assessments as some commenters' suggested[365] because it does not believe that the incremental benefit of such additional assessment would justify the increased burdens and costs on the Participants. The Commission deems it appropriate to modify the timing of the Participant assessments because it would provide the Commission and the public with relevant data on the impact of the Tick Size Pilot before the Pilot Period ends.

Commenters also stated that the Commission should define success metrics for the Tick Size Pilot and what would warrant it being adopted on a permanent basis.[366] The Commission has carefully considered these comments but believes that defining the success metrics before the Tick Size Pilot begins could unduly influence behavior by market participants. The Tick Size Pilot is intended to be a test to inform the Commission and the public about the possible impacts of a wider tick size in small capitalization securities. The NMS plan sets forth the data elements that the Commission believes would be informative and support broad analysis. The Commission has described the questions that it believes the data should be able to address. In

[365] See supra Section IV.E.3.

[366] Id.

particular, the Commission believes that the Tick Size Pilot as designed should generate data that would support analysis and studies of the effect of increased tick size on liquidity, execution quality for investors, volatility, market maker profitability, competition, transparency and institutional ownership. The results of the Tick Size Pilot could reveal tradeoffs among these and other considerations and the potential permutations in the results are likely to be too extensive to define success at this point.

F. Use of an NMS Plan

Certain commenters suggested that the Tick Size Pilot should be implemented via Commission rulemaking, rather than through the NMS plan process.[367] Some commenters suggested that the Tick Size Pilot was too significant to be delegated to the Participants and raised concerns that not all market participants, including market makers, broker-dealers and institutional investors, were included in the development of the Tick Size Pilot. Certain commenters were concerned about potential conflict of interests that could arise in the Participants' development of the NMS plan. A number of commenters questioned whether it was appropriate to have Participants formulate an NMS plan that would affect their competitors. Additionally, some commenters intimated that a conflict of interest may exist by highlighting the Participants' for-profit status.

As discussed above, the Commission has reasons to proceed with the Tick Size Pilot as an NMS plan.[368] The process for an NMS plan has some similarities to a rulemaking. Like a Commission rulemaking, an NMS plan is subject to public notice and comment, which provides all interested parties, including market makers, broker-dealers, investors, and issuers, an

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367 See supra Section IV.F.

368 See supra Section V.A.

opportunity to offer substantive comment on the plan prior to Commission consideration of whether to approve it. The Commission published this NMS plan and therefore, it was subject to notice and comment.[369] In addition, the process is subject to Commission's oversight and approval authority. In this regard, Rule 608(b)(2) provides that the Commission shall approve an NMS plan, with such changes or subject to such conditions as the Commission may deem necessary or appropriate, if it finds that such plan or amendment is necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanisms of, a national market system, or otherwise in furtherance of the purposes of the Act.[370] As discussed throughout this order, the Commission believes the NMS plan meets the standard for approval and has exercised its authority to modify this NMS plan consistent with the standard.

Certain commenters raised concerns related to the role of the Participants, and of potential conflicts of interest, in the development of the Tick Size Pilot. The Commission recognizes that most of the Participants are for-profit exchanges that compete in various respects with their broker-dealer members. However, the Participants also are self-regulatory organizations, with specified regulatory obligations under the Act and Commission rules. Among other things, Section 11A(a)(3) of the Act, and Rule 608 thereunder, contemplate that SROs may act jointly in furtherance of their regulatory obligations by developing and filing proposed NMS plans with the Commission and, if approved, operating them subject to the Commission's oversight and authority.[371] The Commission recognizes that certain provisions of

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369 See Notice supra note 5.

370 17 CFR 242.608(b)(2).

371 15 U.S.C. 78k-1(a)(3). See 17 CFR 242.608.

the NMS plan could have a competitive impact on broker-dealer members and other market participants. The Rule 608 process, however, requires that proposed NMS plans be published for public comment and subject to Commission review and approval. As discussed above, the Commission has reviewed the NMS plan and thoroughly evaluated commenters' concerns, including those relating to the impact of the Tick Size Pilot on competition. The Commission has modified the NMS plan by removing the Venue Limitation, which it believes would have placed an unnecessary burden on competition, and the Commission exercised its authority to make other modifications to address other concerns.

G. Issuer Participation

Commenters suggested that issuers should have the ability to opt-in or opt-out of the Tick Size Pilot,[372] or establish committees that represent the interests of issuers during the Tick Size Pilot. One commenter believed that instead of approving the Tick Size Pilot, the Commission should permit issuers to contract with market makers for the purpose of determining their spreads. The Commission has carefully considered these comments but believes that in order to generate useful and reliable data from the Tick Size Pilot, issuers should not be able to opt-in or opt-out. Allowing such an option would introduce a selection bias that would make the results of the Tick Size Pilot applicable only to the participating securities and limit the ability of researchers to draw specific conclusions about the impact of wider tick sizes on market for small capitalization stocks. The Commission believes that permitting issuers to contract with market makers for the purpose of determining spreads would similarly introduce selection bias and undermine the goal of the Tick Size Pilot.[373]

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372 See supra Section IV.G.

373 In addition, the Commission notes that certain exchanges currently operate pilot

H. Implementation

Commenters noted that a one-year implementation period could be appropriate if the Tick Size Pilot was simplified, by among other things, removing the Trade-At Prohibition.[374] While the Commission has not removed the Trade-At Prohibition, the Commission believes that the modifications to the Tick Size Pilot, such as restricting the Trade-At Prohibition to Regular Trading Hours, removing the Venue Limitation and removing realized trading profits net of fees and rebates from the Market Maker Profitability Data, should lessen some of the implementation burdens.

Accordingly, the Commission believes that he Tick Size Pilot should be implemented within one year after the publication of this order. The Commission believes that the one year period for implementation should provide adequate time for the development and testing of applicable trading and compliance systems, the filing and approval of SRO rules related to the Tick Size Pilot's quoting and trading requirements, and the development and implementation of the written policies and procedures by Participants and their members that are reasonably designed to comply with the applicable quoting and trading increments.

Certain commenters requested that the Commission, or the Participants, release detailed frequently-asked-questions ("FAQs") to assist implementation of the Tick Size Pilot.[375] As the

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programs that permit issuers to, indirectly through the exchange, compensate market makers to provide liquidity in the issuers' securities. See, e.g., NYSE Arca Equities Rule 8.800 (NYSE Arca Equities ETP Incentive Program); BATS Rule 11.8.02 (BATS Competitive Liquidity Provider Program); and Nasdaq Rule 5950 (Market Quality Program).

374 See supra note 244 and accompanying text.

375 See KCG Letter at 17; Liquidnet Letter at 2; and Bloomberg Letter at 20.

implementation period progresses, should questions arise, the Commission and the Participants will consider whether to issue FAQs to address any such questions.

One commenter requested that the list of securities be finalized prior to determining the implementation schedule.[376] The Commission does not believe it is necessary to finalize the list of securities prior to determining the implementation schedule. The Commission notes that the list of securities would be finalized based on data collected during the Measurement Period.[377] To avoid including Pilot Securities whose characteristics would not meet the defined selection criteria, the time gap between the Measurement Period and the beginning of the Pilot Period should be as short as possible. For example, the NMS plan includes price as one criterion in the selection of securities such that the closing price be at least $1.50 on every trading day during the Measurement Period. If the Measurement Period ended six months before the start of the Tick Size Pilot, the risk that securities may have prices below $1.00 during the Tick Size Pilot would be higher than the risk with a later Measurement Period.

VI. Conclusion

For the reasons discussed above, the Commission finds that the NMS Plan to Implement a Tick Size Pilot Program is necessary or appropriate in the public interest, for the protection of investors and the maintenance of fair and orderly markets, to remove impediments to, and perfect the mechanism of, a national market system, or otherwise in furtherance of the purposes of the Act.

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376 See Bloomberg Letter at 20.

377 See NMS plan Section (I)(N), which defines the Measurement Period as the U.S. trading days during the three-calendar-month period ending at least 30 days prior to the effective date of the Pilot Period.

IT IS THEREFORE ORDERED, that pursuant to Section 11A of the Act, and the rules and regulations thereunder, that the NMS plan (File No. 4-657), as modified, be and it hereby is approved and declared effective, and the Participants are authorized to act jointly to implement the NMS plan and its Tick Size Pilot as a means of facilitating a national market system.

By the Commission.

By: Brent J. Fields
Secretary

EXHIBIT A

PLAN TO IMPLEMENT A TICK SIZE PILOT PROGRAM

SUBMITTED TO

THE SECURITIES AND EXCHANGE COMMISSION

PURSUANT TO

RULE 608 OF REGULATION NMS

UNDER THE

SECURITIES EXCHANGE ACT OF 1934

(As Modified by the Commission;

additions are in underline and deletions are in [brackets])

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Section

Preamble

Pursuant to Section 11A(a)(3)(B) of the Exchange Act, which authorizes the SEC to require by order self-regulatory organizations to act jointly with respect to matters as to which they share authority in planning, developing, operating, or regulating a national market system, the SEC issued an order directing the Participants to submit a Tick Size Pilot Plan as a national market system plan pursuant to Rule 608(a)(3) of Regulation NMS under the Exchange Act. In response, the Participants submit this Plan to implement a Tick Size Pilot Program that will allow the Commission, market participants, and the public to study and assess the impact of increment conventions on the liquidity and trading of the common stocks of small capitalization companies. To do so, the Plan provides for the widening of quoting and trading increments for a group of Pilot Securities. As detailed herein, the Pilot Securities will be subdivided into three Test Groups and a Control Group, each with its own requirements and exceptions relating to quoting and trading increments to facilitate the referenced analysis.

I. Definitions

(A) "Average effective spread" has the meaning provided in Rule 600(b)(5) of Regulation NMS under the Exchange Act.

(B) "Average realized spread" has the meaning provided in Rule 600(b)(6) of Regulation NMS under the Exchange Act.

(C) "Benchmark trade" means the execution of an order at a price that was not based, directly or indirectly, on the quoted price of a Pilot Security at the time of execution and for which the material terms were not reasonably determinable at the time the commitment to execute the order was made.

(D) "Best protected bid" means the highest priced protected bid.

(E) "Best protected offer" means the lowest priced protected offer.

(F) "Block Size" means for purposes of this Tick Size Pilot Program, an order (1) of at least 5,000 shares or (2) for a quantity of stock having a market value of at least $100,000 [has the meaning provided in Rule 600(b)(9) of Regulation NMS under the Exchange Act].

(G) "Brokered cross trade" means a trade that a broker-dealer that is a member of a Participant executes directly by matching simultaneous buy and sell orders for a Pilot Security.

(H) "Closing Price" means the closing auction price on the primary listing exchange, or if not available, then the last regular-way trade reported by the processor prior to 4:00 p.m. ET.

(I) "Designated Examining Authority" means, with respect to a member of two or more self-regulatory organizations, the self-regulatory organization responsible for (i) examining such member for compliance with the financial responsibility requirements imposed by the Exchange Act, or by Commission or self-regulatory organization rules, (ii) receiving regulatory reports from such member, (iii) examining such member for compliance with, and enforcing compliance with, specified provisions of the Exchange Act, the rules and regulations thereunder, and self-regulatory organization rules, and (iv) carrying out any other specified regulatory functions with respect to such member.

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

(K) "Inside-the-quote limit order," "at-the-quote limit order," and "near-the-quote limit order" mean non-marketable buy orders that are ranked at a price, respectively, higher than, equal to, and lower by $0.10 or less than the National Best Bid at the time of order receipt, and non-marketable sell orders that are ranked at a price, respectively, lower than, equal to, and higher by $0.10 or less than the National Best Offer at the time of order receipt.

(L) "Market Maker" means a dealer registered with any self-regulatory organization, in accordance with the rules thereof, as (i) a market maker or (ii) a liquidity provider with an obligation to maintain continuous, two-sided trading interest.

(M) "Marketable limit order" means any buy order with a limit price equal to or greater than the National Best Offer at the time of order receipt, or any sell order with a limit price equal to or less than the National Best Bid at the time of order receipt. For price sliding, pegged, discretionary, or similar order types where the ranked price is different from the limit price, the ranked price will determine marketability.

(N) "Measurement Period" means the U.S. trading days during the three-calendar-month period ending at least 30 days prior to the effective date of the Pilot Period.

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

(P) "Negotiated Trade" means (i) a Benchmark trade, including, but not limited to, a Volume-Weighted Average Price trade or a Time-Weighted Average Price trade, provided that, if such a trade is composed of two or more component trades, each component trade complies with the quoting and trading increment requirements of the Plan, or with an exception to such requirements, or (ii) a Pilot Qualified Contingent Trade.

(Q) "NMS common stock" means an NMS stock that is common stock of an operating company.

(R) "NMS stock" has the meaning provided in Rule 600(b)(47) of Regulation NMS under the Exchange Act.

(S) "Operating Committee" has the meaning provided in Section III(C) of the Plan.

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

(U) "Pilot Period" means the operative period of the Tick Size Pilot Program, lasting [one] <u>two</u> years from the date of implementation.

(V) "Pilot Qualified Contingent Trade" means a transaction consisting of two or more component orders, executed as agent or principal, where: (1) at least one component order is in an NMS common stock; (2) all components are effected with a product or price contingency that either has been agreed to by the respective counterparties or arranged for by a broker-dealer as principal or agent; (3) the execution of one component is contingent upon the execution of all other components at or near the same time; (4) the specific relationship between the component orders *(e.g.,* the spread between the prices of the component orders) is determined at the time the contingent order is placed; (5) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or since canceled; and (6) the transaction is fully hedged (without regard to any prior existing position) as a result of the other components of the contingent trade.

(W) "Pilot Securities" means those securities that satisfy the criteria established in Section V.

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

(Y) "Processor" means the single plan processor responsible for the consolidation of information for an NMS stock pursuant to Rule 603(b) of Regulation NMS under the Exchange Act.

(Z) "Protected bid" and "protected offer" have the meanings provided in Rule 600(b)(57) of Regulation NMS under the Exchange Act.

(AA) "Protected quotation" has the meaning provided in Rule 600(b)(58) of Regulation NMS under the Exchange Act.

(BB) "Quotation" has the meaning provided in Rule 600(b)(62) of Regulation NMS under the Exchange Act.

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

(DD) "Retail Investor Order" means an agency order or a riskless principal order originating from a natural person, provided that, prior to submission, no change is made to the terms of the order with respect to price or side of market and the order does not originate from a trading algorithm or any other computerized methodology. The Participant that is the Designated Examining Authority of a member of a Participant operating a trading center executing a Retail

Investor Order will require such trading center to sign an attestation that substantially all orders to be executed as Retail Investor Orders will qualify as such under the Plan.

(EE) "Retail liquidity providing order" means an order entered into a Participant-operated retail liquidity program to execute against Retail Investor Orders.

(FF) "SEC" means the United States Securities and Exchange Commission.

(GG) "SRO quotation feed" means any market data feed disseminated by a self-regulatory organization.

(HH) "Tick Size Pilot Program" means the program established by this Plan and by the corresponding rules of the Participants.

(II) "Time of order execution" means the time (to the second, or to such smaller increments as are available) that an order was executed at any venue.

(JJ) "Time of order receipt" means the time (to the second, or to such smaller increments as are available) that an order was received by a trading center for execution.

(KK) "Time-Weighted Average Price" means the price calculated as the average price of a security over a specified period of time.

(LL) "Trade-at" means the execution by a trading center of a sell order for a Pilot Security at the price of a protected bid or the execution of a buy order for a Pilot Security at the price of a protected offer during Regular Trading Hours.

(MM) "Trade-at Intermarket Sweep Order" means a limit order for a Pilot Security that meets the following requirements:

(1) When routed to a trading center, the limit order is identified as an Intermarket Sweep Order; and

(2) Simultaneously with the routing of the limit order identified as an Intermarket Sweep Order, one or more additional limit orders, as necessary, are routed to execute against the full displayed size of any protected bid, in the case of a limit order to sell, or the full displayed size of any protected offer, in the case of a limit order to buy, for the Pilot Security with a price that is equal to the limit price of the limit order identified as an Intermarket Sweep Order. These additional routed orders also must be marked as Intermarket Sweep Orders.

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

(OO) "Volume-Weighted Average Price" means the price calculated by summing up the products of the number of single-counted shares traded and the respective share price, and dividing by the total number of single-counted shares traded.

II. Parties

(A) List of Parties

The parties to the Plan are as follows:

(1) BATS Exchange, Inc.
8050 Marshall Drive
Lenexa, Kansas 66214

(2) BATS Y-Exchange, Inc.
8050 Marshall Drive
Lenexa, Kansas 66214

(3) Chicago Stock Exchange, Inc.
440 South LaSalle Street
Chicago, Illinois 60605

(4) EDGA Exchange, Inc.
545 Washington Boulevard
Sixth Floor
Jersey City, NJ 07310

(5) EDGX Exchange, Inc.
545 Washington Boulevard
Sixth Floor
Jersey City, NJ 07310

(6) Financial Industry Regulatory Authority, Inc.
1735 K Street, NW
Washington, DC 20006

(7) NASDAQ OMX BX, Inc.
One Liberty Plaza
New York, NY 10006

(8) NASDAQ OMX PHLX LLC
1900 Market Street
Philadelphia, PA 19103

(9) The Nasdaq Stock Market LLC
1 Liberty Plaza
165 Broadway
New York, NY 10006

(10) New York Stock Exchange LLC
11 Wall Street
New York, NY 10005

(11) NYSE MKT LLC
11 Wall Street
New York, NY 10005

(12) NYSE Area, Inc.
11 Wall Street
New York, NY 10005

(B) Compliance Undertaking

By subscribing to and submitting the Plan for approval by the SEC, each Participant agrees to comply with, and to enforce compliance by its members, as applicable, with the provisions of the Plan as required by Rule 608(c) of Regulation NMS under the Exchange Act. To this end, each Participant will adopt rules requiring compliance by its members with the provisions of the Plan, as applicable, and adopt such other rules as are needed for such compliance.

(C) New Participants

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

III. Amendments to Plan

(A) General Amendments

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

(B) New Participants

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

(C) Operating Committee

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

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

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

IV. Policies and Procedures

Consistent with the compliance undertakings set out in Section II(B), all Participants and members of Participants will be required to establish, maintain, and enforce written policies and procedures that are reasonably designed to comply with applicable quoting and trading requirements specified in Section VI for the Pilot Securities.

Each Participant, as applicable, will develop appropriate policies and procedures that provide for collecting and reporting to the SEC the data described in Appendix B. In addition, each Participant that is the Designated Examining Authority of a member of a Participant operating a trading center will require such member to develop appropriate policies and procedures for collecting and reporting the data described in Items I and II of Appendix B, as applicable, to the Designated Examining Authority. Each Participant that is the Designated Examining Authority of a member of a Participant operating a trading center will develop appropriate policies and procedures, as applicable, that provide for collecting and reporting such data to the SEC. The data collection and reporting obligations are described below in Section VII.

Each Participant that is the Designated Examining Authority of a Market Maker will require such Market Maker to develop policies and procedures for collecting the data set out in Appendix C and reporting it to the Designated Examining Authority. Each Participant that is the Designated Examining Authority of a Market Maker will develop appropriate policies and procedures that provide for collecting and reporting such data to the SEC on an aggregated basis. The Designated Examining Authority will also develop policies and procedures reasonably designed to ensure the confidentiality of the non-aggregated data it receives from Market Makers. The data collection and reporting obligations are described below in Section VII.

V. Identification of Pilot Securities

(A) Criteria for Selection of Pilot Securities

Pilot Securities will consist of those NMS common stocks that satisfy the following criteria:

(1) A market capitalization of $[5]3 billion or less on the last day of the Measurement Period, where market capitalization is calculated by multiplying the total number of shares outstanding on such day by the Closing Price of the security on such day;

(2) A Closing Price of at least $2.00 on the last day of the Measurement Period;

(3) A Closing Price on every U.S. trading day during the Measurement Period that is not less than $1.50;

(4) A Consolidated Average Daily Volume ("CADV") during the Measurement Period of one million shares or less, where the CADV is calculated by adding the single-counted share volume of all reported transactions in the Pilot Security during the Measurement Period and dividing by the total number of U.S. trading days during the Measurement Period; and

(5) A Measurement Period Volume-Weighted Average Price ("Measurement Period VWAP") of at least $2.00, where the Measurement Period VWAP is determined by calculating the VWAP for each U.S. trading day during the Measurement Period, summing the daily VWAP across the Measurement Period, and dividing by the total number of U.S. trading days during the Measurement Period.

For purposes of the CADV and Measurement Period VWAP calculations described in Sections V(A)(4) and V(A)(5), U.S. trading days during the Measurement Period with early closes will be excluded. An NMS common stock that had its initial public offering within six months of the start of the Pilot Period will not be eligible to be a Pilot Security.

(B) Grouping of Pilot Securities

The Operating Committee will oversee the Pilot Security grouping process in accordance with the methodology and criteria set out in this subsection. Once the population of Pilot Securities has been determined based on the criteria in Section V(A), the Operating Committee will select the Pilot Securities to be placed into three Test Groups by means of a stratified random sampling process. To effect this sampling, each of the Pilot Securities will be categorized as having (1) a low, medium, or high share price based on the Measurement Period VWAP, (2) low, medium, or high market capitalization based on the last day of the Measurement Period, and (3) low, medium, or high trading volume based on the CADV during the Measurement Period, yielding 27 possible categories. Low, medium, and high subcategories will be established by dividing the categories into three parts, each containing a third of the population.

Pilot Securities will be randomly selected from each of the 27 categories for inclusion into the Test Groups. If, however, a single category of Pilot Securities contains fewer than 10 securities, it will be combined with another of the 27 categories that contains at least 10 securities. If two or more categories of Pilot Securities contain fewer than 10 securities, those categories will be combined, provided the combined category contains at least 10 securities. If the combined category contains fewer than 10 securities, then the category will be combined with another of the 27 categories that contains at least 10 securities.

Pilot Securities will be randomly selected from each category for inclusion in the three Test Groups based on the percentage of Pilot Securities comprised of that category. As a result, each category will be represented in the three Test Groups based on its relative proportion to the population of Pilot Securities. Further, a primary listing market's securities will be selected from each category and included in the three Test Groups in the same proportion as that primary listing market's securities comprise each category of Pilot Securities. Each Test Group will consist of 400 Pilot Securities. Those Pilot Securities not placed into the three Test Groups will constitute the Control Group.

(C) Publication of Pilot Securities and Groups

Each primary listing exchange will make publicly available for free on its website a list of those Pilot Securities listed on that exchange and included in the Control Group and each Test Group, adjusting for ticker symbol changes and relevant corporate actions. The list of Pilot Securities will contain the data specified in Appendix A.

VI. Pilot Test Groups

As described in Section V(B), the Pilot Securities will be divided into four groups: a Control Group and three Test Groups. Each Test Group will consist of 400 Pilot Securities. The Control Group will consist of the Pilot Securities not placed into a Test Group.

(A) Control Group

Pilot Securities in the Control Group may be quoted and traded at any price increment that is currently permitted.

(B) Test Group One

Pilot Securities in Test Group One will be quoted in \$0.05 minimum increments, but may continue to trade at any price increment that is currently permitted. Participants will adopt rules prohibiting Participants or any member of a Participant from displaying, ranking, or accepting from any person any displayable or non-displayable bids or offers, orders, or indications of interest in any Pilot Security in Test Group One in price increments other than \$0.05. However, orders priced to execute at the midpoint and orders entered in a Participant-operated retail liquidity program may be ranked and accepted in increments of less than $0.05.

(C) Test Group Two

Pilot Securities in Test Group Two will be subject to the same quoting requirements as Test Group One, along with the applicable quoting exceptions. In addition, Pilot Securities in Test Group Two may only be traded in $0.05 minimum increments. Participants will adopt rules prohibiting trading centers operated by Participants and members of Participants from executing orders in any Pilot Security in Test Group Two in price increments other than $0.05. The $0.05 minimum trading increment applies to brokered cross trades. Pilot Securities in Test Group Two may trade in increments less than $0.05, however, under the following circumstances:

(1) Trading may occur at the midpoint between the National Best Bid and the National Best Offer or the midpoint between the best protected bid and the best protected offer;

(2) Retail Investor Orders may be provided with price improvement that is at least $0.005 better than the best protected bid or the best protected offer; and

(3) Negotiated Trades may trade in increments less than $0.05.

(D) Test Group Three

Pilot Securities in Test Group Three will be subject to the same quoting and trading requirements as Test Group Two, along with the applicable quoting and trading exceptions. In addition, Pilot Securities in Test Group Three will be subject to a trade-at prohibition.

Trade-at Prohibition. Under the trade-at prohibition, the Plan will (1) prevent a trading center that was not quoting from price-matching protected quotations and (2) permit a trading center that was quoting at a protected quotation to execute orders at that level, but only up to the amount of its displayed size.

In accordance with the trade-at prohibition, Participants will adopt rules prohibiting trading centers operated by Participants and members of Participants from executing a sell order for a Pilot Security at the price of a protected bid or from executing a buy order for a Pilot Security at the price of a protected offer unless such executions fall within an exception set forth below.

Trade-at Prohibition Exceptions. Trading centers will be permitted to execute an order for a Pilot Security at a price equal to a protected bid or protected offer under the following circumstances:

(1) The order is executed by a trading center that is displaying a quotation, via either a processor or an SRO quotation feed, at a price equal to the traded-at protected quotation but only up to the trading center's full displayed size [. Where the quotation is displayed through a national securities exchange, the execution at the size of the order must occur against the displayed size on that national securities exchange. Where the quotation is displayed through the Alternative Display Facility or another facility approved by the Commission that does not provide execution functionality, the execution at the size of the order must occur against the displayed size in accordance with the rules of the Alternative Display Facility or such approved facility];

(2) The order is of Block Size;

(3) The order is a Retail Investor Order executed with at least $0.005 price improvement;

(4) The order is executed when the trading center displaying the protected quotation that was traded at was experiencing a failure, material delay, or malfunction of its systems or equipment;

(5) The order is executed as part of a transaction that was not a "regular way" contract;

(6) The order is executed as part of a single-priced opening, reopening, or closing transaction by the trading center;

(7) The order is executed when a protected bid was priced higher than a protected offer in the Pilot Security;

(8) The order is identified as an Intermarket Sweep Order;

(9) The order is executed by a trading center that simultaneously routed Trade-at Intermarket Sweep Orders to execute against the full displayed size of the protected quotation that was traded at;

(10) The order is executed as part of a Negotiated Trade;

(11) The order is executed when the trading center displaying the protected quotation that was traded at had displayed, within one second prior to execution of the transaction that constituted the trade-at, a best bid or best offer, as applicable, for the Pilot Security with a price that was inferior to the price of the trade-at transaction.

(12) The order is executed by a trading center which, at the time of order receipt, the trading center had guaranteed an execution at no worse than a specified price (a "stopped order"), where:

a. The stopped order was for the account of a customer;

b. The customer agreed to the specified price on an order-by-order basis; and

c. The price of the trade-at transaction was, for a stopped buy order, equal to the national best bid in the Pilot Security at the time of execution or, for a stopped sell order, equal to the national best offer in the Pilot Security at the time of execution; or

(13) The order is for a fractional share of a Pilot Security, provided that such fractional share order was not the result of breaking an order for one or more whole shares of a Pilot Security into orders for fractional shares or was not otherwise effected to evade the requirements of the trade-at prohibition or any other provisions of the Plan.

The following examples illustrate the basic operation of the trade-at prohibition:

Example 1

The NBBO for Pilot Security ABC is $20.00 x $20.10. Trading Center 1 is displaying a 100-share protected bid at $20.00. Trading Center 2 is displaying a 100-share protected bid at $19.95. There are no other protected bids. Trading Center 3 is not displaying any shares in Pilot Security ABC but has 100 shares hidden at $20.00 and has 100 shares hidden at $19.95. Trading Center 3 receives an incoming order to sell for 400 shares. To execute the 100 shares hidden at $20.00, Trading Center 3 must respect the protected bid on Trading Center 1 at $20.00. Trading Center 3 must route a Trade-at Intermarket Sweep Order to Trading Center 1 to execute against the full displayed size of the protected bid, at which point Trading Center 3 is permitted to execute against the 100 shares hidden at $20.00. To execute the 100 shares hidden at $19.95, Trading Center 3 must respect the protected bid on Trading

Center 2 at $19.95. Trading Center 3 must route a Trade-at Intermarket Sweep Order to Trading Center 2 to execute against the full displayed size of the protected bid, at which point Trading Center 3 is permitted to execute against the 100 shares hidden at $19.95.

Example 2

The NBBO for Pilot Security ABC is $20.00 x $20.10. Trading Center 1 is displaying a 100-share protected bid at $20.00. Trading Center 2 is displaying a 100-share protected bid at $20.00. Trading Center 2 also has 300 shares hidden at $20.00 and has 300 shares hidden at $19.95. Trading Center 3 is displaying a 100-share protected bid at $19.95. There are no other protected bids. Trading Center 2 receives an incoming order to sell for 900 shares. Trading Center 2 may execute 100 shares against its full displayed size at the protected bid at $20.00. To execute the 300 shares hidden at $20.00, Trading Center 2 must respect the protected bid on Trading Center 1 at $20.00. Trading Center 2 must route a Trade-at Intermarket Sweep Order to Trading Center 1 to execute against the full displayed size of Trading Center 1's protected bid, at which point Trading Center 2 is permitted to execute against the 300 shares hidden at $20.00. To execute the 300 shares hidden at $19.95, Trading Center 2 must respect the protected bid on Trading Center 3 at $19.95. Trading Center 2 must route a Trade-at Intermarket Sweep Order to Trading Center 3 to execute against the full displayed size of Trading Center 3's protected bid, at which point Trading Center 2 is permitted to execute against the 300 shares hidden at $19.95.

Example 3

The NBBO for Pilot Security ABC is $20.00 x $20.10. Trading Center 1 is displaying a 100-share protected bid at $20.00. Trading Center 1 is also displaying 300 shares at $19.90 on an SRO quotation feed. Trading Center 2 is displaying a 100-share protected bid at

$19.95. Trading Center 2 is also displaying 200 shares at $19.90 on an SRO quotation feed and has 200 shares hidden at $19.90. Trading Center 3 is displaying a 100-share protected bid at $19.90. There are no other protected bids. Trading Center 2 receives an incoming order to sell for 700 shares. To execute against its protected bid at $19.95, Trading Center 2 must comply with the trade-through restrictions in Rule 611 of Regulation NMS and route an intermarket sweep order to Trading Center 1 to execute against the full displayed size of Trading Center 1's protected bid at $20.00. Trading Center 2 is then permitted to execute against its 100-share protected bid at $19.95. Trading Center 2 may then execute 200 shares against its full displayed size at the price of Trading Center 3's protected bid. To execute the 200 shares hidden at $19.90, Trading Center 2 must respect the protected bid on Trading Center 3 at $19.90. Trading Center 2 must route a Trade-at Intermarket Sweep Order to Trading Center 3 to execute against the full displayed size of Trading Center 3's protected bid, at which point Trading Center 2 is permitted to execute against the 200 shares hidden at $19.90. Trading Center 2 does not have to respect Trading Center 1's displayed size at $19.90 for trade-at purposes because it is not a protected quotation.

VII. Collection of Pilot Data

(A) Collection of Trading Center Pilot Data

Throughout the Pilot Period, the Participants will collect the following data with respect to Pilot Securities (as set forth in Appendix B):

(1) Daily market quality statistics of orders by security, order type, original order size (as observed by the trading center), hidden status (as applicable), and coverage under Rule 605 of Regulation NMS;

(2) Specified data regarding market orders and marketable limit orders;

(3) Daily number of registered Market Makers; and

(4) Daily Market Maker participation statistics. Each Participant that is the Designated Examining Authority of a member of a Participant operating a trading center will require such member to collect and provide to the Designated Examining Authority the data described in subparagraphs (1) and (2) above, as applicable, subject to the terms and conditions in Appendix B. The Participants and each member of a Participant operating a trading center will also be required to collect such data for dates starting six months prior to the Pilot Period through six months after the end of the Pilot Period. Each Participant will make available to other Participants a list of members designated as Market Makers on that Participant's trading center.

On a monthly basis, the Participants and the Designated Examining Authority for each member of a Participant operating a trading center will make the data in the applicable subparagraphs specified above publicly available on their websites for free and will report such data to the SEC on a disaggregated basis by trading center. The data made publicly available will not identify the trading center that generated the data.

(B) Collection of Market Maker Profitability Data

Each Participant that is the Designated Examining Authority of a Market Maker will require such Market Maker to provide to the Designated Examining Authority the data specified in Appendix C regarding daily Market Maker trading profits with respect to Pilot Securities on a monthly basis. Each Market Maker will also be required to provide to its Designated Examining Authority such daily data for dates starting six months prior to the Pilot Period through six months after the end of the Pilot Period. On a monthly basis, the Designated Examining Authority will aggregate such data related to Market Makers categorized by the Control Group and each Test Group and make the aggregated data publicly available on its website for free and will report such data to the SEC, provided, however, the data reported to the SEC shall include the profitability statistics categorized by security. The data made publicly available will not identify the Market Makers that generated the data or the individual securities.

VIII. Assessment of Pilot

No later than [six] eighteen months after the [end] start of the Pilot Period, the Participants will provide to the Commission and make publicly available a joint assessment of the impact of the Pilot. The assessment will be conducted using data generated during the first twelve months of the Pilot Period, or a subset of which that represents the impact of the Pilot. The assessment will include:

(1) An assessment of the statistical and economic impact of an increase in the quoting increment on market quality;

(2) An assessment of the statistical and economic impact of an increase in the quoting increment on the number of Market Makers;

(3) An assessment of the statistical and economic impact of an increase in the quoting increment on Market Maker participation;

(4) An assessment of the statistical and economic impact of an increase in the quoting increment on Market Maker profits;

([4]5) An assessment of the statistical and economic impact of an increase in the quoting increment on market transparency;

([5]6) An evaluation whether any market capitalization, daily trading volume, or other thresholds can differentiate the results of the above assessments across stocks (e.g., does the quoting increment impact differently those stocks with daily trading volume below a certain threshold);

([6]7) An assessment of the statistical and economic impact of the above assessments for the incremental impact of a trading increment and for the joint effect of an increase in a quoting increment with the addition of a trading increment;

([7]8) An assessment of the statistical and economic impact of the above assessments for the incremental impact of a trade-at prohibition and for the joint effect of an increase in a quoting increment with the addition of a trading increment and a trade-at prohibition; and

(8) An assessment of any other economic issues that the Participants believe the SEC should consider in any rulemaking that may follow the Pilot.

Participants may individually submit to the SEC and make publicly available additional supplemental assessments of the impact of the Pilot.

IX. Implementation

The Tick Size Pilot Program will be implemented on a [one]two-year pilot basis. The Tick Size Pilot Program will be applicable during and outside of Regular Trading Hours.

X. Withdrawal from Plan

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

XI. Counterparts and Signatures

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

IN WITNESS THEREOF, this Plan has been executed as of the ___ day of ____ [2014] 2015

by each of the parties hereto.

BATS EXCHANGE, INC.	BATS Y-EXCHANGE, INC.
BY:____________________	BY:____________________
CHICAGO STOCK EXCHANGE, INC.	EDGA EXCHANGE, INC.
BY:____________________	BY:____________________
EDGX EXCHANGE, INC.	FINANCIAL INDUSTRY REGULATORY AUTHORITY, INC.
BY:____________________	BY:____________________
NASDAQ OMX BX, INC.	NASDAQ OMX PHLX LLC
BY:____________________	BY:____________________
THE NASDAQ STOCK MARKET LLC	NEW YORK STOCK EXCHANGE LLC
BY:____________________	BY:____________________
NYSE MKT LLC	NYSE ARCA, INC.
BY:____________________	BY:____________________

(7) The cumulative number of orders;

(8) The cumulative number of shares of orders;

(9) The cumulative number of shares of orders canceled;

(10) The cumulative number of shares of orders executed on the receiving trading center;

(11) The cumulative number of orders with special handling instructions (for example, slide, discretion, eligible counterparty, minimum quantity) excluded from price improvement and effective spread statistics;

(12) The cumulative number of shares of orders with special handling instructions (for example slide, discretion, eligible counterparty, minimum quantity) excluded from price improvement and effective spread statistics;

(13) The cumulative number of shares of orders executed at any other trading center;

(14) The cumulative number of shares of orders executed from 0 to less than 100 microseconds after the time of order receipt;

(15) The cumulative number of shares of orders executed from 100 microseconds to less than 100 milliseconds after the time of order receipt;

(16) The cumulative number of shares of orders executed from 100 milliseconds to less than 1 second after the time of order receipt;

(17) The cumulative number of shares of orders executed from 1 second to less than 30 seconds after the time of order receipt;

(18) The cumulative number of shares of orders executed from 30 seconds to less than 60 seconds after the time of order receipt;

(19) The cumulative number of shares of orders executed from 60 seconds to less than 5 minutes after the time of order receipt;

(20) The cumulative number of shares of orders executed from 5 minutes to 30 minutes after the time of order receipt;

(21) The cumulative number of shares of orders canceled from 0 to less than 100 microseconds after the time of order receipt;

(22) The cumulative number of shares of orders canceled from 100 microseconds to less than 100 milliseconds after the time of order receipt;

(23) The cumulative number of shares of orders canceled from 100 milliseconds to less than 1 second after the time of order receipt;

(24) The cumulative number of shares of orders canceled from 1 second to less than 30 seconds after the time of order receipt;

(25) The cumulative number of shares of orders canceled from 30 seconds to less than 60 seconds after the time of order receipt;

(26) The cumulative number of shares of orders canceled from 60 seconds to less than 5 minutes after the time of order receipt;

(27) The cumulative number of shares of orders canceled from 5 minutes to 30 minutes;

(28) The share-weighted average realized spread for executions of orders;

(29) Original Percentage Hidden - the received share-weighted average percentage of shares not displayable as of order receipt;

(30) Final Percentage Hidden - the received share-weighted average percentage of shares not displayed prior to final order execution or cancellation;

(31) Quoted Size at the National Best Bid and National Best Offer -the share-weighted average of the consolidated quoted size at the inside price at the time of order execution;

(32) Share-weighted average NBBO Spread at the time of order execution; and

(33) Share-weighted average BBO Spread of reporting exchange at the time of order execution.

b. For market orders and marketable limit orders, except those noted as excluded:

(1) The share-weighted average effective spread for executions of orders;

(2) The cumulative number of shares of orders executed with price improvement;

(3) For shares executed with price improvement, the share-weighted average amount per share that prices were improved;

(4) For shares executed with price improvement, the share-weighted average period from the time of order receipt to the time of order execution;

(5) The cumulative number of shares of orders executed at the quote;

(6) For shares executed at the quote, the share-weighted average period from the time of order receipt to the time of order execution;

(7) The cumulative number of shares of orders executed outside the quote;

(8) For shares executed outside the quote, the share-weighted average amount per share that prices were outside the quote; and

(9) For shares executed outside the quote, the share-weighted average period from the time of order receipt to the time of order execution.

II. Market and Marketable Limit Order Data – The following columns of information with respect to Market Orders and non-booked portions of Marketable Limit Orders:

a. Exchange code or trading center identifier;

b. Ticker Symbol;

c. Date;

d. Time of order receipt;

e. Order Type;

f. Order Size in Shares;

g. Order side-"B", "S" (including sell short exempt), "SS";

h. Order price (if marketable limit);

i. NBBO quoted price;

j. NBBO quoted depth in lots;

k. Receiving market offer for buy or bid for sell (as applicable);

l. Receiving market depth (offer for buy and bid for sell) (as applicable);

m. ISO flag (Y/N);

n. Retail Investor Order flag (Y/N);

o. Routable flag (Y/N);

p. IOC (Y/N);

q. Indicator for quote leader-"1" if the receiving market is the first market to post the NBB for a sell or NBO for a buy (as applicable);

r. Average execution price-share-weighted average that includes only executions on the receiving market;

s. Average execution time-share-weighted average period that includes only executions on the receiving market;

t. Executed shares-the number of shares in the order that are executed;

u. Canceled shares – the number of shares in the order that are canceled;

v. Routed shares- the number of shares in the order that are routed to another exchange or market;

w. Routed average execution price-share-weighted average that includes only shares routed away from the receiving market;

x. Average routed execution time-share-weighted average period that includes only executions on the routed markets; and

y. Indicator for special handling instructions (for example, slide, discretion, eligible counterparty, minimum quantity)-identifies orders that contain instructions that could result in delayed execution or an execution price other than the quote.

III. Daily Market Maker Registration Statistics - Each Participant that is a National Securities Exchange will collect daily Market Maker registration statistics categorized by security, including the following columns of information:

a. Ticker Symbol;

b. SRO;

c. Number of registered market makers; and

d. Number of other registered liquidity suppliers.

IV. Daily Market Maker Participation Statistics- Each Participant will collect daily Market Maker participation statistics with respect to each Market Maker engaging in trading activity on the trading center operated by the Participant. With respect to each Market Maker, the Participant will collect such statistics irrespective of whether the Market Maker is registered with the Participant. The participation statistics will be categorized by security, including the columns of information listed below, except that a Participant that is a national securities association will not be required to collect such statistics unless a Market Maker registers with its Alternative Display Facility prior to or during the Pilot Period:

a. Ticker Symbol;

b. Share participation – the number of shares purchased or sold by Market Makers in a principal trade, not including riskless principal. When aggregating across Market Makers, share participation will be an executed share-weighted average per Market Maker;

c. Trade participation – the number of purchases and sales by Market Makers in a principal trade, not including riskless principal. When aggregating across Market Makers, trade participation will be a trade-weighted average per Market Maker;

d. Cross-quote share (trade) participation– the number of shares purchased (the number of purchases) at or above the NBO and the number of shares sold (the number of sales) at or below the NBB at the time of the trade;

e. Inside-the-quote share (trade) participation- the number of shares purchased (the number of purchases) and the number of shares sold (the number of sales) between the NBBO at the time of the trade;

f. At-the-quote share (trade) participation- the number of shares purchased (the number of purchases) that are equal to the National Best Bid price and the number of shares sold (the number of sales) that are equal to the National Best Offer price at the time of or immediately before the trade. In the case of a downward moving National Best Bid or Offer, the National Best Bid or National Best Offer price immediately before the trade will be used; and

g. Outside-the-quote share (trade) participation- the number of shares purchased (the number of purchases) that are less than the National Best Bid price and the number of shares sold (the number of sales) that are greater than the National Best Offer price at the time of or immediately before the trade. In the case of a downward moving National Best Bid or Offer, the National Best Bid or National Best Offer price immediately before the trade will be used.

Appendix C – Data Collected by Market Makers

Each Participant that is the Designated Examining Authority of a Market Maker will require such Market Maker to collect the data described in Item I with respect to orders and executions in Pilot Securities on any trading center and to transmit such data in a pipe delimited format to the Designated Examining Authority on a monthly basis, to be provided within 30 calendar days following month end. Data will only be collected with respect to those orders and executions occurring during Regular Trading Hours. The data will be provided for dates starting six months prior to the Pilot Period through six months after the end of the Pilot Period. Each Designated Examining Authority will be responsible for aggregating the data provided by the Market Makers under Item I and providing the data described in Item II in a pipe delimited format to the SEC.

I. **Market Maker Profitability-** Daily Market Maker profitability statistics categorized by security, including the following columns of information:

a. Total number of shares of orders executed by the Market Maker;

b. Raw Market Maker realized trading profits – the difference between the market value of Market Maker sales (shares sold x price) and the market value of Market Maker purchases (shares purchased x price). A LIFO-like method will be used for determining which share prices to use in the calculation; and

c. [Market Maker realized trading profits net of fees and rebates -realized trading profits plus rebates the Market Maker collects from trading on that day minus access fees the Market Maker pays for trading on that day (if estimated before allocation of rebates and fees, use expected rebates and fees); and] [d.] Raw Market Maker unrealized trading profits – the difference between the purchase or sale price of the end-of-day inventory position of the Market Maker and the Closing Price. In case of a short position, the Closing Price from the sale will be subtracted. In the case of a long position, the purchase price will be subtracted from the Closing Price.

II. Aggregated Market Maker Profitability- Total Daily Market Maker profitability statistics categorized by security <u>as well as categorized by the Control Group and each Test Group,</u> including the following columns of information:

a. Total Raw Market Maker realized trading profits-the difference between the market value of Market Maker sales (shares sold x price) and the market value of Market Maker purchases (shares purchased x price). A LIFO-like method will be used for determining which share prices to use in the calculation;

b. Volume-weighted average of Raw Market Maker realized trading profits;

[c. Total Market Maker realized trading profits net of fees and rebates-realized trading profits plus rebates the Market Maker collects from trading on that day minus access fees the Market Maker pays for trading on that day (if estimated before allocation of rebates and fees, use expected rebates and fees);

d. Volume-weighted average of Market Maker realized trading profits net of fees and rebates;]

<u>c.</u>[e.] Total Raw Market Maker unrealized trading profits-the difference between the purchase or sale price of the end-of-day inventory position of the Market Maker and the Closing Price. In case of a short position, the Closing Price from the sale will be subtracted. In the case of a long position, the purchase price will be subtracted from the Closing Price; and

d.[f.] Volume-weighted average of Market Maker unrealized trading profits.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74886 / May 6, 2015

Admin. Proc. File No. 3-15628

In the Matter of

DANIEL IMPERATO

ORDER DENYING REQUEST FOR RECONSIDERATION

On March 27, 2015, we issued an opinion and order collaterally barring Daniel Imperato based on his having been enjoined from violating antifraud, registration, and related provisions of the federal securities laws.[1] Imperato now seeks reconsideration of that decision. As discussed below, we deny Imperato's request.

I.

The district court entered its injunction after finding that Imperato acted as an unregistered broker when he sold unregistered shares of Imperiali, Inc., a corporation he controlled, to at least twenty-six investors, defrauding them of approximately $2.5 million. In documents distributed to investors and in Commission filings, Imperato portrayed Imperiali as a "thriving, multinational corporation" with "multiple, valuable subsidiaries" when, in fact, it was "just a shell corporation" with "virtually no assets or operations," and its subsidiaries were "worthless or, in some cases, even non-existent." The district court's opinion was affirmed on appeal.[2]

We then instituted follow-on administrative proceedings based on the injunction and determined in those proceedings that the public interest required Imperato's exclusion from the securities industry, noting the egregious and recurrent nature of his violative conduct, high degree of scienter, and unwillingness to acknowledge that misconduct. We further determined that the

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1 *Daniel Imperato*, Exchange Act Release No. 74596 (Mar. 27, 2015), 2015 WL 1389046. We also imposed a penny stock bar against Imperato.

2 *SEC v. Imperiali, Inc.*, 594 Fed. App'x 957 (11th Cir. 2014).

bulk of Imperato's arguments consisted of impermissible collateral attacks on the district court's factual findings and legal conclusions in the underlying injunctive proceeding.

II.

"The remedy of a motion for reconsideration is designed to correct manifest errors of law or fact or permit the presentation of newly discovered evidence. Respondents may not use a motion for reconsideration to reiterate arguments previously made or to cite authority previously available." [3] Reconsideration is intended to be an "extraordinary" remedy.[4]

Imperato's motion fails to meet these requirements. In general, Imperato reiterates arguments already made and specifically considered by us in the March 27 opinion and order, including that: (1) he never acted as a broker; (2) he did not control Imperiali; (3) he did not draft the fraudulent statements at issue or act with scienter; and (4) he was denied due process because he did not have a hearing. We will not readdress those matters here. He also makes various challenges to the civil injunctive proceedings, but such challenges have already been considered and rejected by the Eleventh Circuit, as noted in our March 27 opinion and order. Imperato provides no other arguments that give us any reason to reconsider our prior decision.

Accordingly, it is ORDERED that the motion for reconsideration filed by Daniel Imperato be, and it hereby is, DENIED.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

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3 *Steven Altman, Esq.*, Order Denying Motion for Reconsideration and a Stay, Exchange Act Release No. 63665 (Jan. 6, 2011), 2011 WL 52087, at *1 (citations omitted).

4 *Johnny Clifton*, Corrected Order Denying Motions for Reconsideration and a Stay, Exchange Act Release No. 70639 (Oct. 9, 2013), 2013 WL 5553865, at *1.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74904 / May 7, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3655 / May 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16527

In the Matter of **GRUBER & COMPANY LLC and** **EDWARD RANDALL GRUBER (CPA),** **Respondents.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Gruber & Company LLC ("Gruber & Co.") and Edward Randall Gruber, CPA ("Gruber") (collectively "Respondents") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondents have 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

[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.

which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over each of them and the subject matter of these proceedings, and the findings contained in Section III.4. below, which are admitted, Respondents consent 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 Respondents' Offer, the Commission finds that:

1. Gruber & Company LLC, located during the pertinent period in Lake Saint Louis, Missouri, is a Missouri limited liability company and public accounting firm licensed by the Missouri State Board of Accountancy, and formerly registered with the Public Company Accounting Oversight Board ("PCAOB"). Gruber & Co. acted as the independent auditor for Gold Standard Mining Corporation ("Gold Standard") from February 14, 2008 to February 4, 2011. Gruber & Co. performed public company audits of, and issued an audit report on June 21, 2010 containing an unqualified opinion on, the consolidated financial statements of Gold Standard for the fiscal years ending December 31, 2009, 2008 and 2007. Gold Standard filed Gruber & Co.'s audit report in its amended Form 8-K with the Commission on October 5, 2010. In addition, Gruber & Co. performed a review of the consolidated financial statements contained in Gold Standard's September 30, 2010 Form 10-Q, which was filed with the Commission on November 22, 2010. Gruber & Co. resigned as Gold Standard's independent auditor on February 4, 2011. Gruber & Co. ceased to perform public company audits as of June 27, 2013, when its registration with the PCAOB was permanently revoked. See PCAOB Release No. 105-2013-005 (June 27, 2013).

2. Edward Randall Gruber, age 63, is a Certified Public Accountant ("CPA") licensed to practice in Missouri. During the pertinent period, Gruber was a resident of Lake Saint Louis, Missouri. Gruber is the sole managing member and owner of Gruber & Co. Gruber served as the engagement partner for Gruber & Co.'s audits of Gold Standard's consolidated financial statements for the fiscal years ending December 31, 2009, 2008 and 2007, and review of Gold Standard's September 30, 2010 financial statements. As the engagement partner on the audits of Gold Standard's financial statements, Gruber was responsible for supervising the engagements and causing Gruber & Co. to issue the audit reports for Gruber & Co. On June 27, 2013, Gruber was permanently barred from being an associated person of a registered public accounting firm, as that term is defined in Section 2(a)(9) of the Sarbanes-Oxley Act of 2002, as amended. See PCAOB Release No. 105-2013-005 (June 27, 2013).

3. Gold Standard was a Nevada corporation whose principal office was located in Beverly Hills, California during the pertinent period. At times relevant to this Order, Gold Standard's securities were registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and quoted on the over-the-counter bulletin board under the symbol "GSTP".

4. On February 4 and 12, 2015, final judgments were entered against Gruber and Gruber & Co. respectively permanently enjoining them from future violations of Sections 10(b) and 10A(a) of the Exchange Act and Rule 10b-5 adopted thereunder; and from aiding and abetting violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 adopted thereunder, in the civil action entitled *SEC v. Gold Standard Mining Corp., et al.*, Civil Action Number 2:12-cv-5662-JCB-CW in the United States District Court for the Central District of California.

5. The Commission's complaint alleged, among other things, that during 2009 Gold Standard reported that it had acquired a Russian gold mining company, and filed unaudited, consolidated financial statements which increased its assets to more than $1.3 billion, but failed to disclose material information that the acquisition had not been completed because the change in ownership was not registered with, or approved by Russian regulatory authorities. The complaint alleged that Gruber & Co. violated, and Gruber aided and abetted violations of, Section 10(b) of the Exchange Act and Rule 10b-5 when Gruber & Co. made false and misleading statements in its audit report filed with Gold Standard's amended Form 8-K on October 5, 2010. Gruber, the engagement partner on the audit, caused Gruber & Co. to issue the false and misleading audit report that stated: Gruber & Co. had conducted the audit of Gold Standard's consolidated financial statements in accordance with PCAOB standards, when in fact it did not; and the consolidated financial statements fairly presented the financial position of Gold Standard and its subsidiaries, when they did not. The complaint alleged that during the audit Gruber raised questions about whether Gold Standard had consummated its purchase of the Russian gold mining company by properly registering the acquisition with Russian regulatory authorities, but failed to obtain sufficient competent evidential matter to determine whether the registration ever occurred. In addition, the complaint alleged that Gruber & Co. and Gruber failed to design audit procedures to provide reasonable assurance of detecting illegal acts that would have a direct and material effect on the determination of financial statement amounts in violation of Section 10A(a) of the Exchange Act. Furthermore, the complaint alleged that Gruber & Co. and Gruber aided and abetted Gold Standard's violations of the reporting requirements of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 by submitting the false and misleading audit report for inclusion in Gold Standard's amended Form 8-K filed on October 5, 2010, and performing a deficient review of the financial statements in the September 30, 2010 Form 10-Q, which contained estimated financial statements not prepared in conformance with generally accepted accounting principles.

IV.

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

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

A. Gruber & Company LLC is suspended from appearing or practicing before the Commission as an accountant; and

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 74903 / May 7, 2015

Admin. Proc. File No. 3-15935

In the Matter of the Application of

MICHAEL PINO

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY PROCEEDINGS

Discretionary Trading without Written Authorization

Conduct Inconsistent with Just and Equitable Principles of Trade

Registered securities association found that registered representative, while associated with two member firms, engaged in discretionary trading in a customer's accounts without written authorization. *Held*, association's findings of violations with respect to all but two sales transactions and sanctions it imposed are *sustained*.

APPEARANCES:

Michael Pino, pro se.

Alan Lawhead, *Jennifer C. Brooks*, and *Celia L. Passaro*, for Financial Industry Regulatory Authority, Inc.

Appeal filed: June 17, 2014
Last brief received: September 26, 2014

Michael Pino, formerly a registered representative associated with FINRA member firms Centennial Securities Company, LLC ("Centennial") and Money Concepts Capital Corp. ("Money Concepts"), appeals from FINRA disciplinary action. FINRA found that Pino engaged in discretionary trading without written authorization in the Centennial and Money Concepts accounts of one of his customers, in violation of NASD Conduct Rules 2510(b) and 2110, and FINRA Rule 2010.[1] Based upon these violations, FINRA fined Pino $5,000, suspended him in all capacities for thirty business days, and imposed costs. We base our findings on an independent review of the record.[2]

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1 On July 26, 2007, the Commission approved a proposed rule change that NASD filed seeking to amend its Certificate of Incorporation to reflect its name change to the Financial Industry Regulatory Authority, Inc. ("FINRA"), in connection with the consolidation of its member firm regulatory functions with NYSE Regulation, Inc. *See* Securities Exchange Act Release No. 56148 (July 26, 2007), 72 Fed. Reg. 42,146 (Aug. 1, 2007). Following the consolidation, FINRA began developing a new "Consolidated Rulebook" of FINRA Rules. The first phase of the new consolidated rules became effective on December 15, 2008. *See* Exchange Act Release No. 58643 (Sept. 25, 2008), 73 Fed. Reg. 57,174 (Oct. 1, 2008).

NASD Rule 2510(b) provides that "[n]o . . . registered representative shall exercise any discretionary power in a customer's account unless such customer has given prior written authorization to a stated individual or individuals and the account has been accepted by the member, as evidenced in writing. . . ." NASD Rule 2510 has not yet been replaced by a new FINRA Rule in the Consolidated Rulebook, and it remains in effect.

NASD Rule 2110 provided that "[a] member, in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade." According to "our long-standing and judicially-recognized policy . . . a violation of another Commission or NASD rule or regulation . . . constitutes a violation of [NASD] Rule 2110." *Stephen J. Gluckman*, Exchange Act Release No. 41628, 54 SEC 175, 1999 WL 507864, at *6, (July 20, 1999). In September 2008, the Commission approved the new FINRA Rule 2010, which replaced NASD Rule 2110. The new FINRA rule, which became effective December 15, 2008, does not alter, in any material respect, the prior NASD rule. *See FINRA Regulatory Notice 08-57* (Oct. 2008). NASD Rule 2110 applies to Pino's conduct before December 15, 2008, and the new FINRA Rule 2010 applies to his conduct after that date.

2 Our briefing schedule in this proceeding ordered Pino to file a brief in support of his application for review by August 7, 2014. Pino missed this deadline. He asserted that he had mailed the brief on time, but it was returned to him due to insufficient postage, and that he planned to re-submit the brief (which he subsequently did). Before we received Pino's opening brief, FINRA filed a motion to dismiss Pino's application, arguing that Pino had abandoned his appeal by failing to file a timely brief. We have exercised our discretion to accept Pino's late-filed brief, and we accordingly deny FINRA's motion to dismiss.

I. Background

Pino entered the securities industry in 1988 and became registered as a general securities representative associated with Centennial in 2002, where he stayed until the end of 2008. In January 2009, Pino became registered with Money Concepts as a general securities representative, where he remained employed until August 31, 2010. Pino currently is not employed in the securities industry. The conduct at issue took place between January 2007 and May 2010 and involved the Centennial and Money Concepts accounts of one of Pino's customers.

A. The customer at issue opened an account with Pino at Centennial.

In 2006, the customer at issue retired and opened an account with Pino. The customer's previous investment experience was limited to an account he held at Fidelity that was part of an employee benefits program. That account was worth approximately $48,800 at the time of his retirement. Although the customer had never worked with a broker or investment adviser, he testified that he contacted Pino because a former co-worker had an account with Pino and the customer was "impressed with how much [his former co-worker] told [the customer] he was making."

When the customer first met with Pino in late 2006, Pino did not discuss specific investments or strategies, and he generally recommended investing half of the customer's account in stocks and the rest in bonds.[3] The customer testified that he emphasized to Pino that he did not want to purchase any securities in the automotive industry "because at that time GM and Chrysler were talking about bankruptcy." The customer also expressed an interest in "environmental" stocks, which he considered to be the "coming thing" because he had read a newspaper article discussing the possibility of windmills in Lake Erie, although he "didn't know any of [the environmental companies] personally by name." After their initial meeting, the customer filled out and signed the necessary documents to open an account with Pino at Centennial.[4] Shortly thereafter, the customer transferred the entire value of his Fidelity account to his new account with Pino at Centennial.

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3 Pino described the customer's investment preferences when he opened the Centennial account as "very aggressive," based on investments in emerging markets mutual funds in his Fidelity account.

4 The customer filled in boxes on his account-opening form by stating that he had nineteen years of investment experience in mutual funds, stocks, and bonds. The customer testified that he filled out the form that way because that was when he started the Fidelity employee benefits account, and that he had no other investment experience besides that account.

B. Pino executed discretionary transactions in the customer's Centennial account without the customer's written or oral authorization.

Pino executed discretionary transactions in the customer's Centennial account, although it is undisputed that the customer never provided Pino with written authorization for discretionary trading.[5] First, in January 2007, Pino purchased relatively large quantities of Ford and General Motors bonds, notwithstanding the customer's instructions to Pino during their initial meeting that he did not want to invest in the automotive industry. The bonds totaled $21,370.00, approximately forty-four percent of the account's value. The customer complained to Pino about the purchases, but, according to the customer's testimony, Pino convinced him to keep the bonds by telling him that "bonds are different from stocks and [the bonds Pino purchased] are guaranteed even if they go bankrupt they still have to pay these off." The customer also testified that he "didn't know how to stop trading and freeze the account," and he felt that there was nothing he could do about the purchases Pino had made.

After the purchase of the bonds, Pino began ~~to make unauthorized trades~~ in the customer's account to implement a self-described "earnings strategy." Pursuant to this strategy, Pino would wait for a positive market reaction to an earnings report of a prominent issuer and then purchase the securities of a company in the prominent issuer's "peer group" shortly before that company released its own earnings report. Pino would then sell that stock at some later point in time, preferably after the price of the security had increased as a result of the earnings news. Pino believed that, if the prominent issuer's earnings were strong, others in the industry peer group also were likely to report strong earnings.[6]

Although the majority of Pino's trading in the customer's account exhibited characteristics of Pino's earnings strategy—the trades involved a purchase of shares one day followed by a sale of those same shares a couple of days or, often, weeks later—a few of the transactions spanning periods longer than two months may have been executed pursuant to a strategy Pino described as

5 In fact, Centennial's policies prohibited any discretionary trading by a registered representative, except in circumstances not applicable here (such as transactions to satisfy margin requirements or exchanging one money market fund for another). Two other exceptions to Centennial's prohibition ("isolated or infrequent discretion . . . when a customer is unavailable for a limited period of time" and "buying or selling a security or type of security within limited specific parameters established by the customer") both required written authorization from the customer, which did not occur here. Further, Pino attended Centennial's 2007-08 annual continuing education meeting, at which Centennial's prohibitions against discretionary accounts were covered. And he checked "No" on a Centennial annual certification questionnaire, which asked, "Excluding fee based business, do you handle any customer accounts on a discretionary basis?"

6 Pino testified that he used this strategy in no more than ten of his customers' accounts.

"buy and hold."[7] The customer testified that Pino called him about once a month during his time at Centennial, but that they did not discuss the specific securities that Pino planned to purchase and sell. Instead, they often discussed sports and general market conditions. The customer acknowledged that he could not recall every conversation he had with Pino during this time period, but he maintained that, with two possible exceptions, Pino: (i) did not discuss any specific securities he planned to purchase or sell in the customer's account; (ii) did not talk about the quantities of securities he planned to purchase or sell; nor (iii) did he discuss the price at which he planned to execute any transactions.[8] The customer's testimony applied to all sales transactions in his accounts, regardless of the strategy Pino employed. According to the customer, the trades in his account "just happened." The customer testified that he did not ever "verbally tell [Pino] to go ahead and trade on [his] behalf and just let [him] know later on after the trades were made." The customer did not complain about Pino's activity in the account because, after his experience following Pino's early unauthorized purchases of the Ford and General Motors bonds, the customer believed that he had no way to undo Pino's trading.

While Pino was at Centennial, he sold securities in the customer's account without the customer's written or oral authorization on fifty-six occasions. None of the sales in the customer's account occurred on the same business day as the purchase of that security. And, while some of Pino's sales of a security at Centennial occurred the following day after his initial

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7 Pino testified that he began using the earnings strategy in the customer's accounts in March 2007 and continued to use it for at least the following two years. He testified that approximately thirty to fifty percent of the trades in the customer's accounts were earnings strategy trades, and he separately stated that sixty to eighty percent of the customer's portfolio was "subject to a buy and hold strategy." Pino did not identify which transactions were executed under each of the two strategies, but the record establishes that the majority of the transactions in the customer's account follow a pattern of trading consistent with the earnings strategy, *i.e.*, a purchase and sale of the same quantity of the same security within two months. This pattern appears as early as January 2007 and continues until May 2010. A few of the transactions at issue, spanning periods longer than two months between the purchase and sale, may have been part of Pino's "buy and hold" strategy.

8 The customer testified that Pino may have discussed beforehand the sales of the Jet Blue and Noah Education Holdings securities in his accounts, "but that was it." There were approximately ten months between the purchase and sale of the Jet Blue securities and just under two years between the purchase and sale of the Noah Education securities (both much longer than the typical amount of time between purchase and sale transactions in the customer's accounts), indicating that these transactions may not have been part of the earnings strategy. The customer stated that Pino told him that "because we held [the Jet Blue stock] so long . . . even though we . . . would take a big loss it's time to get rid of it to have more capital to work with." The customer's testimony regarding Noah Education was less specific—he simply stated that when Pino sold the Noah Education stock, "he told me about it." Pino's testimony did not address either Jet Blue or Noah Education specifically.

purchase of that security, over half of the transactions spanned periods longer than one week between purchase and sale (although the overwhelming majority occurred within a period of less than two months). For example, on April 25, 2007, Pino purchased 137 shares of Halliburton Company (which announced its quarterly earnings the following day), which he then sold on May 9, 2007, fourteen days later.

C. Pino and the customer moved to Money Concepts, where Pino continued to execute sales transactions in the customer's account without written or oral authorization.

In approximately January 2009, Pino sent the customer a letter stating that he had moved to Money Concepts "to be able to manage assets independent of Wall Street's buy and hold strategies that have been so wrong over the last 10 years" and that he "pledge[d] to restore and grow [the customer's account]."[9] On January 23, 2009, the customer moved his account to Money Concepts. At Money Concepts, Pino continued a pattern of trading in the customer's account that was largely consistent with the earnings strategy, resulting in thirty-nine sales transactions between February 2009 and May 2010. All of the purchase transactions at Money Concepts had a corresponding sale within two months of the purchase date, indicating that they were made pursuant to the earnings strategy. A few sales transactions at Money Concepts involved securities that were originally purchased while Pino and the customer's account were at Centennial, and those transactions spanned periods longer than two months, possibly indicating that they were "buy and hold" trades.

As at Centennial, it is undisputed that Pino did not have written authorization to exercise discretionary authority over the customer's account at Money Concepts. And Money Concepts expressly prohibited registered representatives from "accepting an account from a customer on a discretionary basis." At the time, Money Concepts permitted only registered investment advisory accounts (which the customer's account was not) to be traded on a discretionary basis. Pino admitted that he was aware of this prohibition.

At Money Concepts, Pino's communications with the customer were more frequent. The customer testified that Pino and he talked once every week or two during the first six months of 2009, after Pino moved to Money Concepts. After that point, they spoke as often as two or three times a week, although the customer did not know why Pino suddenly started to call more frequently.

The customer testified that he may have discussed the purchase of specific securities with Pino once his account was at Money Concepts, but that they never discussed any of the subsequent sales of those same securities. None of the sales transactions occurred on the same business day as the initial purchase of that security. And, while some of Pino's sales of securities at Money Concepts occurred the day after his initial purchase of that security, over half of the

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9 While Pino was at Centennial, the customer's account lost approximately half of its value in two years. The record does not include evidence regarding the cause of this loss.

transactions at Money Concepts spanned periods longer than one week between purchase and sale (although the overwhelming majority were completed in less than two months). For example, Pino purchased 333 shares of Skyworks Solutions, Inc. on January 20, 2010 (the day the company announced its first quarter fiscal year 2010 earnings), at a price of $30.00 per share. He did not sell those shares until February 2, 2010, thirteen days after the initial purchase, at the same $30.00 price.

D. Procedural history

On May 16, 2012, FINRA's Department of Enforcement issued a one-cause complaint against Pino, charging that he violated NASD Rules 2510(b) and 2110 and FINRA Rule 2010 when he "improperly exercised his discretion to effect approximately 95 trades." The Complaint noted that "Pino did not call [the customer] regarding the sale transactions" and "on occasion, waited several days [after the initial purchase] before selling the stock to increase profitability." In calculating the number of violative transactions, the Complaint referred specifically to the fifty-six sales transactions at Centennial and the thirty-nine sales transactions at Money Concepts.

After a one-day hearing, a FINRA Hearing Panel issued a decision finding that, as charged, "Pino exercised discretion in [the customer's] account when he sold stock without first speaking to [the customer]." In reaching its finding, the Hearing Panel stated that the customer's "testimony and statements, which were corroborated in large measure by Pino's testimony, supported [the customer's] credibility." Based on the finding of violations, the Hearing Panel suspended Pino in all capacities for thirty business days, fined him $5,000, and ordered him to pay costs. In its sanctions determination, the Hearing Panel found it to be aggravating that Pino "made approximately 95 discretionary transactions in [the customer's] accounts."

Pino appealed the Hearing Panel's decision to FINRA's National Adjudicatory Council. The NAC affirmed the Hearing Panel's decision and the sanctions it imposed, stating that it would not disturb the Hearing Panel's findings. Pino subsequently filed this timely appeal.

II. Analysis

Section 19(e) of the Securities Exchange Act of 1934 provides that, in reviewing a disciplinary proceeding by a self-regulatory organization, we shall determine whether the associated person engaged in the conduct found by the SRO, whether the conduct violated the SRO rules at issue, and whether those rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[10] In conducting our *de novo* review, we apply a preponderance of the evidence standard to determine whether the record supports FINRA's findings that Pino violated its rules.[11] Based on our independent review of the record, we find that a preponderance of the evidence supports FINRA's findings of violations with respect to ninety-three of the ninety-five sales transactions in the customer's Centennial and Money Concepts accounts.

A. Pino violated NASD and FINRA rules when he engaged in discretionary trading without written authorization from the customer or approval by the member firm.

We sustain FINRA's finding that Pino engaged in discretionary trading without written authorization in violation of NASD Rules 2510(b) and 2110 and FINRA Rule 2010. Rule 2510(b) states that registered representatives shall not "exercise any discretionary power in a customer's account unless such customer has given prior written authorization to a stated individual or individuals and the account has been accepted by the member, as evidenced in writing . . . . " The Rule is significant because "[d]iscretionary trading in a customer's account is a practice that is inherently susceptible to abuse."[12]

It is undisputed that the customer did not give Pino written authorization for any discretionary trading in his accounts at either Centennial or Money Concepts. Likewise, neither account was accepted (as evidenced in writing) for discretionary trading by Centennial or Money Concepts, both of which prohibited such trading in accounts like the customer's. Thus, Pino lacked the required written authorization from the customer as well as the required acceptance by Centennial or Money Concepts under Rule 2510(b).

It is also undisputed that Pino executed sales transactions pursuant to his self-described earnings strategy in the customer's accounts without discussing those transactions with the customer, much less obtaining written authorization as required under Rule 2510. The customer

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10 15 U.S.C. § 78s(e); *see, e.g.*, *Joseph Abbondante*, Exchange Act Release No. 53066, 2006 WL 42393, at *6 (Jan. 6, 2006), *petition denied*, 209 F. App'x 6 (2d Cir. 2006). Pino does not argue, and the record does not support a finding, that NASD Rules 2510(b) and 2110, and FINRA Rule 2010 are, or FINRA's application of them were, inconsistent with the Exchange Act.

11 *See, e.g.*, *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *9 (May 27, 2011), *aff'd*, 693 F.3d 251 (1st Cir. 2012).

12 *William M. Murphy*, Exchange Act Release No. 41804, 1999 WL 668560, at *3 (Aug. 27, 1999).

testified that, with two possible exceptions,[13] Pino had not discussed any of the sales transactions in the customer's accounts before executing them, and Pino himself admitted that he did not discuss the sales transactions under the earnings strategy on the day he executed them, claiming that he received oral approval from the customer for the sales transaction during an initial telephone call to discuss the purchase transaction.

Finally, it is undisputed that the customer did not authorize any sales transactions that were executed pursuant to a "buy and hold" strategy, except for the two trades discussed above. Unlike sales executed as part of the earnings strategy, Pino did not claim to have received authorization for the "buy and hold" sales during the initial discussion regarding the purchase. Pino testified regarding his belief that the customer granted discretion for the sale during the initial discussion of the purchase applied "only for [the] earnings strategy . . . not across the board."[14] Furthermore, the customer testified that, except for the two transactions discussed above, Pino never discussed any sales transactions (regardless of the strategy being employed). The customer's testimony was consistent with his earlier on-the-record testimony, which "supported [the customer's] credibility." Both the Hearing Panel and the NAC found the customer's hearing testimony credible. We agree with this finding.

We find that the record evidence Pino cites does not support his contention that the customer provided oral authorization for Pino to execute the transactions at issue. Pino argues that the customer's testimony was inconsistent and alleges that the customer "perjured himself when stating [Pino] rarely phoned him and did not authorize trades." In support of this claim, Pino relies on some notes taken by the FINRA examiner who conducted an initial, on-the-record telephone interview of the customer during the early stages of FINRA's investigation. Although the examiner who drafted the notes left FINRA before the hearing, the examiner's successor testified and Pino asked the successor to read aloud this sentence from the notes: "At Money Concepts Pino would call before placing trades."

But the examiner's successor was not present during the telephone interview and did not know what the customer had told the first examiner or the context for the statement in the notes. Therefore, we do not credit the notes and find that they do not call into question the customer's other testimony. Even if we determined to credit the notes, the sentence in question referred only to Money Concepts and not to Pino's activities at Centennial, which encompassed fifty-six of the

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13 *See supra* note 8. The customer testified that Pino may have discussed the sales of Jet Blue and Noah Education stocks in his accounts. But it is undisputed that, even if Pino orally mentioned those sales transactions to the customer before executing them, the customer provided no written authorization for Pino to exercise discretion with respect to those, or any other, trades.

14 Pino did not specifically testify regarding his discussions with the customer about "buy and hold" strategy sales transactions. We note that the overwhelming majority of the sales transactions took place less than two months after the securities were purchased, which is more consistent with the earnings strategy than a "buy and hold" strategy.

ninety-five sales transactions at issue. Thus, the sentence does not support Pino's contentions that the customer "admitted that Pino called before every transaction." Nor is there support for Pino's contention that the sentence is "entirely opposite" the customer's testimony. As discussed above, the customer acknowledged that Pino spoke to him much more frequently at Money Concepts than he had at Centennial, and that they may have discussed specific securities before the purchase transactions at Money Concepts.

Pino claims that the customer provided oral authorization, at least for the earnings strategy transactions. Pino testified during the proceeding below that there was no difference between his communications with the customer when Pino was at Centennial and those he had with the customer when Pino was at Money Concepts. Pino stated, contrary to the customer's testimony, that they had discussed each individual stock purchase at Centennial. Pino also testified that, when the customer authorized the purchase of securities pursuant to the earnings strategy, the customer also authorized Pino's later sales of those securities, regardless of when the sales transaction occurred. Pino stated that they discussed "target prices" for the earnings strategy securities, which he interpreted as granting him time and price discretion. But even if Pino had received oral authorization for the sales transactions at issue, oral permission is insufficient (with certain exceptions discussed below) to exercise discretionary power in a customer's account under Rule 2510.[15] Despite lacking written approval from his customer and written acceptance by Centennial or Money Concepts, Pino exercised discretionary power by selling securities in the customer's accounts on ninety-three occasions over a three-and-a-half year period (the ninety-five total sales transactions charged in the complaint minus the two transactions that Pino may have discussed with the customer before executing). The record thus amply supports, and we sustain, FINRA's finding that Pino engaged in discretionary trading without written authorization with respect to ninety-three sales transactions in the customer's Centennial and Money Concepts accounts.[16]

B. The "time and price discretion" exception to Rule 2510 does not apply here.

Pino argued in the proceeding below that the customer had granted "time and price discretion" over the earnings strategy sales transactions when the customer agreed to the initial

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15 *William J. Murphy*, Exchange Act Release No. 69923, 2013 WL 3327752, at *8 (July 2. 2013).

16 FINRA's decision did not specify the number of violative transactions it found, referring instead to Pino's general violation of its rules by exercising discretion in the customer's accounts. Based on FINRA's finding that the customer did not grant Pino any discretionary authority over his accounts at Centennial or Money Concepts, which we have determined to sustain, FINRA's decision necessarily included findings of violations as to the ninety-five sales transactions charged in the complaint. Because of the ambiguity of the evidence regarding the Jet Blue and Noah Education Holdings sales transactions, however, we have not included those two transactions in our findings of violative conduct. *See supra* note 8.

purchases of securities.[17] But a customer's approval of a general strategy does not meet the requirements of the "time and price discretion" exception to Rule 2510.[18] NASD Rule 2510 does not apply to a registered representative exercising "discretion as to the price at which or the time when an order given by a customer for the purchase or sale of a definite amount of a specified security shall be executed."[19] Further, "time and price discretion will be considered to be in effect only until the end of the business day on which the customer granted such discretion, absent a specific, written contrary indication signed and dated by the customer."[20]

We find that the time and price discretion exception does not apply to the ninety-three violative sales transactions in the customer's accounts. Pino did not meet the exception's requirements because he was not granted discretion by the customer as to the sale of definite amounts of specified securities in the customer's accounts, and Pino was not granted such discretion on the same business day that he executed the sales transactions. First, Pino could not have had discretion as to the sale of definite amounts of specified securities because he did not speak with the customer before executing these sales transactions with the possible exception of the Jet Blue and Noah Education trades.[21] The customer's testimony, which the Hearing Panel

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17 In fact, during the hearing, Pino characterized his earnings strategy trading as not being an exercise of discretion, stating that he simply tried "to sell something based on a strategy that's been well in place, that to me is not discretion."

18 *See Murphy*, 2013 WL 3327752, at *8 (stating that approval of a covered call strategy did not mean that trading would come within the time and price discretion exception); *Raghavan Sathianathan*, Exchange Act Release No. 54722, 2006 WL 3228694, at *12 (Nov. 8, 2006) (rejecting applicant's claim that the time and price discretion exception applied where a representative and customer had "discussed a general strategy" to buy and sell a specific security, but did not discuss the amounts of the security to be purchased and sold).

19 NASD Rule 2510(d)(1).

20 See NASD Notice to Members 04-71 (Oct. 2004); see also NASD Rule 2510(d)(1).

21 *See Sathianathan*, 2006 WL 3228694, at *12 (holding that Rule 2510(d) exception does not apply where customer and broker have not agreed as to the specific amounts of the transaction and where purchases are made pursuant to a "general strategy").

credited,[22] was that Pino did not discuss any of the sales transactions, regardless of the strategy employed, with the exception of the Jet Blue and Noah Education sales.[23] And Pino testified that he usually did not talk to the customer before selling securities pursuant to the earnings strategy, stating that it was difficult to reach the customer, who often slept late after watching sporting events on television. Because there was no discussion before the sales transactions, even under Pino's description of the purported grant of discretion, the customer could not have granted any authority with respect to the definite amount of the specified securities that Pino could sell.

Second, none of the sales in the customer's accounts occurred on the same business day as the purchases.[24] Although there is some evidence that Pino may have spoken with the customer on the same business day as some of the purchase transactions, Pino repeatedly admitted that he did not speak with the customer on the same day as the sales transactions.[25] And when a NAC panelist mentioned the requirement that time and price discretion must be exercised on the same business day that it is granted, Pino said, "then I'm guilty of the charge . . . [and] there's no need going further with this." Thus, based on Pino's own admissions, any discretion with respect to earnings strategy-related sales transactions that the customer could have granted Pino on the day of the purchase transactions did not satisfy the requirement that it

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22 In assessing the credibility of the customer's testimony, the Hearing Panel found that he testified "candidly" and "confidently" about the discussions he had with Pino. Such determinations, based on hearing the witness's testimony and observing demeanor, are entitled to considerable deference. *See Wanda P. Sears*, Exchange Act Release No. 58075, 2008 WL 2597567, at *2 (July 1, 2008) (quoting *Jon R. Butzen*, Exchange Act Release No. 36512, 52 SEC 512, 1995 WL 699189, at *2 & n.7 (Nov. 27, 1995) ("[T]he credibility determination of the initial decision maker [in a FINRA disciplinary proceeding] is entitled to considerable weight and deference, since it is based on hearing the witnesses' testimony and observing their demeanor.")). The Hearing Panel additionally found that the consistency of the customer's hearing testimony with his earlier on-the-record testimony supported his credibility. *Cf. Robert E. Gibbs*, Exchange Act Release No. 32401, 51 SEC 482, 1993 WL 190913, at *2 (June 2, 1993) (sustaining NASD credibility determination regarding customer's testimony by phone because testimony was comprehensive, not discredited or called into question during cross-examination, and "was consistent on the relevant facts with an affidavit that [customer] and his wife had previously submitted to the NASD").

23 *See supra* note 8.

24 Pino acknowledged in his hearing testimony that he frequently held the securities he purchased pursuant to the earnings strategy for more than one day because "sometimes with a blue chip you want to give it a little more time" and, at other times, "we waited until [the stock] came back up" if it had not performed as expected.

25 At Money Concepts, the record indicates that Pino and the customer may have discussed specific securities before the initial purchase pursuant to the earnings strategy. But even under Pino's description of the purported grant of discretion, there was no discussion before he sold the securities.

be exercised on the same business day it was granted. And, with respect to the few sale transactions that may have been pursuant to the "buy and hold" strategy, we sustain FINRA's determination that the customer credibly testified that he gave no authorization to exercise such discretion.[26]

C. Pino's other arguments are without merit.

Pino raises a number of other arguments regarding the origins of the customer's complaint, the fairness of the proceeding against him, and the accuracy of certain FINRA factual findings. We find that all of these contentions lack merit.

Pino argues that the customer's complaint was prompted by the broker who took over the customer's account at a new firm after he left Pino. Pino contends that the customer's new broker "encourage[d] [the customer] to complain simply to get the securities firm to make whole his original investment" and asserts, without support, that the new broker "physically authored and faxed complaint demanding [the customer's] account to be made whole." Although the customer acknowledged in his testimony that he received advice from his new broker about how to file a complaint against Pino, the origins of a customer's complaint are irrelevant in determining a violation of FINRA rules. It is well established that FINRA maintains the authority to enforce its Rules regardless of whether customers themselves have complained.[27]

Pino also argues that the customer's testimony was "coached" and that he "submitted written and oral communications that were not authored by himself." Pino cites no evidence to support this allegation, and we have found no such evidence in our *de novo* review of the record. Pino describes as "highly irregular" FINRA staff trips to the customer's residence before the hearing. While FINRA acknowledges that its staff prepared the customer before his hearing testimony, we agree that its "preparation of its customer witness is a necessary, appropriate, and common component of trial preparation." The Hearing Panel found that the customer's hearing testimony was consistent with his earlier on-the-record interview (about which Pino makes no "coaching" claims) and that this "supported [his] credibility." Further, FINRA provided Pino

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26 As discussed above, the customer testified that Pino may have discussed the Jet Blue and Noah Education sales transactions, and we have not included those two transactions in our findings of violations. *See supra* note 16.

27 *See Maximo Justo Guevara*, Exchange Act Release No. 42793, 54 SEC 655, 2000 WL 679607, at *6 (May 18, 2000) (finding that "NASD's power to enforce its rules is independent of a customer's decision not to complain"); *Bernard D. Gorniak*, Exchange Act Release No. 35996, 52 SEC 371, 1995 WL 442063, at *2 n.5 (July 20, 1995) (same and noting that customer decisions about whether to complain "may be influenced by many factors"); *Raymond M. Ramos*, Exchange Act Release No. 26007, 49 SEC 868, 1988 WL 902244, at *4 (Aug. 18, 1988) (finding violations of NASD Rules against misappropriating customer funds despite the fact that affected customer had written to NASD requesting leniency for applicant).

with ample opportunity to cross-examine the customer during the hearing. We have held that claims of witness coaching are undermined when the applicant had a full opportunity to cross-examine the witness.[28] We find that Pino's claims that the customer's testimony was "coached" by FINRA staff are unsubstantiated, and that FINRA afforded Pino a full opportunity to address any alleged false testimony through cross-examination during the hearing.

Pino indicates that his self-representation during the FINRA proceeding rendered the proceeding unfair. He claims, without reference to any specific testimony, that his self-representation led him to testify in a way that was "construed to make it appear as activity violating Rule 2510(b)." The exact import of this argument is unclear. But FINRA did not prohibit Pino from seeking the advice of counsel, and "[a]lthough FINRA's rules permit the participation of counsel, it is well established that 'there is no right to counsel in [its] disciplinary proceedings.'"[29]

Pino alleges that FINRA engaged in unspecified "bullying tactics to settle." But the parties ultimately did not settle the proceeding, so it is unclear how any alleged "bullying tactics" could have harmed Pino. Further, FINRA followed all of its procedural rules. It provided Pino with notice and an opportunity to be heard as required under Exchange Act Section 15A(b)(8). Its Complaint clearly set forth the charges against Pino, and Pino had an opportunity to testify on his own behalf, to call witnesses, and to cross-examine FINRA's witnesses. There is no evidence to suggest that FINRA denied Pino a fair proceeding.[30]

Pino "objects to . . . assertions that" the customer "was inexperienced, unsophisticated, risk adverse [sic], and an investor of conservative objectives." He does not explain the relevance of this objection to our consideration of the violations at issue, nor does he cite any evidence to support his objection. Even if the customer had been sophisticated, this would not have permitted Pino to exercise discretionary authority in the customer's accounts without the required authorizations under Rule 2510. And, in any event, we find that the record amply supports FINRA's characterization of the customer's inexperience. The customer had little prior investment experience (and no experience working with a broker) when he opened his account with Pino. The customer testified consistently throughout the investigation and proceeding

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28 *See Dan Adlai Druz*, Exchange Act Release No. 36306, 52 SEC 416, 1995 WL 579536, at *8 & n.37 (Sept. 29, 1995) (noting lack of evidence that witness was coached and pointing out that witness was subject to examination and cross-examination), *aff'd* 103 F.3d 112 (3d Cir. 1996) (Table).

29 *See Robert D. Tucker*, Exchange Act Release No. 68210, 2012 WL 5462896, at *12 (Nov. 9, 2012) (quoting *Jason A. Craig*, Exchange Act Release No. 59137, 2008 WL 5328784, at *6 (Dec. 22, 2008).

30 *See Craig*, 2008 WL 5328784, at *6 (finding that respondent had been provided with a fair proceeding where he "had the opportunity to present evidence and arguments in his favor, to testify, and to cross-examine witnesses").

below that he did not believe he was able to do anything about Pino's unauthorized trading in his accounts.

Further, Pino contends that Centennial "compliance representatives" had "refut[ed] any violation of [Centennial's] and FINRA's rules, regulations, and conduct." Pino bases this claim on a statement in Centennial's response to a FINRA Rule 8210 request, in which a Centennial compliance officer stated that "[c]ertainly Mr. Pino was not authorized to exercise discretion in [the customer's] account, and from my talks with Mr. Pino I do not think that he did." But the Centennial Rule 8210 response merely reflects the compliance officer's own views after hearing Pino's explanation of the trading, and it confirms that Centennial had not authorized Pino to exercise discretionary authority. As discussed herein, we find that the evidence supports FINRA's finding that Pino exercised discretion in the account without authorization from the customer or acceptance by Centennial.

Finally, Pino objects to what he describes as FINRA's "admission of evidence and assertions" that Pino was "immoral to promise client he would try harder to recoup monies lost due to the devastating market decline of 2008-2010." Pino also claims repeatedly that FINRA sought to taint his reputation and describe him as "an anti-Wall Street rogue trader." Although the record includes a January 2009 letter Pino sent the customer, in which Pino "pledge[d] to restore and grow [the customer's] IRA," FINRA made no findings with respect to this letter, and made no findings about Pino's morality. Nor did it refer to him as a "rogue trader."

For all of these reasons, we sustain FINRA's findings that Pino violated NASD Rules 2510(b) and 2110, and FINRA Rule 2010, with respect to the ninety-three sales transactions in the customer's Centennial and Money Concepts accounts.[31]

III. Sanctions

Section 19(e)(2) of the Exchange Act directs us to sustain FINRA's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[32] Although the Commission is not bound by FINRA's Sanction Guidelines, we use them as a benchmark in conducting our review under Section 19(e)(2).[33] For exercising discretion without written authorization, the Sanction Guidelines recommend a fine between $2,500 and $10,000 and, in egregious cases, a suspension of between ten and thirty business days.[34] Finding that

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31 A violation of any other NASD Rule also constitutes a violation of NASD Rule 2110 and FINRA Rule 2010. *See supra* note 1.

32 15 U.S.C. § 78s(e)(2).

33 *See, e.g., John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *11 (June 14, 2013).

34 See FINRA Sanction Guidelines, at 85.

Pino's violations were egregious, FINRA fined Pino $5,000 and suspended him in all capacities for thirty business days.

For violations of Rule 2510, the Sanction Guidelines recommend that adjudicators consider: (1) whether the customer's grant of discretion was express or implied; and (2) whether the member firm's policies or procedures prohibited discretionary trading and whether the firm prohibited the respondent from exercising discretion in customer accounts.[35] Accordingly, FINRA found it aggravating that, as we find above, Pino did not have express authority from the customer to make discretionary trades in his accounts. FINRA also found it aggravating that, to the extent the customer orally granted any time and price discretion under the earnings strategy, Pino exceeded such authority by exercising it, on every occasion, beyond the day on which any such grant may have occurred. FINRA further found it aggravating that Pino exercised discretion in the customer's accounts even though both Centennial and Money Concepts prohibited such trading in accounts like the customer's. As a result, as FINRA stated, "Pino's firms were not supervising the account as a discretionary account and [the customer] did not have the benefit of this added supervision." Finally, FINRA found it aggravating that Pino's misconduct was intentional and lasted for several years.[36] The record fully supports FINRA's findings of these aggravating factors, and we sustain them.[37]

FINRA found no mitigating factors. Specifically, FINRA found that it was not mitigating that Pino incorrectly believed that the customer had granted him time and price discretion to trade under the earnings strategy because that authority would have extended only to sales executed on the same day as the corresponding purchases. Pino exceeded any such purported authority because the purchase and sales transactions did not occur on the same day. As we have held, an applicant's belief that a customer had granted oral permission to trade is not mitigating where the applicant exceeded such purported authority or where the customer testified credibly that no such authority had been granted.[38]

On appeal, Pino raises two arguments that speak to mitigation of the sanctions imposed against him, and we find that those arguments lack merit. Pino claims that it is not true that he

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[35] *Id.*

[36] *Id.* at 6-7 (Principal Considerations in Determining Sanctions, Nos. 8 and 13). Although FINRA's sanctions analysis states that Pino's conduct lasted for two years, this appears to be a typographical error because FINRA clearly finds elsewhere (and the record supports the finding) that Pino's conduct spanned the full three-and-a-half years that the customer had accounts at Centennial and Money Concepts.

[37] The number of violative transactions was potentially an aggravating factor. *See id.* (Principal Considerations in Determining Sanctions, No. 8). But the NAC "decline[d] to consider the number of transactions related to [Pino's] misconduct to be an aggravating factor." In our review, we also have not considered the number of violations as an aggravating factor.

[38] *Murphy*, 2013 WL 3327752, at *24 & n.138.

"lost client money through trading." According to Pino, the customer lost money due to general market conditions and "illegal mortgage activities that occurred without regulatory oversight resulting in large temporary declines of stock and bond market prices." But FINRA expressly stated that, when it assessed sanctions, it did not consider any losses the customer suffered. And even assuming Pino is correct in arguing that he did not harm the customer financially by discretionary trading, such a finding would not be mitigating.[39] Pino also states that his disciplinary record throughout his career is "exemplary." But we consistently have held that the lack of disciplinary history is not mitigating for sanctions purposes in our review of FINRA disciplinary proceedings.[40] We therefore find that the record supports FINRA's finding that there were no mitigating factors, and we reject Pino's additional mitigation arguments raised on appeal.

In light of the numerous aggravating factors and the absence of any mitigating factors, we agree with FINRA's characterization of Pino's violations as egregious and, based on our assessment of all factors bearing on the remedial nature of the sanctions FINRA imposed, we find them to be neither excessive nor oppressive. The suspension and fine imposed on Pino are remedial because they will encourage Pino to obtain the proper authorizations required under

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39 *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 WL 6044123, at *18 & n.137 (Nov. 15, 2013) ("[T]he absence of . . . customer harm is not mitigating, as our public analysis focus[es] . . . on the welfare of investors generally.") (citing *Howard Braff*, Exchange Act Release No. 66467, 2012 WL 601003, at *7 & n.25 (Feb. 24, 2012) (internal quotations omitted); *PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 WL 1697153, at *5 (Apr. 11, 2008) (holding that applicants' failure to comply with NASD rule "are not mitigated because those failures did not, in themselves, produce a monetary benefit to Applicants or result in injury to the investing public"), *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009); *Coastline Fin., Inc.*, Exchange Act Release No. 41989, 54 SEC 388, 1999 WL 798874, at *5 (Oct. 7, 1999) (rejecting absence of customer harm as a mitigating factor for sanctions)).

40 *John B. Busacca III*, Exchange Act Release No. 63312, 2010 WL 5092726, at *16 & n.77 (Nov. 12, 2010) (citing *Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006); *Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 WL 3313843, at *6 (Nov. 8, 2006) (stating that a "[l]ack of disciplinary history is not mitigating for purposes of sanctions because an associated person should not be rewarded for acting in accordance with his duties as a securities professional")).

Rule 2510 from his customers before executing securities transactions in customer accounts. We further find that the sanctions will "have the salutary effect of deterring others from engaging in the same serious misconduct."[41]

An appropriate order will issue.[42]

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, STEIN AND PIWOWAR).

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

41 *See PAZ Sec., Inc.*, 494 F.3d 1059, 1066 (D.C. Cir. 2007) ("[W]e are mindful that although 'general deterrence is not, by itself, sufficient justification for expulsion or suspension . . . it may be considered as part of the overall remedial inquiry.'").

42 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 74903 / May 7, 2015

Admin. Proc. File No. 3-15935

In the Matter of the Application of

MICHAEL PINO

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING DISCIPLINARY ACTION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by FINRA against Michael Pino is hereby sustained.

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. 74905 / May 7, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-11676

In the Matter of **JOHN W. ADAMS and AIP, LLC,** **Respondents.**	**ORDER MODIFYING THE MODIFIED DISTRIBUTION PLAN AND DIRECTING DISBURSEMENT OF DISGORGEMENT FUND**

On February 23, 2009, the Commission issued a Notice of Proposed Plan of Disgorgement Distribution and Opportunity for Comment ("Notice") in connection with this proceeding pursuant to Rule 1103 of the Commission's Rules on Fair Fund and Disgorgement Plans ("Rules"), 17 C.F.R. §201.1103 (Exchange Act Rel. No. 59433). The Notice advised parties they could obtain a copy of the Proposed Plan of Distribution ("Distribution Plan") at www.sec.gov. The Notice also advised that all parties desiring to comment on the Distribution Plan could submit their comments, in writing, no later than March 25, 2009. No comments were received by the Commission in response to the Notice. On May 6, 2009, the Commission issued an Order Approving Distribution Plan of a Disgorgement Fund (Exchange Act Rel. No. 59870). Subsequently, a non-material modification was made to the Distribution Plan ("Modified Distribution Plan") and on January 25, 2013, the Commission issued an Order Modifying Distribution Plan and Directing Disbursement of Disgorgement Fund ("Order") (Exchange Act Rel. No. 68736).

The Modified Distribution Plan provides that the Disgorgement Fund[1] consisting of approximately $2.47 million paid by John W. Adams and AIP, LLC, plus any interest and less any taxes, fees, or expenses for any reserves and the administration of the plan, be transferred to Huntington National Bank to be distributed by the Fund Administrator to Eligible Recipients according to the methodology set forth in the plan. Pursuant to the Modified Distribution Plan, and following the issuance of the Order, the Fund Administrator distributed $2,628,775.28 to investors. There is approximately $61,455 left in the Disgorgement Fund, which is considered the residual pursuant to the Modified Distribution Plan. Paragraph 25 of the Modified Distribution Plan

[1] Capitalized terms used but not defined herein shall have the meanings ascribed to them in the Modified Plan of Distribution approved by the Commission.

provides that money that remains in the Disgorgement Fund one year after all approved Eligible Recipients who filed a claim before the Claim Deadline are paid shall be distributed to otherwise Eligible Recipients who file claims after the Claim Deadline. Any such distribution is to be paid at the same *pro rata* distribution factor of the recognized loss that was used in the initial distribution and with the same $10.00 minimum payout requirement. This paragraph further states that any remaining funds shall be paid to the Commission for transfer to the United States Treasury after the final accounting is approved by the Commission.

A late claim was filed with the Fund Administrator. The Fund Administrator has determined that the claim is valid and recommends $413.95 be disbursed to the late claimant.

The Fund Administrator has also determined that a residual distribution is feasible and recommends a residual distribution to Eligible Recipients who negotiated their initial distribution and whose *pro rata* residual distribution will be for at least the minimum amount of $10.00. To effectuate a residual distribution, Commission staff requests that the Commission approve a modification to Paragraph 25 so that it reads as follows:

> 25. A residual within the Disgorgement Fund is established for any amounts remaining after all assets have been disbursed. The residual may include funds reserved for future taxes and related expenses, distributions from checks that have not been cashed, distributions from checks that were not delivered or accepted upon delivery, and tax refunds. In consultation with Commission staff, money that remains in the Disgorgement Fund one year after all approved Eligible Recipients who filed claims before the Claim Deadline are paid shall be distributed:
>
> A. First, to otherwise Eligible Recipients who filed claims after the Claim Deadline. Any such distribution shall be paid at the same *pro rata* distribution factor of the recognized loss that was used in the original distribution with the same $10.00 minimum payout requirement. Such claims shall be paid on a first filed, first distributed basis; and
>
> B. Second, if any funds remain, to Eligible Recipients who negotiated their initial distribution and whose *pro rata* residual distribution will be for at least the minimum amount of $10.00.
>
> Any remaining funds shall be paid to the Commission for transfer to the United States Treasury after the final accounting is approved by the Commission.

The Modified Distribution Plan also provides that in order to distribute the funds, the Fund Administrator will submit a Payment List to the assigned Commission staff, who will obtain authorization from the Commission to disburse pursuant to Rule 1101(b)(6). The Payment List for the late claim in the amount of $413.95, and the residual distribution in the amount of $47,106.31 has been received by Commission staff and the staff requests that the Commission authorize disbursement of the funds.

Accordingly, it is ORDERED that:

1) The Fund Administrator shall distribute $413.95 from the funds held at Huntington National Bank to the late claimant;

2) Pursuant to Rule 1104, Paragraph 25 of the Modified Distribution Plan is hereby modified and now reads as provided above; and

3) The Fund Administrator shall distribute $47,106.31 as a residual distribution from the funds held at Huntington National Bank as provided in Paragraph 25 of the Modified Distribution Plan as hereby modified.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74912 / May 8, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16528

In the Matter of **Express Commercial Capital LLC and Sidney Banner,** **Respondents.**	**ORDER INSTITUTING PUBLIC 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 Express Commercial Capital LLC ("Express Commercial") and Sidney Banner ("Banner") (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents 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 and the findings contained in Section III.3 below, which are admitted, Respondents consent to the entry of this Order Instituting Public 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 Respondents' Offer, the Commission finds that:

1. Banner, age 87, resides in Delray Beach, Florida. From at least January 2013 through August 2013, Banner engaged in the business of inducing or attempting to induce the

purchase or sale of a security in the form of an investment contract in a trading program offered by Worldwide Funding Limited III LLC ("Worldwide Funding"), a Florida limited liability company. Banner was never registered with the Commission as a broker or dealer, or associated with a broker or dealer registered with the Commission. Banner was the sole managing member of Express Commercial, a financial consulting company.

2. Express Commercial was a Florida limited liability company operated by Banner from his home in Delray Beach, Florida. From at least January through August 2013, Express Commercial engaged in the business of inducing or attempting to induce the purchase or sale of a security in the form of an investment contract in a trading program offered by Worldwide Funding through emails sent to prospective investors by Banner as the manager of Express Commercial and postings on its Internet website at http://expcomcap.com.

3. On April 2, 2015, a judgment was entered by consent against Banner and Express Commercial permanently enjoining them from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 promulgated thereunder, in the civil action entitled Securities and Exchange Commission v. Bernard H. Butts Jr., et al., Civil Action Number 1:13-CV-23115, in the United States District Court for the Southern District of Florida.

4. The Commission's complaint alleged that Banner and Express Commercial acted as sales agents that offered and sold securities in a fictitious prime bank instrument trading program offered by Worldwide Funding. Banner and Express Commercial lured investors into the scheme with promises of extraordinary profits. As part of the scheme they told investors that an investment of between USD $60,000 and $90,000 would generate profits of at least €6,660,000 (Euros) within 15 to 45 days and continue to earn profits of approximately 14% per week for 40 to 42 weeks. The complaint alleged that defendants falsely promised that when an investor's funds were deposited into an attorney's trust account, the attorney would not release the funds until he received proof from the receiving bank that a €10,000,000 Standby Letter of Credit ("SBLC") had been deposited into a securities trading program that was to generate the profits for investors. The complaint alleges that Banner, Express Commercial and others did not disclose that instead of using the investors' funds to obtain SBLCs they misappropriated investors' funds and paid the sales agents approximately 10% of the investor's funds. Contrary to the representations, the acquisition of the SBLCs never occurred, no loans were obtained, and no promised returns were earned in a trading program or paid to investors. Over more than a year, Banner, Express Commercial and others obtained at least $3.5 million from approximately forty-five investors nationwide and in foreign countries by making false and misleading statements or omitting material facts in the offer and sale of securities, which were not registered with the Commission at the time they were sold. In addition, the complaint alleged that Banner and Express Commercial were not registered as brokers or dealers when they offered the securities of Worldwide Funding.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondents Banner and Express Commercial be, and hereby are 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 that Respondents Banner and Express Commercial be, and hereby are 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 Respondents 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

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 74913 / May 8, 2015

Admin. Proc. File No. 3-15990

In the Matter of the Application of

NORTH WOODWARD FINANCIAL CORPORATION
and
DOUGLAS A. TROSZAK

For Review of Disciplinary Action Taken by

FINRA

CORRECTED OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY PROCEEDINGS

Failure to Provide Requested Information

Failure to Timely Amend Form U4

Associated person, officer, and control person of member firm failed to respond fully to FINRA's requests for information made pursuant to FINRA Rule 8210. Associated person also failed to timely amend his Form U4 to disclose a federal tax lien. *Held*, association's findings of violations and sanctions imposed are *sustained.*

APPEARANCES:

Douglas A. Troszak, pro se and for North Woodward Financial Corporation.

Alan Lawhead and *Jennifer C. Brooks*, for FINRA.

Appeal filed: August 28, 2014
Last brief received: December 1, 2014

North Woodward Financial Corporation, a FINRA member firm, and Douglas A. Troszak, North Woodward's president, chief financial officer, chief compliance officer, financial and operations principal ("FINOP"), and sole registered representative (together "Applicants"), appeal from FINRA disciplinary action. FINRA found that Applicants provided only partial responses to FINRA's information requests in violation of FINRA Rules 8210 and 2010. FINRA also found that Applicants did not timely amend Troszak's Uniform Application for Securities Industry Registration ("Form U4") to disclose that he was subject to a federal tax lien and, as a result, violated Article V, Section 2 of FINRA's By-Laws, FINRA Rule 2010, and NASD Rule 2110. FINRA expelled North Woodward from membership and barred Troszak in all capacities for the Rule 8210 violation. FINRA declined to impose any other sanctions. Applicants claim, among other things, that FINRA's requests were beyond the scope of Rule 8210, that the failure to timely amend the Form U4 was justifiable, and that sanctions were unwarranted. Based on our independent review of the record, we sustain FINRA's findings of violations and imposition of sanctions.

I. Background

The relevant facts are largely undisputed. In 2000, Troszak founded North Woodward, a general securities firm. Troszak is a certified public accountant and has owned and operated Troszak CPA, an accounting firm, since the mid-1980s. All of North Woodward's customers are also Troszak CPA's accounting clients.

A. FINRA investigated the circumstances under which Troszak borrowed money from North Woodward's customers to pay off his defaulted mortgage.

In February 2010, FINRA began investigating Applicants after receiving a tip that Troszak borrowed money from North Woodward's customers. On February 12, 2010, FINRA requested information from Applicants pursuant to Rule 8210. On March 10, 2010, Applicants, who were represented by counsel throughout the investigation, provided complete and timely responses.[1] As a result, FINRA learned the following:

In February 2009, Troszak was unable to pay the mortgage on a commercial condominium unit that he owned in Michigan. In November 2009, after the unit went into foreclosure, Troszak sought and acquired a total of $200,000 in loans from ten North Woodward customers to redeem ownership of the property. Troszak issued a promissory note to each of the ten customers that required repayment of the principal plus 10% annual interest over six consecutive quarterly installments. Troszak arranged to make payments to the firm's customers through Troszak Capital Corp., an entity that he created for the purpose of receiving a tax deduction on the interest portion of the payments.[2] On December 8, 2009, Troszak redeemed his ownership in the property using $188,689.52 of the loan proceeds.

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[1] Applicants discharged their counsel on December 7, 2011, the day before FINRA held a hearing in this matter.

[2] Troszak was the president and sole shareholder of Troszak Capital Corp.

B. FINRA made additional requests for information and documents pursuant to Rule 8210, but Applicants did not provide complete responses.

On April 22, 2010, FINRA requested information and documents pursuant to Rule 8210 to learn more about the circumstances surrounding the loans and Troszak's ability to repay North Woodward's customers. FINRA also informed Troszak that he was required to amend his Form U4 to disclose that he was subject to a federal tax lien and requested an explanation as to why he had not yet amended his Form U4.[3]

On May 20, 2010, Applicants sent FINRA a letter that answered only some of FINRA's questions and failed to provide any of the requested documents. Applicants did not provide:

- copies of the firm's customer new account forms, account amendments, and account statements for 2009 and 2010 for each North Woodward customer who loaned Troszak money;
- explanations about whether such customer account statements reflected the promissory notes, including supporting documentation;
- an accounting, with documentation, of the $11,310.48 difference between the amount Troszak borrowed from the customers and the mortgage payoff total;
- a statement showing the February 2010 and May 2010 principal and interest payments that Troszak made to each of the ten North Woodward customers at issue;
- documentation about negotiated debt forgiveness for a credit card Troszak owned;
- copies of bank and brokerage statements for accounts in which Troszak had a beneficial interest for the period January 2009 to April 2010, including the account statements for Troszak Capital Corp.; and
- copies of all correspondence with the IRS in connection with the tax lien.

Applicants variously stated that they could not provide the information and documents listed above because they were "personal and confidential" and "irrelevant" to FINRA's investigation or that they were not within their possession or control. Applicants further contended that Troszak was not required to amend the Form U4 because the tax lien "originated with his CPA practice."

On May 25, 2010, FINRA sent a further Rule 8210 request to Applicants seeking the outstanding information and documents. FINRA's letter also reminded Troszak that he was required to amend his Form U4 to disclose the tax lien. Applicants responded by letter dated June 8, 2010, refusing to provide any of the requested documents. Applicants reiterated their view that the information sought by FINRA was "private and confidential" or was not within their possession or control.

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[3] Question 14M on the Form U4 asked: "Do you have any unsatisfied judgments or liens against you?" The record contains a "Notice of Federal Tax Lien," sent by the Internal Revenue Service ("IRS") to Applicants in October 2008, that identifies "Douglas A. Troszak" as one of the taxpayers subject to the lien in the amount of $19,802.07.

FINRA sent another Rule 8210 request to Applicants on June 10, 2010, attaching the prior requests (including the requirement to amend Troszak's Form U4 to disclose the tax lien) and cautioning Applicants that failure to comply could result in disciplinary action against them. On the same day, FINRA staff spoke by telephone with Applicants' counsel to stress the importance of responding in full to the Rule 8210 requests and to warn counsel that FINRA would pursue formal action against Applicants if the requested documents were not provided. Applicants responded by letter dated June 18, 2010, again refusing to provide any of the requested documents and asserting that the information was "personal and confidential" and "irrelevant" to FINRA's investigation or "not within [their] control."

C. FINRA pursued formal action against Applicants, prompting them to produce some information and update Troszak's Form U4.

On February 15, 2011, FINRA notified Applicants that it intended to recommend formal disciplinary action against them and invited them to make a Wells submission in response. Troszak, by letter dated February 25, 2011, claimed that Applicants already had supplied a large amount of documents and that FINRA was requesting privileged documents. Applicants included no documents with the response.

On May 18, 2011, FINRA filed a complaint against Applicants, alleging that they failed to respond to information requests in violation of FINRA Rules 8210 and 2010, and failed to timely amend Troszak's Form U4 in violation of Article V, Section 2 of FINRA's By-Laws, FINRA Rule 2010, and NASD Rule 2110. Between October 5, 2011 and November 23, 2011, Applicants produced 5,601 documents to FINRA, including correspondence with the IRS; litigation records related to Applicants' taxes and liens; various bank account statements held in Troszak's name or in which he had a beneficial interest; and some of North Woodward's securities account statements for the customers who loaned Troszak the money at issue.[4] But these documents were not entirely responsive to FINRA's earlier Rule 8210 requests because FINRA still had not received:

- an accounting, with documentation, of the $11,310.48 difference between the amount that Troszak borrowed from his customers and the mortgage payoff total;
- a statement showing the February 2010 and May 2010 principal and interest payments that Troszak made to each of the ten customers at issue; and
- copies of bank and brokerage statements for accounts in which Troszak had a beneficial interest for the period January 2009 to April 2010, including the account statements for Troszak Capital Corp.

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4 The description of the documents listed above is based on an index, prepared by FINRA staff, that the parties agreed to admit at the hearing. The documents themselves are not in the record.

D. FINRA held a hearing, and Applicants appealed the FINRA decisions.

During a hearing held on December 8, 2011, the FINRA examiner who sent the Rule 8210 letters testified that she requested the information and documents to determine whether Applicants misused customer funds and whether the promissory notes were suitable investments for the customers. For example, FINRA knew that some of the customers were elderly and withdrew funds from their retirement accounts ("IRAs") to loan Troszak money, but it was unclear whether the customers suffered tax consequences or had any retirement savings left after the withdrawals. FINRA also wanted to determine whether Applicants were financially stable enough to repay the customers in full. The examiner testified that she could not make any of those determinations because Applicants did not provide all of the information and documents requested.

At the hearing, Troszak testified that accounting rules and federal tax laws prevented him from disclosing the customers' information to FINRA without their written consent. But Troszak also testified that he never sought such consent. He admitted that his counsel "tried to educate" him and "explain in great detail" why FINRA was entitled to the information notwithstanding the accounting rules and federal tax laws, and had told him, "You have no choice. You just have to give them everything they ask for." Troszak testified that one of his lawyers "guaranteed[d] that this is all sealed," yet still had to "wrestle him down and make [the information] go towards [FINRA]."

As to the tax lien, Troszak admitted in on-the-record testimony taken in November 2011 that the IRS notified him about the lien in October 2008. At the hearing, Troszak testified that he satisfied the lien on October 13, 2010. But Troszak also testified that he did not update his Form U4 to disclose the details about the tax lien until one year later, after others had convinced him that an update was necessary.

A Hearing Panel found that Applicants committed the violations alleged in the complaint. For the Rule 8210 violation, the Hearing Panel expelled North Woodward and barred Troszak. The Hearing Panel found other sanctions to be appropriate but declined to impose them in light of the bar and expulsion—those sanctions included, for the Rule 8210 violation, a $50,000 fine, to be paid jointly and severally, and, for the violations regarding the Form U4, a $10,000 fine, to be paid jointly and severally, and a thirty-business-day suspension. Applicants appealed the Hearing Panel decision to the National Adjudicatory Council ("NAC"), which affirmed the findings of violations and modified the sanctions. The NAC expelled North Woodward and barred Troszak for the Rule 8210 violation. The NAC declined to impose any other sanctions. It found that, absent a bar and expulsion, it would have been appropriate to impose the fines ordered by the Hearing Panel, but would have suspended Troszak for sixty days for failing to amend his Form U4. This appeal followed.

II. Analysis

A. Standard of review

We base our findings on an independent review of the record and apply the preponderance of the evidence standard for self-regulatory organization disciplinary actions.[5] Pursuant to Exchange Act Section 19(e)(1), in reviewing an SRO disciplinary action, we determine whether the aggrieved person engaged in the conduct found by the SRO, whether such conduct violates the SRO's rules, and whether such SRO rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[6]

B. Applicants violated FINRA Rules 8210 and 2010 by providing only partial responses to FINRA's requests.

Rule 8210(a)(1) requires member firms and their associated persons to provide information to FINRA in the course of an investigation.[7] There is no dispute that Applicants provided complete and timely responses to FINRA's Rule 8210 request made in February 2010. But, from April to June 2010, FINRA sent three Rule 8210 requests to Applicants seeking additional information and documents regarding the loans that Troszak received from the Firm's customers and his ability to repay them, and Applicants did not provide FINRA with any documents responsive to these requests until after FINRA filed a complaint. And that belated response was incomplete: At no point did FINRA receive an accounting, with supporting documentation, of the $11,310.48 difference between the loan amount and the payoff amount; proof that the interest and principal payments that were required by the promissory notes were made to the customers; and the 2009 to 2010 securities account statements for Troszak Capital Corp. We therefore find that the record supports FINRA's finding that Applicants failed to provide information and documents that fully responded to FINRA's requests, and we sustain FINRA's finding that Applicants violated Rules 8210 and 2010.[8]

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[5] *See David M. Levine*, Exchange Act Release No. 48760, 2003 WL 22570694, at *9 n.42 (Nov. 7, 2003).

[6] 15 U.S.C. § 78s(e)(1).

[7] *CMG Inst'l Trading, LLC & Shawn D. Baldwin*, Exchange Act Release No. 59325, 2009 WL 223617, at *5 (Jan. 30, 2009).

[8] *Gregory Evan Goldstein*, Exchange Act Release No. 71970, 2014 WL 1494527, at *2-6 (Apr. 17, 2014) (finding that applicant violated Rule 8210 by providing responses to some, but not all, of FINRA's requests for information). A violation of FINRA rules constitutes conduct inconsistent with just and equitable principles of trade and therefore also establishes a violation of FINRA Rule 2010. *See William J. Murphy*, Exchange Act Release No. 69923, 2013 WL 3327752, at *8 n.29 (July 2, 2013).

C. FINRA sought information that was within the scope of its regulatory authority and Applicants' control, and did not seek customer tax return information.

We reject Applicants' arguments that FINRA exceeded the scope of its regulatory authority by seeking information about loans rather than securities, by seeking documents that were not in Applicants' control, and by seeking information that was provided to Troszak CPA as a tax preparer. As discussed below, FINRA's Rule 8210 requests concerning the loans fell within the scope of its regulatory authority because the requests probed whether Applicants' conduct contravened the high ethical standards to which all members and associated person must adhere. Further, the information FINRA sought was within Applicants' control, and FINRA did not seek information provided to a tax preparer. Rather, FINRA requested information about Troszak's own principal and interest payments to customers.

1. FINRA may request information even if the conduct at issue does not involve a security.

We reject Applicants' argument that Rule 8210 does not apply here because the loans at issue are not securities. FINRA's disciplinary authority is broad enough to encompass business-related conduct that may contravene the high ethical standards to which members and associated persons must adhere, even if that conduct does not involve a security.[9] The fact that Troszak sought and received a substantial amount of money in the form of loans from customers of North Woodward to address his financial difficulties logically raised questions for FINRA about whether his business-related conduct comported with those ethical standards. FINRA has emphasized that "[l]oans between registered persons and their customers are of legitimate interest to [FINRA] and member firms because of the potential for misconduct."[10] Thus, FINRA

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[9] *See Daniel C. Adams*, Exchange Act Release No. 19915, 1983 SEC LEXIS 1367, at *5 (June 27, 1983) (finding that Article III, Section 1 of the NASD's Rules of Fair Practice (now FINRA Rule 2010) required member firms and their associated persons "in the conduct of [their] business . . . [to] observe high standards of commercial honor and just and equitable principles of trade" and that "the NASD's disciplinary authority is broad enough to encompass business-related activity that contravenes those standards even if that activity does not involve a security"); *see also Dante J. DiFrancesco*, Exchange Act Release No. 66113, 2012 WL 32128, at *5 n.18 (Jan. 6, 2012) (finding that FINRA's disciplinary authority under NASD Rule 2110 (now FINRA Rule 2010) was broad enough to encompass business-related conduct that is inconsistent with just and equitable principles of trade, even if that activity does not involve a security) (citing *Vail v. SEC*, 101 F.3d 37, 39 (5th Cir. 1996) (per curiam)).

[10] *See* NASD Notice to Members 03-62, 2003 WL 22324879, at *1 (Oct. 8, 2003) (stating that FINRA "has brought disciplinary action against registered persons who have violated just and equitable principles of trade by taking unfair advantage of their customers by inducing them to lend money in disregard of the customers' best interests, or by borrowing funds from, but not repaying, customers").

was within its authority to investigate the circumstances surrounding the loans regardless of whether they are securities.[11]

2. The record does not support Applicants' contention that certain information and documents did not exist or were not in their possession, custody, or control.

FINRA never received an accounting, with documentation, for the $11,310.48 difference between the loan amount and the mortgage payoff amount or all of the bank and brokerage statements for accounts in which Troszak had a beneficial interest. Applicants argue that they could not respond to FINRA's request because the information and documents did not exist or were not in their possession, custody, or control. We disagree.

At the time of this conduct in 2010, Rule 8210(a)(2) stated in part that FINRA may, for the purpose of an investigation, "inspect and copy the books, records, and accounts of such member or person [associated with a member] with respect to any matter involved in the investigation."[12] The plain text of the rule required that the information requested be "of" the member or associated person. Thus, the information and documents at issue here fall within the scope of Rule 8210(a)(2) because they were "of" Troszak or the firm.

Applicants argue that "Troszak could not possibly complete an accounting on the remaining [$11,310.48] because he does not have all of the necessary information, which is possessed and controlled, not by Troszak or any of his associated entities, but by Bayview Title." Applicants state in their brief on appeal that, "[o]nce Troszak had the [loan] funds, he turned them over to Bayview Title, the title company handling the redemption transaction." Applicants miss the point. The $11,310.48 was the remainder of the money that North Woodward's customers loaned to Troszak, not Bayview. Whether the money was with Bayview Title or in another account held by Troszak or one of his entities, Troszak owned and controlled the money. Therefore, FINRA's request was within the scope of its authority because the records it sought were "of " Troszak under Rule 8210(a)(2).[13]

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11 *See Adams*, 1983 SEC LEXIS 1367, at *5 (finding that, even if the instrument at issue was not a security, "it was entirely proper for the NASD to investigate" the circumstances surrounding applicant's solicitation and sale of that instrument).

12 In December 2012, we approved FINRA's proposed amendments to Rule 8210, which became effective on February 25, 2013 and expressly requires members and associated persons to provide FINRA with information that is in their "possession, custody, or control." *Order Granting Accelerated Approval*, Exchange Act Release No. 68386, 2012 WL 6100226, at *9 (Dec. 7, 2012); *see also* FINRA Regulatory Notice 13-06, 2013 WL 392397, at *1 (Jan. 25, 2013) (providing notice that the Commission approved FINRA's proposed amendments to Rule 8210). We apply the 2010 version of Rule 8210 because that was the version in effect when Applicants were subject to FINRA's Rule 8210 requests.

13 *See Goldstein*, 2014 WL 1494527, at *5 (finding that information and documents were "of" applicant because he had an ownership interest in the entity subject to FINRA's Rule 8210

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Moreover, during on-the-record testimony and in Applicants' brief on appeal, Troszak admitted that he set up the escrow account with Bayview Title, he instructed Bayview Title about what to do with the funds, and he remained in constant contact with Bayview Title to ensure that taxes were being paid from the escrow account. If Troszak did not have the information necessary to complete an accounting, he simply needed to ask Bayview Title for the information.[14]

Applicants also argue that they could not provide the bank or brokerage statements for all of the accounts in which Troszak had a beneficial interest. But the parties agree that the only account statements at issue are those of Troszak Capital Corp., a tax relief vehicle created by Troszak specifically for repaying the loans. Although Applicants claim that Troszak Capital Corp.'s account statements "would have been generated by First Southwest, a company that Troszak has no ownership interest in and no control over," Troszak owns and controls Troszak Capital Corp., including information about its assets and account statements generated by third party providers. Thus, Troszak Capital Corp.'s account statements are "of" Troszak.[15]

According to Applicants, "it is possible that no such account statements exist" because First Southwest "does not generate account statements when there is no activity in such a small account." Yet, Troszak testified at the hearing that Troszak Capital Corp. "has a securities statement, and it's down at First Southwest . . . ." We find that the evidence does not support Applicants' claim that the information was out of their control or was unavailable.

In any event, Applicants have an obligation beyond a mere statement that information is unavailable. "If such a person cannot readily provide the information sought by [FINRA], such a person ha[s] an obligation to explain, as completely as possible, his efforts, and his inability to do so."[16] Applicants offer no evidence that they asked Bayview Title or First Southwest for any information at all in an effort to respond to FINRA's request. The record demonstrates that Applicants neither attempted to obtain the information that FINRA sought nor provided any meaningful explanation to FINRA as to why Applicants could not obtain the information.

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request).

14 *See CMG Inst'l Trading*, 2009 WL 223617, at *7 (rejecting applicant's claim that he fully responded to NASD's Rule 8210 request for his firm's foreign exchange dealer account statements where applicant "merely stated" that he could not access the online account and did not explain his efforts to obtain the requested information or why, as an account holder, he did not possess hard copies of the statements).

15 *Goldstein*, 2014 WL 1494527, at *5.

16 *CMG Inst'l Trading*, 2009 WL 223617, at *7 (citation omitted).

3. FINRA may obtain confidential information.

Applicants never responded to FINRA's request for a statement showing the February 2010 and May 2010 principal and interest payments that Troszak made to each of the ten North Woodward customers. Applicants assert that two federal tax statutes would have subjected Troszak to criminal punishment if he had produced the requested statement.[17] Those statutes generally prohibit preparers of tax returns from disclosing information given to them in connection with the preparation of tax returns. Applicants state that the information regarding the interest payments was included in the North Woodward customers' tax returns, which were prepared by Troszak CPA, and thus was not subject to disclosure.[18] But FINRA did not ask Troszak CPA for any information. Rather, FINRA requested information from Troszak about principal and interest payments *Troszak* made to the customers. This information originated with Troszak even if the customers independently gave the same information to Troszak CPA in connection with the preparation of their tax returns. The fact that the information also appeared in the customers' tax returns does not excuse Troszak's obligation to provide it to FINRA.

Applicants refer to Regulation S-P, which limits disclosure by broker-dealers of a customer's non-public personal information to nonaffiliated third parties.[19] FINRA was correct in finding that Regulation S-P contains exceptions that permit a broker-dealer to disclose customer information to an SRO, such as FINRA, for certain purposes without first giving the customer notice of and an opportunity to opt out of the disclosure.[20] Such an exception is consistent with the fact that "FINRA investigations are non-public and confidential."[21] We find that Regulation S-P did not preclude Applicants from providing FINRA with the information it requested.

Applicants acknowledge that FINRA's "authority to request documents pursuant to Rule 8210 stems from the contractual relationship entered into voluntarily by [FINRA] members and associated persons with [FINRA]."[22] But they assert that a contract is void if it requires illegal

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[17] 26 U.S.C. §§ 6713, 7216.

[18] Applicants argue that, while only the interest portion of the payments falls under these statutes, they could not provide the principal portion of the payments either because "payments of principal were sometimes included in the same check as interest payments." Applicants fail to explain why they could not have prepared a statement for FINRA showing at least the principal portion of the payments.

[19] 17 C.F.R. § 248.10.

[20] *See, e.g.*, 17 C.F.R. § 248.15(a)(4) (excepting certain disclosures to law enforcement and regulatory authorities, including disclosures to an SRO pursuant to SRO rules); 17 C.F.R. § 248.15(a)(7)(i) (excepting disclosures made to comply with laws and other applicable legal requirements, including applicable SRO rules). We find that Regulation S-P did not preclude Applicants from providing FINRA with the information it requested.

[21] FINRA Regulatory Notice 09-17, 2009 WL 741194, at *2 (Mar. 18, 2009).

[22] *Jay Alan Ochanpaugh*, Exchange Act Release No. 54363, 2006 WL 2482466, at *5 (Aug.

(continued...)

conduct. Applicants reason that their contract with FINRA is void because it required them to disclose confidential information in violation of the two federal tax statutes and Regulation S-P. As discussed above, those laws did not prohibit Applicants from responding to FINRA's request.

Applicants urge us to excuse their failure to provide all of the information to FINRA "even if the contractual basis for FINRA's authority to issue 8210 requests to the Applicants is not void." We decline to do so. When Applicants registered with FINRA, they agreed to abide by its rules, which are unequivocal with respect to their obligation to provide information requested by FINRA.[23] We repeatedly have held that members and their associated persons may not "second guess" FINRA's requests for information.[24] "Because much of the information that FINRA needs to conduct its investigations is non-public and confidential, FINRA's ability to police the activities of its members and associated persons would be eviscerated if FINRA could not request such information under Rule 8210."[25] If Applicants had concerns about responding to FINRA's requests, they should have "raised, discussed, and resolved [them] with [FINRA] in the cooperative spirit and prompt manner contemplated by the Rules."[26] Instead, Applicants refused to comply with FINRA's requests in violation of FINRA Rule 8210.

Applicants assert that FINRA did not find that they violated FINRA Rule 3240 by borrowing money from their customers and, therefore, their conduct was "consistent with just and equitable principles of trade." But Rule 3240 is not at issue. While FINRA did not charge Applicants with violating Rule 3240, borrowing from customers is regulated by that rule and such conduct is within FINRA's authority to investigate, including through information requests made pursuant to Rule 8210.

In summary, FINRA's requests were within its regulatory authority pursuant to Rule 8210. Yet Applicants failed to respond to those requests in two significant respects. First, Applicants did not provide any documents in response to the three Rule 8210 letters that FINRA sent from April to June 2010 until after FINRA instituted proceedings. Second, even after proceedings began, Applicants failed to provide three important categories of information.

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25, 2006); *see also Morton Bruce Erenstein*, Exchange Act Release No. 56768, 2007 WL 3306103, at *6 (Nov. 8, 2007) ("Erenstein's contractual relationship with [FINRA], entered into when he became an associated person with [a FINRA] member, included his agreement to abide by all its rules.").

[23] *Joseph G. Chiulli*, Exchange Act Release No. 42359, 2000 WL 91733, at *5 (Jan. 28, 2000); *see also Goldstein*, 2014 WL 1494527, at *10 (finding that applicant consented as an associated person to FINRA's ability under Rule 8210 to request information).

[24] *CMG Inst'l Trading*, 2009 WL 223617, at *8 (citation omitted).

[25] *Goldstein*, 2014 WL 1494527, at *10 (rejecting applicant's argument that FINRA was precluded from requesting confidential information).

[26] *Richard J. Rouse*, Exchange Act Release No. 32658, 1993 WL 276149, at *3 n.9 (July 19, 1993).

Applicants offer no persuasive reason for failing to respond fully to FINRA's information requests. We find that Applicants' incomplete responses to FINRA's information requests violated Rules 8210 and 2010.

D. Applicants violated Article V, Section 2(c) of FINRA's By-Laws, NASD Rule 2110, and FINRA Rule 2010 by not timely amending Troszak's Form U4.

Article V, Section 2(c) of FINRA's By-Laws provides that every Form U4 filed with FINRA be kept current at all times by supplementary amendments that must be filed within thirty days of learning of the facts or circumstances giving rise to the amendment. The duty to maintain an accurate Form U4 lies primarily with an associated person who is in the best position to provide information about the questions presented in the form. But a member, which is required to file the Form U4, also is subject to that duty and therefore can be held liable for failing to satisfy it.[27] Question 14M on the Form U4 asked: "Do you have any unsatisfied judgments or liens against you?" There is no dispute that Applicants did not timely amend the answer to that question. As FINRA found, the IRS notified Troszak in October 2008 that he was subject to a tax lien, and FINRA repeatedly reminded him of that fact in mid-2010. Applicants nonetheless waited until October 2011 to amend the Form U4. We therefore find that Applicants violated Article V, Section 2(c) of FINRA's By-Laws.[28]

NASD Rule 2110 and FINRA Rule 2010 require members and associated persons to observe high standards of commercial honor and just and equitable principles of trade.[29] Consistent with those rules, the duty to amend a Form U4 assures regulatory organizations, employers, and members of the public that they have all material, current information about the securities professionals with whom they are dealing.[30] Applicants undermined those assurances

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27 *See Order Approving Proposed Rule Change*, Exchange Act Release No. 60348, 2009 WL 2176837, at *2 (July 20, 2009) (stating that a new electronic filing rule "merely codifies a member's existing obligation under Article V, Section 2(c) of FINRA's By-Laws that every U4 be kept current, and implicit in this duty is the expectation that the member will seek to ensure that such information is accurate and complete").

28 FINRA, an SRO, is authorized to impose sanctions for violations of its By-Laws, among other things. Art. XIII, Sec. 1(b), FINRA By-Laws. When an applicant seeks review by the Commission of a sanction imposed by an SRO, the Commission must determine, among other things, whether the applicant's conduct violated the provisions found by the SRO, including any of the SRO's rules. Exchange Act Section 19(e)(1), 15 U.S.C. § 78s(e)(1). "Rules" are defined in the Exchange Act to include an SRO's bylaws. Exchange Act Section 3(a)(27), (28), 15 U.S.C. § 78c(a)(27), (28).

29 NASD Rule 2110 was effective until December 15, 2008, when its identical successor, FINRA Rule 2010, became effective. *See* FINRA Regulatory Notice 08-57, 2008 WL 4685588, at *3 (Oct. 16, 2008). The conduct at issue covers a period when each rule was effective. We therefore apply both rules.

30 *Richard A. Neaton*, Exchange Act Release No. 65598, 2011 WL 5001956, at *6 (Oct. 20, 2011).

when they failed to update Troszak's Form U4 to include the tax lien. The timeliness of disclosing that information was particularly important because, as FINRA found, North Woodward's customers should have been able to consider the potential impact the tax lien had on the risks associated with the loans Troszak sought, such as his ability to repay the loans, *before* they decided to loan money to Troszak. Moreover, FINRA was unable to engage in basic oversight of Applicants.[31] We find that Applicants' failure to timely amend Troszak's Form U4 is inconsistent with just and equitable principles of trade.[32]

Applicants argue that their failure was justifiable. Applicants assert that "it was the position of [Applicants'] counsel that the lien did not need to be disclosed because [Troszak] was not personally subject to it." But the record contradicts this assertion. Form U4 specifically asks whether the associated person has any unsatisfied liens against him. A notice sent by the IRS identifies "Douglas A. Troszak" as one of the taxpayers subject to the lien. The fact that his accounting firm was identified as a taxpayer subject to the tax lien does not negate the fact that Troszak also was subject to the lien. Applicants had no basis, much less a justifiable basis, for failing to timely amend Troszak's Form U4. We therefore reject Applicants' argument.

E. FINRA's rules are and were applied in a manner consistent with the purposes of the Exchange Act.

Rule 8210 is the principal means by which FINRA obtains information from FINRA member firms and associated persons in order to detect and address industry misconduct.[33] The rule therefore is consistent with the purposes of the Exchange Act.[34] Here, FINRA found that

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31 *See Scott Mathis*, Exchange Act Release No. 61120, 2009 WL 4611423, at *9 (Dec. 7, 2009) (finding that information about applicant's tax liens "would have allowed [investors] to assess whether [his] tax problems and large financial obligations had a bearing on their confidence in him" and would have provided regulators "with an early notice about his financial difficulties and information on his ability to manage his financial obligations"), *petition denied*, 671 F.3d 210 (2d Cir. 2012).

32 *See Mathis*, 2009 WL 4611423, at *6 (finding that applicant's failure to timely amend his Form U4 to disclose that he was subject to tax liens and customer complaints was inconsistent with just and equitable principles of trade).

33 *Charles C. Fawcett, IV*, Exchange Act Release No. 56770, 2007 WL 3306105, at *6 (Nov. 8, 2007) (stating that SROs lack subpoena power and instead must rely on Rule 8210 as a "vitally important" tool to acquire information and satisfy an obligation to police the activities of its members and associated persons).

34 *See* Exchange Act Section 15A(b)(6), 15 U.S.C. § 78o-3(b)(6), (requiring that registered securities association's rules be designed to prevent fraudulent and manipulative practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating securities, and, in general, to protect investors and the public interest); *Order Approving Proposed Rule Change*, Exchange Act Release No. 42036, 1999 WL 961340, at *2 (Oct. 19, 1999) (finding that amending the definition of "person associated with a member" in the By-Laws of the NASD would expand Rule 8210's applicability and thereby

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Applicants violated Rule 8210 by hampering FINRA's ability to investigate possible improprieties with respect to the loans that Troszak received from North Woodward's customers. Some of these customers were elderly and used their IRAs to fund the loan—facts that raise questions about whether the loans were proper. Potential conflicts of interest such as this are of particular concern in the industry, and it is important for FINRA to be able to monitor members and associated persons who may be putting their interests ahead of their customers.[35] In fact, Troszak admits in his brief on appeal that he has not repaid all of the loans in full, claiming that repayment "has since been delayed upon the wishes of the lenders." Troszak's self-serving statement, absent any other corroborating evidence, underscores the need for FINRA's oversight. We therefore find that FINRA applied Rule 8210 in a manner consistent with the purposes of the Exchange Act.

Form U4 "is critical to the effectiveness of the screening process used to determine who may enter (and remain in) the industry" because it enables regulators and the public to determine and monitor the fitness of securities professionals.[36] Thus, the form "ultimately serves as a means of protecting the investing public."[37] Article V, Section 2 of FINRA's By-Laws is designed to ensure such protection by requiring members and associated persons to update crucial information in the Form U4. We find that the rule is consistent with the purposes of the Exchange Act.[38] The tax lien against Troszak called into question his ability to repay the customers' loans and was a specific disclosure item on his Form U4.[39] We further find that

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"promote the objectives of Section 15A(b)(6) of the Act by helping the NASD obtain necessary information to conduct its regulatory investigations and proceedings").

35 *See, e.g.*, *John Edward Mullins and Kathleen Maria Mullins*, Exchange Act Release No. 66373, 2012 WL 423413, at *11 (Feb. 10, 2012) (finding that applicants' failure to disclose to their firm a sizeable loan from an elderly customer with a fixed income carried a significant potential for conflicts of interests and misconduct); *William Louis Morgan*, Exchange Act Release No. 32744, 1993 WL 307557, at *6 (Aug. 12, 1993) (finding that applicant's failure to disclose to his firm over $345,000 in loans from customers illustrated the potential for substantial harm to investors, resulted in substantial losses by the customers, and undermined the NASD's ability to carry out its self-regulatory functions).

36 *Joseph S. Amundsen*, Exchange Act Release No. 69406, 2013 WL 1683914, at *6 (Apr. 18, 2013).

37 *Id.*

38 *See* Exchange Act Section 15A(b)(6) (requiring that registered securities association's rules be designed to prevent fraudulent and manipulative practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest).

39 *See Robert D. Tucker*, Exchange Act Release No. 68210, 2012 WL 5462896, at *11 (Nov. 9, 2012) (finding that disclosure on Form U4 about judgments, bankruptcies, and tax liens was significant "because they cast doubt on Tucker's ability to manage his personal financial affairs and provide investors with appropriate financial advice").

FINRA applied Article V, Section 2 of FINRA's By-Laws here in a manner consistent with the purposes of the Exchange Act.

NASD Rule 2110 and FINRA Rule 2010 reflect the mandate of Exchange Act Section 15A(b)(6), which requires, among other things, that FINRA design its rules to "promote just and equitable principles of trade."[40] As we have stated, "[t]his general ethical standard . . . is broader and provides more flexibility than prescriptive regulations and legal requirements. NASD Rule 2110 [and FINRA Rule 2010] protect[] investors and the securities industry from dishonest practices that are unfair to investors or hinder the functioning of a free and open market, even though those practices may not be illegal or violate a specific rule or regulation. NASD Rule 2110 [and FINRA Rule 2010] ha[ve] proven effective through nearly 70 years of regulatory experience."[41] We agree with FINRA's determination that Applicants engaged in conduct inconsistent with just and equitable principles of trade by failing to timely amend Troszak's Form U4. We therefore find that NASD Rule 2110 and FINRA Rule 2010 are, and were applied in a manner, consistent with the purposes of the Exchange Act.

III. Sanctions

A. Standard of Review

Exchange Act Section 19(e)(2) directs us to sustain FINRA's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary or inappropriate burden on competition.[42] As part of this review, we must consider any aggravating or mitigating factors[43] and whether the sanctions imposed by FINRA are remedial in nature and not punitive.[44] As discussed below, we find the sanctions imposed on Applicants to be consistent with the statutory requirements and sustain them.

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40 15 U.S.C. § 78o-3(b)(6).

41 *Notice of Filing of a Proposed Rule Change*, Exchange Act Release No. 58095, 2008 WL 2971979, at *2 (July 3, 2008); *Rule Change Approved Without Modification*, Exchange Act Release No. 58643, 2008 WL 4468749 (Sept. 25, 2008).

42 15 U.S.C. § 78s(e)(2). Applicants do not allege, and the record does not show, that FINRA's sanctions imposed an undue burden on competition.

43 *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1064-65 (D.C. Cir. 2007).

44 *Paz Sec.*, 494 F.3d at 1065 ("The purpose of the order [must be] remedial, not penal.") (quoting *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940)); *see also* FINRA Sanction Guidelines at 2 ("Disciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry.").

B. The sanctions imposed by FINRA are neither excessive nor oppressive.

For the Rule 8210 violation, FINRA barred Troszak and expelled North Woodward.[45] Although the Commission is not bound by FINRA's Sanction Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2).[46] Where, as here, an individual has provided a partial response to Rule 8210 requests made by FINRA, the Sanction Guidelines state that a bar is standard "unless the person can demonstrate that the information provided substantially complied with all aspects of the request."[47] The Sanction Guidelines recommend expelling a firm in an egregious case.[48] The Sanction Guidelines note further that an adjudicator should consider suspending the individual or the firm in any or all capacities for up to two years where mitigation exists.[49]

The Sanction Guidelines also identify three "principal considerations" for determining sanctions where an individual or firm has provided a partial response to Rule 8210 requests. They are (i) the "[i]mportance of the information requested that was not provided as viewed from FINRA's perspective, and whether the information provided was relevant and responsive to the request"; (ii) the "[n]umber of requests made, the time the respondent took to respond, and the degree of regulatory pressure required to obtain a response"; and (iii) "[w]hether the respondent thoroughly explains valid reason(s) for the deficiencies in the response."[50]

Applicants have not demonstrated that the information they provided to FINRA substantially complied with all aspects of FINRA's Rule 8210 requests. Applicants did not provide any of the documents requested by FINRA in April 2010; nor did they answer all of FINRA's questions. As FINRA found, Applicants "never provided three critical categories of information," including "an accounting, with supporting documentation, of the $11,310.48 difference between the amount that Troszak borrowed from his customers and the redemption payment"; "proof that the interest and principal payments that were required by the promissory notes were made to the customers"; and "the 2009 and 2010 securities account statement for the entity that issued the promissory notes, Troszak Capital Corp."

From FINRA's perspective, the requested information was important and Applicants' failure to provide the information frustrated the staff's efforts to determine whether the

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45 FINRA determined that other sanctions for the Rule 8210 violation and the violations regarding the failure to timely amend Troszak's Form U4 "would be appropriate," but FINRA declined to impose them. We therefore do not address those sanctions.

46 *Goldstein*, 2014 WL 1494527, at *10 (citation omitted).

47 FINRA Sanction Guidelines at 33.

48 *Id.*

49 *Id.* The Sanction Guidelines include a list of non-exhaustive aggravating and mitigating factors. *See id.* at 6-7.

50 *Id.* at 33.

promissory notes were a legitimate investment and suitable for the Firm's customers, especially given that some of the customers were elderly and loaned Troszak money from their IRAs. FINRA also could not evaluate whether Troszak could and would repay the loans. We agree with FINRA that the staff also was unable to determine if Troszak engaged in other serious misconduct, such as the misappropriation or conversion of North Woodward's customers' funds. The limited information that Applicants provided, while helpful to some degree, did not adequately shed light on the circumstances surrounding the propriety of Troszak's conduct or his ability to repay the loans.

FINRA exerted a high degree of regulatory pressure in seeking the requested information. Applicants supplemented their May 2010 partial response only after FINRA sent three Rule 8210 requests to Applicants in mid-2010, provided Applicants with an opportunity to make a Wells submission in early 2011, and filed a complaint in mid-2011. Applicants submitted some information to FINRA approximately eighteen months after FINRA first requested it and five months after FINRA filed a complaint—but they still failed to provide key information and documents.

Applicants did not provide a valid reason for the deficiencies in their responses. They claimed that the requested information was not within their possession, custody, or control, or was irrelevant and confidential. But as discussed above, the information was "of" Troszak, was relevant, and FINRA was entitled to it notwithstanding Troszak's concerns. And for the information that Applicants claim they did not have, Applicants made no attempt to obtain it elsewhere or explain to FINRA why the information was not available.

Applicants assert that they relied on the advice of counsel in refusing to respond to FINRA's Rule 8210 requests. A claim of reliance on the advice of counsel requires a showing that the party claiming it "made complete disclosure to counsel, sought advice as to the legality of his conduct, received advice that his conduct was legal, and relied on that advice in good faith."[51] Applicants have not satisfied those elements. To the contrary, Troszak's own testimony shows that Applicants' counsel encouraged full compliance by explaining why Applicants were required to respond to FINRA's requests notwithstanding Troszak's concerns. Instead, Applicants repeatedly chose not to respond fully.

Applicants argue that FINRA erred in finding that there were several aggravating factors and no mitigating factors. FINRA found that Applicants acted intentionally and did not accept responsibility for their actions.[52] Applicants state that they have "not accepted responsibility for misconduct only because [they] ha[ve] legitimate legal concerns given the fact that federal law prohibits [them] from disclosing documents requested by FINRA." Applicants are entitled to present a vigorous defense. But Applicants' continued refusal to acknowledge that they were required to respond fully to FINRA's requests, even after their counsel explained the necessity of

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51 *Markowski v. SEC*, 34 F.3d 99, 104-05 (2d Cir. 1994) (citing *SEC v. Savoy Indus., Inc.*, 665 F.2d 1310, 1314 n.28 (D.C. Cir. 1981)).

52 Sanction Guidelines at 6-7.

doing so, demonstrates a misunderstanding of, or lack of regard for, their professional obligations.[53]

FINRA considered Applicants' disciplinary history to be another aggravating factor. It cited a 2009 Commission opinion in which we affirmed FINRA's findings that North Woodward violated Exchange Act Rule 17a-3 and NASD Rules 3110 and 2110 by failing to prepare and maintain a current general ledger and trial balance for two months and that Troszak, who was responsible for North Woodward's violations, violated NASD Rule 3110 and 2110 ("2009 Final Action").[54] Applicants were fined $5,000. FINRA also cited a January 6, 2005 settled action in which Applicants consented to findings that the firm, acting through Troszak, engaged in securities-related activities without a FINOP for thirteen months.[55] Applicants agreed to pay a $5,000 fine ("2005 Settled Action"). Based on the 2009 Final Action and the 2005 Settled Action, we agree with FINRA that Applicants' disciplinary history "reflects a serial disregard of fundamental regulatory obligations, including requirements to keep accurate records and to operate with a necessary principal registration."

In a footnote, FINRA noted the existence of a Hearing Panel decision issued on May 16, 2014 ("2014 Pending Action"). FINRA briefly recited the violations found by the Hearing Panel and sanctions imposed and stated that the "case is not final and is currently pending on appeal." Applicants assert that "[t]he NAC's consideration of ongoing regulatory matters [involving Applicants] was erroneous and may have led to an increased sanction for the Applicants."[56] But the footnote regarding the 2014 Pending Action appeared the end of a three-paragraph passage in which the NAC focused its analysis on whether the 2009 Final Action and 2005 Settled Action were aggravating factors. Based on that context, coupled with the fact that the footnote did not elaborate or discuss the import of the 2014 Pending Action, we find that the NAC did not rely on the 2014 Pending Action as part of their sanctions analysis. In any event, the 2009 Final Action and the 2005 Settled Action by themselves support FINRA's finding that "respondents are recidivists whose disregard for FINRA rules and regulatory requirements place the public

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53 *See Wendy McNeeley, CPA*, Exchange Act Release No. 68431, 2012 WL 6457291, at *18 (Dec. 13, 2012) (finding that, while the respondent had the right to present a vigorous defense, her testimony and arguments on appeal reflected a continuing failure to grasp her role as a professional); *Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 WL 2790633, at *8 (Sept. 26, 2007) (finding respondent's denial that his conduct was wrongful demonstrated either a misunderstanding or a lack of recognition of his duties as a professional and of his regulatory obligations).

54 *North Woodward Fin. Corp. and Douglas A. Troszak*, Exchange Act Release No. 60505, 2009 WL 2488066, at *5 (Aug. 14, 2009).

55 *Id.* at *6.

56 Sanction Guidelines at 2 (stating that "pending investigations or the existence of ongoing regulatory proceedings prior to a final decision are not relevant" to the determination of sanctions).

interest at risk."[57] Moreover, Applicants' disciplinary history was just one of many aggravating factors that FINRA considered. Even aside from any consideration of Applicants' disciplinary history, the record supports the imposition of a bar and expulsion. We therefore reject Applicants' argument.

Applicants urge us to reduce the sanctions because they "have not engaged in fraudulent activity or activity which was harmful to [their] customers or non-client investors." But, "a Rule 8210 violation will rarely, in itself, result in direct harm to a customer."[58] "The purpose of the rule is to give [FINRA], in the absence of subpoena power, the ability to detect misconduct among its members and associated persons in the interest of protecting investors and the integrity of the markets."[59]

Applicants argue that the sanctions are punitive because "NWFC is a small firm with relatively few clients and a low level of trading activity." But "an otherwise remedial sanction does not become punitive simply because its imposition might cause some harm to a small firm. Rather, such harm is one factor, among others, to consider as part of the overall remedial inquiry."[60] Here, a bar and expulsion are remedial because Applicants pose a continuing danger to the investing public. Nor do we find mitigating Applicants' assertions that they made an "honest mistake" and that they acted out of fear of facing criminal charges for potentially violating two federal tax statutes. Applicants ignored FINRA's information requests despite repeated efforts by Applicants' counsel and FINRA staff to explain why a full response was necessary. A failure to fully respond to FINRA's Rule 8210 requests "threatens the self-regulatory system and, in turn, investors by impeding [FINRA's] detection of violative

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57 *Id.* ("Adjudicators should consider imposing more severe sanctions when a respondent's disciplinary history includes . . . past misconduct that evidences disregard for regulatory requirements, investor protection or commercial integrity.").

58 *CMG Inst'l Trading*, 2009 WL 223617, at *9 (rejecting applicants' argument that the absence of customer harm or fraud in connection with their Rule 8210 violation was mitigating) (citing *PAZ Sec., Inc.*, Exchange Act Release No. 57656, 2008 WL 1697153, at *5 (Apr. 11, 2008), *pet. for review denied*, 566 F.3d 1172 (D.C. Cir. 2009)); *see also* Sanction Guidelines at 33 n.2 (stating that the lack of harm to customers is not mitigating).

59 *CMG Inst'l Trading*, 2009 WL 223617, at *9 (citing *Paz Sec., Inc.*, 2008 WL 1697153, at *5).

60 *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 WL 32121, at *15 & n.81 (Jan. 6, 2012) (citing *Hans N. Beerbaum*, Exchange Act Release No. 55731, 2007 WL 1376365, at *5 (May 9, 2007) (rejecting argument by firm's president and sole owner who claimed barring him would cause him "great economic hardship" and "unfair" punishment because, effectively, "[he] is the Firm")); *see also Ashton Noshir Gowadia*, Exchange Act Release No. 40410, 1998 WL 564575, at *4 (Sept. 8, 1998) (stating that "economic harm alone is not enough to make the sanctions imposed . . . by [FINRA] excessive or oppressive").

conduct."[61] A bar and expulsion will protect investors by encouraging full and timely cooperation and deter others who might ignore FINRA's requests for information.[62]

An appropriate order will issue.[63]

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, STEIN, and PIWOWAR).

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

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61 *CMG Inst'l Trading*, 2009 WL 223617, at *9.

62 *See Erenstein*, 2007 WL 3306103, at *10 (finding that a bar for a Rule 8210 violation served as a deterrent to others who might ignore NASD's information requests and protected the investing public by encouraging the timely cooperation essential to promptly discovering and remedying industry misconduct).

63 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74913 / May 8, 2015

Admin. Proc. File No. 3-15990

In the Matter of the Application of

NORTH WOODWARD FINANCIAL CORPORATION
and
DOUGLAS A. TROSZAK

For Review of Disciplinary Action Taken by

FINRA

CORRECTED ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY FINRA

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by FINRA against North Woodward Financial Corporation and Douglas A. Troszak is hereby sustained.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9769 / May 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16532

In the Matter of **THE REGISTRATION STATEMENT OF ORION GLOBAL CORP.** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS, MAKING FINDINGS, AND ISSUING STOP ORDER**

I.

A. On May 27, 2014, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $36,000 public offering. The registration statement was amended on July 1, 2014, July 24, 2014, and August 6, 2014. The registration statement has not become effective.

B. The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that administrative proceedings be, and hereby are, instituted pursuant to Section 8(d) of the Securities Act of 1933 ("Securities Act") to determine whether a stop order should issue suspending the effectiveness of Respondent's registration statement.

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 Proceedings, Making Findings, and Issuing Stop Order (the "Order"), as set forth below.

III.

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

1. Respondent is a Florida corporation headquartered in Sarasota, Florida which was dissolved on November 20, 2014.

2. On May 27, 2014, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $36,000 public offering. The registration statement was amended on July 1, 2014, July 24, 2014, and August 6, 2014 (together, the "Registration Statement").

3. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading, for example:

a. The Registration Statement states that "[o]ur sole Officer and Director will be responsible for the business development" of a storage facility business. These disclosures are untrue and misleading because Respondent has no business of its own, and is an undisclosed "blank check company" as defined in Rule 419 under the Securities Act.

b. The Registration Statement states that "[p]resently, [Respondent's sole officer and director] earns his livelihood as a Manager of a Storage Center facility." This disclosure is untrue and misleading because Respondent's sole officer and director was not presently employed in the same industry as the purported business plan of Respondent at the time of the filing of the Registration Statement.

c. The Registration Statement states that Respondent's sole officer and director "is the only 'parent' and 'promoter' of the company" and will "continue to control the operations of the Company" after the offering. This disclosure is untrue and misleading because Respondent is controlled and/or promoted by an undisclosed control person, parent and/or promoter.

d. The Registration Statement states that Respondent "is entirely dependent on the efforts of our sole officer and director," and that "[a]ll decisions regarding the management of our affairs will be made exclusively by [the sole officer and director]." The Registration Statement further states that Respondent is "currently operating out of our sole director and officer's office located at his residence." These disclosures are untrue and misleading because Respondent's sole officer and director has not engaged in any business activities for Respondent other than the opening of a corporate bank account.

e. The Registration Statement states that the "Board of Directors is comprised [ ] solely of [Respondent's sole officer and director] who was integral to our business and who is involved in our day to day operations." The Registration Statement also states that Respondent's sole officer and director "is devoting 10-25 hours per week to our operations" and "is prepared to devote more time to our operations." The Registration Statement further states that "[t]he functions of [an Audit Committee, a Compensation Committee or a Nominating Committee] are being undertaken by our sole director." These disclosures are untrue and misleading because Respondent's sole officer and director has had no involvement in, and spent no time on, Respondent's operations.

f. The Registration Statement states that Respondent's "sole officer and director . . . will be responsible to market and sell these securities" and that "[i]t is our belief [Respondent's sole officer and director] had such knowledge and experience in financial and business matters that he was capable of evaluating the merits and risks of the investment and therefore did not need the protections offered their [sic] shares under Securities and Act of 1933 [sic], as amended. [Respondent's sole officer and director] certified that he was purchasing the shares for their [sic] own accounts, with investment intent." These disclosures are untrue and misleading because Respondent's sole officer and director does not have any knowledge of the shares, does not plan to sell the shares, does not have the described knowledge or experience in financial or business matters, and made no such certification.

g. The Registration Statement claims that there was a capital contribution by Respondent's sole officer and director on April 4, 2014. This disclosure is untrue and misleading because Respondent's sole officer and director made no such capital contribution and has not received any shares related to Respondent.

h. The Registration Statement states that "[p]ursuant to the requirements of the Securities Act, the registrant has duly caused this registration statement to be signed on its behalf by [Respondent's sole officer and director]." This disclosure is untrue and misleading because Respondent's sole officer and director did not sign the Registration Statement.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to issue a stop order suspending the effectiveness of the Registration Statement, as agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 8(d) of the Securities Act, that the effectiveness of the Registration Statement filed by Respondent be, and hereby is, suspended.

This Order shall be served on Respondent by certified mail forthwith.

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 ACT OF 1933
Release No. 9768 / May 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16530

In the Matter of **the Registration Statement of** **First Xeris Corp.** **7329 Featherstone Blvd.** **Sarasota, FL 34238** **Respondent.**	**ORDER FIXING TIME AND PLACE OF PUBLIC HEARING AND INSTITUTING PROCEEDINGS PURSUANT TO SECTION 8(d) OF THE SECURITIES ACT OF 1933**

I.

The Commission's public official files disclose that:

On April 22, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $39,000 public offering. The registration statement was amended on June 5, 2013, November 7, 2013, December 16, 2013 and December 24, 2013, and became effective on January 8, 2014.

II.

After an examination, the Division of Enforcement alleges that:

A. <u>RESPONDENT</u>

1. Respondent is a Florida corporation headquartered in Sarasota, Florida.

2. On April 22, 2013, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $39,000 public offering. The registration statement was amended on June 5, 2013, November 7,

2013, December 16, 2013 and December 24, 2013, and became effective on January 8, 2014 (together, the "Registration Statement").

B. MATERIAL UNTRUE STATEMENTS AND OMISSIONS

3. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading, for example:

a. The Registration Statement states that "[o]ur sole officer and director will be responsible for the business plan development" of a landscaping business. These disclosures are untrue and misleading because Respondent has no business of its own, and the plan of Respondent, at all material times, was to combine with another business.

b. The Registration Statement states that Respondent's sole officer and director "is the only 'parent' and 'promoter' of the company" and will "continue to control the operations of the Company" after the offering. This disclosure is untrue and misleading because Respondent is controlled and/or promoted by an undisclosed control person, parent and/or promoter.

c. The Registration Statement states that Respondent is "entirely dependent on the efforts of its sole officer and director," and that "[a]ll decisions regarding the management of our affairs will be made exclusively by [the sole officer and director]." The Registration Statement further states that Respondent is "currently operating out of our sole director and officer's office located at [his residence]." These disclosures are untrue and misleading because Respondent's sole officer and director has not engaged in any business activities for Respondent other than opening a corporate bank account, signing documents at the undisclosed control person's direction, and contributing to the drafting of the purported business plan.

d. The Registration Statement states that the "Board of Directors is comprised . . . solely of [Respondent's sole officer and director] who was integral to our business and who is involved in our day to day operations." The Registration Statement also states that Respondent's sole officer and director "is devoting approximately 10-25 hours per week to our operations" and "is prepared to devote more time to our operations as may be required." The Registration Statement further states that "[t]he functions of [an Audit Committee, a Compensation Committee or a Nominating Committee] are being undertaken by our sole director." These disclosures are untrue and misleading because Respondent's sole officer and director has had *de minimis* involvement in and time spent on Respondent's operations.

e. The Registration Statement states that Respondent's "sole officer and director . . . will be responsible to market and sell these securities" and that "[i]t is our belief [Respondent's sole officer and director] had such knowledge and experience in financial and business matters that he was capable of evaluating the merits and risks of the investment and therefore did not need the protections offered their [sic] shares under Securities and Act of 1933 [sic], as amended. [Respondent's sole officer and director] certified that he was purchasing the shares for their [sic] own accounts, with investment intent." These disclosures are untrue and misleading because Respondent's sole officer and director did not purchase the shares, had minimal involvement in the marketing and sale of the securities, does not have the described knowledge or experience in financial or business matters, and made no such certification.

f. The Registration Statement claims that there was a $9,000 capital contribution by Respondent's sole officer and director on March 26, 2013. This disclosure is untrue and misleading because Respondent's sole officer and director made no such capital contribution and has not received any shares related to Respondent.

III.

The Commission, having considered the aforesaid, deems it appropriate and in the public interest that public proceedings pursuant to Section 8(d) of the Securities Act be instituted with respect to the Registration Statement to determine whether the allegations of the Division of Enforcement are true; to afford the Respondent with an opportunity to establish any defenses to these allegations; and to determine whether a stop order should issue suspending the effectiveness of the Registration Statement referred to herein.

Accordingly, IT IS ORDERED that public proceedings be and hereby are instituted under Section 8(d) of the Securities Act, such hearing to be commenced at 9:30am on May 28, 2015, at the Commission's offices at 100 F Street N.E., Washington, DC 20549, and to continue thereafter at such time and place as the hearing officer may determine.

IT IS FURTHER ORDERED that these proceedings shall be presided over by an Administrative Law Judge to be designated by further order, who is authorized to perform all the duties of an Administrative Law Judge as set forth in the Commission's Rules of Practice or as otherwise provided by law.

IT IS FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, pursuant to Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220. If the 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 the Respondent 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 in accordance with Rule 141 of the Commission's Rules of Practice, 17 C.F.R. §201.141.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to

Rule 360(a)(2) of the Commission's Rules of Practice. 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9767 / May 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16529

In the Matter of **the Registration Statement of** **Visual Acumen, Inc.** **432 Maple Hill Avenue** **Newington, CT 06111-3419** **Respondent.**	**ORDER FIXING TIME AND PLACE OF PUBLIC HEARING AND INSTITUTING PROCEEDINGS PURSUANT TO SECTION 8(d) OF THE SECURITIES ACT OF 1933**

I.

The Commission's public official files disclose that:

On February 5, 2014, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $33,000 public offering. The registration statement was amended on May 1, 2014, and became effective on May 9, 2014.

II.

After an examination, the Division of Enforcement alleges that:

A. RESPONDENT

1. Respondent is a Florida corporation headquartered in Newington, Connecticut.

2. On February 5, 2014, Respondent filed a Form S-1 registration statement seeking to register the offer and sale of 3,000,000 common shares in a $33,000 public offering. The registration statement was amended on May 1, 2014, and became effective on May 9, 2014 (together, the "Registration Statement").

B. MATERIAL UNTRUE STATEMENTS AND OMISSIONS

3. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading, for example:

a. The Registration Statement states that Respondent has a business plan to develop a process for extracting descriptive data from images, has "no plans to change our business activities or to combine with another business and [is] not aware of any events or circumstances that might cause us to change our plans." These disclosures are untrue and misleading because the business plan of Respondent, at all material times, was to combine with another business.

b. The Registration Statement states that Respondent "intends to use the proceeds from this offering to create the business and marketing plan." These disclosures are untrue and misleading because Respondent used, and intended to use, all proceeds from the offering to pay professional and other fees related to Respondent's public status, not for the purported business plan set forth in the Registration Statement.

c. The Registration Statement states that Respondent is "entirely dependent on the efforts of our sole officer and director," who "is the only 'parent' or 'promoter' of the company," will exclusively make "[a]ll decisions regarding the management of the Company's affairs," and "will continue to control the operations of the Company" after the offering. These disclosures are untrue and misleading because Respondent has been dependent on and controlled by undisclosed control persons, parents and promoters.

d. The Registration Statement states that "[o]ur sole officer and director will sell the common stock upon effectiveness of this registration statement on a best efforts basis," and "will be responsible to market and sell these securities." These disclosures are untrue and misleading because Respondent's sole officer and director has had no responsibility for or involvement in the marketing and sale of the securities in the registered offering.

e. The Registration Statement states that "[i]t is our belief [Respondent's sole officer and director] had such knowledge and experience in financial and business matters that he was capable of evaluating the merits and risks of the investment and therefore did not need the protections offered their [sic] shares under Securities and Act of 1933 [sic], as amended. [Respondent's sole officer and director] certified that he was purchasing the shares for their [sic] own accounts, with investment intent." These disclosures are untrue and misleading because Respondent's sole officer and director does not have the described knowledge or experience in financial or business matters, did not purchase the described shares, and did not make the described certification.

f. The Registration Statement claims that there was a capital contribution of $9,000 by Respondent's sole officer and director on October 7, 2013. This disclosure is untrue and misleading because Respondent's sole officer and director did not make such capital contribution.

III.

The Commission, having considered the aforesaid, deems it appropriate and in the public interest that public proceedings pursuant to Section 8(d) of the Securities Act be instituted with respect to the Registration Statement to determine whether the allegations of the Division of Enforcement are true; to afford the Respondent with an opportunity to establish any defenses to these allegations; and to determine whether a stop order should issue suspending the effectiveness of the Registration Statement referred to herein.

Accordingly, IT IS ORDERED that public proceedings be and hereby are instituted under Section 8(d) of the Securities Act, such hearing to be commenced at 9:30 a.m. on May 28, 2015, at the Commission's offices at 100 F Street N.E., Washington, DC 20549, and to continue thereafter at such time and place as the hearing officer may determine.

IT IS FURTHER ORDERED that these proceedings shall be presided over by an Administrative Law Judge to be designated by further order, who is authorized to perform all the duties of an Administrative Law Judge as set forth in the Commission's Rules of Practice or as otherwise provided by law.

IT IS FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, pursuant to Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220. If the 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 the Respondent 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 in accordance with Rule 141 of the Commission's Rules of Practice, 17 C.F.R. §201.141.

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4081 / May 11, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16531

In the Matter of **Stephen Goodrich,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Stephen Goodrich ("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.2., below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant To Section 203(f) of the Investment Advisers Act Of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Goodrich, 57 years old, is a resident of Rocky Hill, Connecticut. From about 2006 through 2012, Goodrich acted as an unregistered investment adviser.

2. On October 7, 2014, Goodrich pled guilty to one count of mail fraud pursuant to 18 U.S.C. § 1341 and one count of making and subscribing a false tax return pursuant to 26 U.S.C. § 7206(1) before the United States District Court for the District of Connecticut in USA v. Stephen Goodrich, Case No. 3:14-cr-00198-AWT. On February 26, 2015, the Court entered a judgment against Goodrich, sentenced him to 60 months imprisonment followed by three years of supervised release, and ordered him to pay restitution of $1,827,815.05.

3. The counts of the criminal information to which Goodrich pled guilty alleged, inter alia, that:

(a) Beginning in or about 2006 through 2012 Goodrich operated an investment scheme that defrauded more than ten investors out of more than $1.8 million;

(b) Goodrich falsely represented to investors that he was a licensed investment adviser and that investor funds would be fully invested in a pool of stocks, commodities, and currencies;

(c) In furtherance of the scheme to defraud, Goodrich failed to inform investors that he lost over $1 million through his strategies and that he used more than $600,000 of investor funds for personal expenses; and

(d) Goodrich provided investors with statements, some of which were sent through the United States mail, that falsely represented the value of their investment and falsely represented that investors had received positive returns on their investments.

IV.

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

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

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

By the Commission.

Brent J. Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

COMMODITY FUTURES TRADING COMMISSION

RIN 3038-AE24

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-74936; File No. S7-16-11]

RIN 3235-AK65

Forward Contracts With Embedded Volumetric Optionality

AGENCY: Commodity Futures Trading Commission; Securities and Exchange Commission.

ACTION: Final interpretation.

SUMMARY: In accordance with section 712(d)(4) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), the Commodity Futures Trading Commission (the "CFTC") and the Securities and Exchange Commission ("SEC"), after consultation with the Board of Governors of the Federal Reserve System ("Board of Governors"), are jointly issuing the CFTC's clarification of its interpretation concerning forward contracts with embedded volumetric optionality.

DATES: This interpretation is effective on [insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: CFTC: Elise Pallais, Counsel, (202) 418-5577, epallais@cftc.gov; Mark Fajfar, Assistant General Counsel, (202) 418-6636, mfajfar@cftc.gov, Office of the General Counsel, Commodity Futures Trading Commission, 1155 21st Street, NW, Washington, DC 20581. SEC: Carol McGee, Assistant Director, (202) 551-5870, mcgeec@sec.gov, Office of Derivatives Policy,

Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Introduction

In *Further Definition of "Swap," Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping* (the "Products Release"), the CFTC provided an interpretation, in response to requests from commenters, with respect to forward contracts that provide for variations in delivery amount (*i.e.*, that contain "embedded volumetric optionality").[1] Specifically, the CFTC identified when an agreement, contract, or transaction would fall within the forward contract exclusion from the "swap" and "future delivery" definitions in the Commodity Exchange Act (the "CEA")[2] notwithstanding that it contains embedded volumetric

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[1] *See* 77 FR 48207, 48238-42 (Aug. 13, 2012). As described in the Products Release, the interpretation included the following seven elements:

1. The embedded optionality does not undermine the overall nature of the agreement, contract, or transaction as a forward contract;

2. The predominant feature of the agreement, contract, or transaction is actual delivery;

3. The embedded optionality cannot be severed and marketed separately from the overall agreement, contract, or transaction in which it is embedded;

4. The seller of a nonfinancial commodity underlying the agreement, contract, or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction to deliver the underlying nonfinancial commodity if the optionality is exercised;

5. The buyer of a nonfinancial commodity underlying the agreement, contract or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction, to take delivery of the underlying nonfinancial commodity if it exercises the embedded volumetric optionality;

6. Both parties are commercial parties; and

7. The exercise or non-exercise of the embedded volumetric optionality is based primarily on physical factors, or regulatory requirements, that are outside the control of the parties and are influencing demand for, or supply of, the nonfinancial commodity.

[2] *See* 7 U.S.C. 1a(47)(B)(ii) (excluding from the definition of "swap" "*any sale* of a nonfinancial commodity or security for *deferred shipment or delivery*, so long as the transaction is intended to be

optionality.[3] In providing its interpretation, the CFTC was guided by and sought to reconcile agency precedent regarding forward contracts containing embedded options[4] with the statutory definition of "swap" in section 1a(47) of the CEA, which provides, among other things, that commodity options are swaps, even if physically settled.[5]

In response to requests from market participants,[6] the CFTC proposed in November 2014 to clarify its interpretation of when an agreement, contract, or transaction with embedded volumetric optionality would be considered a forward contract.[7] In

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physically settled"); 1a(27) (excluding from the definition of "future delivery" "*any sale* of any cash commodity for *deferred shipment or delivery*") (emphasis added).

[3] *See* 77 FR at 48238-42 & n.335. As explained in the Products Release, the CFTC interprets the exclusions in CEA sections 1a(47)(B)(ii) and 1a(27) as coextensive and thus requiring a consistent interpretation. *See id.* at 48227-8. *See also id.* at 48227-36 (discussing the CFTC's interpretation regarding the forward contract exclusion for nonfinancial commodities).

[4] *See id.* at 48237-39 (citing *In re Wright*, CFTC Docket No. 97-02, 2010 WL 4388247 (CFTC Oct. 25, 2010), and *Characteristics Distinguishing Cash and Forward Contracts and "Trade" Options*, 50 FR 39656 (Sept. 30, 1985) ("1985 CFTC OGC Interpretation")).

[5] *See id.* at 48236-37; 7 U.S.C. 1a(47)(A)(i) (defining "swap" to include "[an] option of any kind that is for the purchase or sale, or based on the value, of 1 or more * * * commodities * * *"). CEA section 1a(47)(A)(i) does not differentiate between financially- and physically-settled options. Certain physically-settled options, termed "trade options," are nevertheless exempt from most requirements applicable to swaps. *See* 17 C.F.R. 32.3. Additionally, the CFTC is proposing to amend its trade option exemption to further reduce the reporting and recordkeeping requirements applicable to certain commercial end users. *See Trade Options*, 80 FR 26200 (May 7, 2015).

[6] The Products Release included a request for comment on the CFTC's interpretation regarding forward contracts with embedded volumetric optionality. *See* 77 FR at 48241-42. CFTC staff also solicited comments in connection with a public roundtable on issues concerning end users and the Dodd-Frank Act. These comments are available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1256 and http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1485, respectively. In general, commenters asserted that uncertainty with regard to the CFTC's interpretation, particularly the seventh element, has led to confusion over whether to characterize certain transactions as excluded forward contracts with embedded volumetric optionality or regulated trade options.

[7] *Forward Contracts With Embedded Volumetric Optionality*, 79 FR 69073 (Nov. 20, 2014) (the "Proposed Interpretation"). Section 712(d)(4) of the Dodd-Frank Act provides that "[a]ny interpretation of, or guidance by either Commission regarding, a provision of this title, shall be effective only if issued jointly by the Commodity Futures Trading Commission and the Securities and Exchange Commission, after consultation with the Board of Governors, if this title requires the Commodity Futures Trading Commission and the Securities and Exchange Commission to issue joint regulations to implement the provision." While the Dodd-Frank Act requires this interpretation, which was originally included in the Products Release, to be issued jointly by the CFTC and the SEC, it is an interpretation solely of the CFTC and does not apply to the exclusion from the swap and security-based swap definitions for security forwards or to the distinction between security forwards and security futures products.

particular, the CFTC proposed to (a) modify the fourth and fifth elements of its interpretation to clarify that the interpretation applies to embedded volumetric optionality in the form of both puts and calls[8] and (b) modify the seventh element to clarify that the embedded volumetric optionality must be primarily intended, at the time the parties enter into the agreement, contract, or transaction, to address physical factors or regulatory requirements that reasonably influence demand for, or supply of, the nonfinancial commodity.[9] The CFTC requested comment on all aspects of its proposal.[10]

II. Overview

After a careful review of the comments received, the CFTC has determined to finalize its interpretation as proposed with some additional clarifications. Accordingly, an agreement, contract, or transaction falls within the forward exclusion from the swap and future delivery definitions, notwithstanding that it contains embedded volumetric optionality, when:

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[8] *Id.* at 69074.

[9] *Id.* at 69074-76.

[10] *See id.* at 69076. The CFTC also requested comment in response to specific questions relating to its proposal. *Id.* The comment file, which includes 22 unique comments and one (1) ex parte communication, is available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1541. Commenters include American Gas Association; American Petroleum Institute; American Public Power Association, Edison Electric Institute, Electric Power Supply Association, Large Public Power Council, and National Rural Electric Cooperative Association; Americans for Financial Reform; Barnard, Chris; Better Markets Inc.; Business Council for Sustainable Energy; Coalition for Derivatives End-Users; Coalition of Physical Energy Companies; Cogen Technologies Linden Venture LP; Commercial Energy Working Group and Commodity Markets Council; Dairy Farmers of America; EDF Trading North America LLC; Federal Energy Regulatory Commission staff; Fig, Willem; International Energy Credit Association; International Swaps and Derivatives Association Inc.; National Association of Manufacturers; National Corn Growers Association and Natural Gas Supply Association; National Energy Marketers Association; Public Citizen; and Southern Company Services Inc., acting on behalf of and as agent for Alabama Power Co., Georgia Power Co., Gulf Power Co., Mississippi Power Co., and Southern Power Co. None of the commenters requested any revisions to SEC rules or regulations (or interpretations thereof), but rather addressed issues relating solely to the CFTC's interpretation.

1. The embedded optionality does not undermine the overall nature of the agreement, contract, or transaction as a forward contract;

2. The predominant feature of the agreement, contract, or transaction is actual delivery;

3. The embedded optionality cannot be severed and marketed separately from the overall agreement, contract, or transaction in which it is embedded;

4. The seller of a nonfinancial commodity underlying the agreement, contract, or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction to deliver the underlying nonfinancial commodity if the embedded volumetric optionality is exercised;

5. The buyer of a nonfinancial commodity underlying the agreement, contract or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction, to take delivery of the underlying nonfinancial commodity if the embedded volumetric optionality is exercised;

6. Both parties are commercial parties; and

7. The embedded volumetric optionality is primarily intended, at the time that the parties enter into the agreement, contract, or transaction, to address physical factors or regulatory requirements that reasonably influence demand for, or supply of, the nonfinancial commodity.

As stated in the Proposed Interpretation, the first six elements of this interpretation are largely unchanged from the Products Release.[11] Among them, only the fourth and fifth elements have been modified, as proposed, to clarify that the CFTC's

[11] *See* 77 FR at 48238.

interpretation applies to embedded volumetric optionality in the form of both puts and calls.[12] Accordingly, the CFTC's discussion of these six elements in the Products Release remains relevant and applicable.[13] The seventh element of the interpretation is discussed further below.

As a general matter, the CFTC clarifies that its interpretation with respect to forward contracts with embedded volumetric optionality should not be read to alter or expand the historic interpretation of the forward contract exclusion. As the first two elements affirm, the interpretation presupposes the existence of an underlying forward contract, as determined by applying the historic interpretation of the forward contract exclusion.[14] The CFTC's interpretation, as provided herein, merely identifies the circumstances under which volumetric optionality embedded in such a forward contract would not operate to take the contract outside the forward contract exclusion.[15] As explained in the Products Release, the historic interpretation of the forward contract exclusion remains relevant and applicable.[16]

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[12] As described in the Products Release, the fifth element did not appear to contemplate circumstances where the seller of the nonfinancial commodity might exercise the embedded volumetric optionality. *See* 77 FR at 48238 ("The buyer of a nonfinancial commodity underlying the agreement, contract or transaction with embedded volumetric optionality intends, at the time it enters into the agreement, contract, or transaction, to take delivery of the underlying nonfinancial commodity if *it exercises* the embedded volumetric optionality.") (emphasis added).

[13] *See* 77 FR at 48238-39.

[14] *See id.* at 48227-36.

[15] The CFTC's interpretation only addresses when a forward contract with embedded volumetric optionality would be excluded from the swap or future delivery definitions in the CEA; it does not address whether a contract would otherwise fall within the swap definition. In other words, a contract that does not meet one or more elements of the CFTC's interpretation may or may not be a swap depending on the characteristics of the contract. *See, e.g.*, *id.* at 48246-52 (discussing application of the swap definition to consumer and commercial agreements).

[16] *See, e.g.*, *id.* at 48228.

In response to commenters, the CFTC clarifies that the fourth and fifth elements of the interpretation do not preclude bandwidth (a.k.a. "swing") contracts, which provide for delivery of a nonfinancial commodity within a certain minimum and maximum range, from falling within the forward contract exclusion from the swap and future delivery definitions.[17] As indicated in the Products Release, the fourth and fifth elements merely require that the intent to make or take delivery (as applicable) required of the underlying forward contract extends to the embedded volumetric optionality, such that both parties to the contract intend to make or take delivery (as applicable) of the nonfinancial commodity under the contract if the embedded volumetric optionality is exercised.[18] The embedded volumetric optionality may therefore operate to increase and/or decrease the quantity delivered under the underlying forward contract and still not take the contract out of the forward exclusion provided that all elements of the CFTC's interpretation, as provided herein, are satisfied.

III. The Seventh Element

As stated in the Proposed Interpretation, the seventh element addresses the primary reason for including embedded volumetric optionality in a forward contract.[19] Embedded volumetric optionality offers commercial parties the flexibility to vary the

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[17] *See* Letter from Coalition of Physical Energy Companies (Dec. 22, 2014) at 4; Letter from Commercial Energy Working Group and Commodity Markets Council (Dec. 22, 2014) at 3-4; Letter from EDF Trading North America LLC ("EDFTNA") (Dec. 22, 2014) at 15-17; Letter from International Energy Credit Association ("IECA") (Dec. 22, 2014) at 4-5; Letter from International Swaps and Derivatives Association Inc. (Dec. 22, 2014) at 3 (each requesting clarification that the fourth and fifth elements permit both increases and decreases in volume).

[18] *See* 77 FR at 48239 ("The fourth and fifth elements are designed to ensure that both parties intend to make or take delivery (as applicable), subject to the relevant physical factors or regulatory requirements, which may lead the parties to deliver more *or less* than originally intended.") (emphasis added).

[19] *See* 79 FR at 69074-75.

amount of the nonfinancial commodity delivered during the life of the contract in response to uncertainty in the demand for or supply of the nonfinancial commodity.[20] The seventh element ensures that this purpose, consistent with the historical interpretation of a forward contract,[21] is the primary purpose for including embedded volumetric optionality in the contract. In other words, the embedded volumetric optionality must primarily be intended as a means of assuring a supply source or providing delivery flexibility in the face of uncertainty regarding the quantity of the nonfinancial commodity that may be needed or produced in the future, consistent with the purposes of a forward contract.[22]

As indicated in the Proposed Interpretation, the focus of the seventh element is the intent of the party with the right to exercise the embedded volumetric optionality at the time of contract initiation.[23] In line with the CFTC's historical interpretation of the

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[20] *See, e.g.*, Letter from the Commodity Markets Council, the National Corn Growers Association, and the Natural Gas Supply Association ("CMC/NCGA/NGA") (April 17, 2014) at 2 ("Physical end-users need these contracts to address supply input or production output uncertainty associated with the operation of a physical business."); Letter from the Plains All American Pipeline, L.P. (April 17, 2014) at 2 ("Such contracts provide us with the ability to allow our customers flexibility to increase or decrease the amount of purchase or sale of a commodity in response to prevailing market conditions.").

[21] *See* 77 FR 48228 (describing a forward contract as a "commercial merchandising transaction" in which delivery is delayed for "commercial convenience or necessity").

[22] *See* 77 FR at 48228 ("The primary purpose of a forward contract is to transfer ownership of the commodity and not to transfer solely its price risk."). *See also* Letter from the CMC/NCGA/NGA (April 17, 2014) at 2 ("[Contracts with volumetric optionality] exist to permit end-users to have agreements in place so that they can effectively and economically manage the purchase or sale of commodities related to their commercial businesses, not as a substitute for a financially settled contract or for speculative purposes."); Letter from ONEOK, Inc. (July 22, 2011) at 7 (stating that "[a]lthough the amounts that can be taken on delivery may vary, the primary intent of the contracts is not to provide price protection").

[23] For example, in choosing whether to obtain additional supply by exercising the embedded volumetric optionality under a given contract or turning to another supply source – whether storage, the spot market, or another forward contract with embedded volumetric optionality – commercial parties would be able to consider a variety of factors, including price, provided that the intended purpose for including the embedded volumetric optionality in the contract at contract initiation was to address physical factors or regulatory requirements influencing the demand for or supply of the commodity. *See also* Letter from

forward contract exclusion, as discussed in the Products Release, such intent may be ascertained by the relevant facts and circumstances surrounding the contract, including the parties' course of performance thereunder.[24] Nevertheless, commercial parties may rely on counterparty representations with respect to the intended purpose for embedding volumetric optionality in the contract provided they do not have information that would cause a reasonable person to question the accuracy of the representation. In response to commenters, the CFTC clarifies that commercial parties are not required to conduct due diligence in order to rely on such representations.[25]

The CFTC clarifies that the seventh element's reference to "physical factors" should be construed broadly to include any fact or circumstance that could reasonably influence supply of or demand for the nonfinancial commodity under the contract. Such facts and circumstances could include not only environmental factors, such as weather or location, but relevant "operational considerations" (*e.g.*, the availability of reliable transportation or technology) and broader social forces, such as changes in demographics or geopolitics.[26] The CFTC further clarifies that the parties' having some influence over

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EDFTNA (Dec. 22, 2014) at 20 (requesting further clarification that the seventh element only addresses the intent of the party with the right to exercise the embedded volumetric optionality.)

[24] *See* 77 FR 48228 ("In assessing the parties' expectations or intent regarding delivery, the CFTC consistently has applied a 'facts and circumstances' test."). For example, if one party has an option to settle a contract financially based upon a value change in an underlying cash market, then the contract may be a swap. *See id.* at 48241 n. 370. *See also* Letter from ONEOK, Inc. (July 22, 2011) at 6 (acknowledging that "[t]he intent of the parties to defer delivery of a varying amount can be ascertained based on objective criteria, such as the pattern of deliveries in relation to variation in weather, customer demand, or other similar factors.").

[25] *See* Letter from EDFTNA (Dec. 22, 2014) at 22-23 (arguing that requiring counterparties to conduct due diligence in order to ensure that facts suggesting an alternate purpose for the embedded volumetric optionality are not present would be "infeasible" and may undercut the utility of the Proposed Interpretation).

[26] As stated in the Products Release, system reliability issues that lead to voluntary supply curtailments would be considered "physical factors" within the scope of the seventh element. *See* 77 FR at 48239 n.345.

such physical factors (*e.g.*, the scheduling of plant maintenance, plans for business expansion) would not be inconsistent with the seventh element, provided that the embedded volumetric optionality is included in the contract at initiation primarily to address potential variability in a party's supply of or demand for the nonfinancial commodity, consistent with the purposes of a forward contract.

The CFTC reiterates, however, that if the embedded volumetric optionality is primarily intended, at contract initiation, to address concerns about price risk (*e.g.*, to protect against increases or decreases in the cash market price), the seventh element would not be satisfied absent an applicable regulatory requirement, including guidance, whether formal or informal, received from a public utility commission or other similar governing body, to obtain or provide the lowest price (*e.g.*, the buyer is an energy company regulated on a cost-of-service basis).[27] The CFTC recognizes that, as commenters have pointed out, price is likely to be a consideration when entering into any contract, including a forward contract.[28] However, to ensure that, as required by the first element, the overall nature of the contract as a forward is not undermined,[29] the embedded volumetric optionality must, as stated above, be primarily intended as a means

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[27] The CFTC confirms that, as stated in the Proposed Interpretation and in the Products Release, the deliverable quantities allowable under embedded volumetric optionality may be justified by a combination of regulatory requirements and physical factors, such that the quantity provided for by the embedded volumetric optionality may reasonably exceed quantities required by regulation. *See* 77 FR at 48238 n.340.

[28] *See* 77 FR at 48228 ("The primary purpose of a forward contract is to transfer ownership of the commodity and not to transfer *solely* its price risk.") (emphasis added). *See also* Letter from American Gas Association ("AGA") (Dec. 22, 2014) at 8-10; Letter from Coalition for Derivatives End-Users (Dec. 22, 2014) at 6; Letter from American Public Power Association, Edison Electric Institute, Electric Power Supply Association, Large Public Power Council, and National Rural Electric Cooperative Association ("Joint Associations") (Dec. 22, 2014) at 4-5; Letter from Southern Company Services Inc., acting on behalf of and as agent for Alabama Power Co., Georgia Power Co., Gulf Power Co., Mississippi Power Co., and Southern Power Co. (Dec. 22, 2014) at 2-3.

[29] *See* 77 FR at 48227-36.

of securing a supply source in the face of uncertainty (arising from physical factors or regulatory requirements, such as an obligation to ensure system reliability) regarding the volume of the nonfinancial commodity to be needed or produced.[30]

Additionally, as stated in the Proposed Interpretation, the CFTC understands that in certain retail electric market demand-response programs, electric utilities have the right to interrupt or curtail service to a customer to support system reliability.[31] The CFTC clarifies that, given that a key function of an electricity system operator is to ensure grid reliability, demand response agreements, even if not specifically mandated by a system operator, may be properly characterized as the product of regulatory requirements within the meaning of the seventh element.[32]

Finally, in response to requests from commenters, the CFTC clarifies that commercial parties may choose to either rely on their good faith characterization of an existing contract (e.g., as an excluded forward contract with embedded volumetric

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[30] *See* 1985 CFTC OGC Interpretation, 50 FR at 39658. *But see* supra note 23; Letter from National Corn Growers Association and Natural Gas Supply Association (Dec. 22, 2014) (recognizing that price concerns are acceptable "if they arise subsequent to execution or are motivated by an applicable regulatory requirement").

[31] *See* Letter from the National Rural Electric Cooperative Association, the American Public Power Association, the Large Public Power Association, and the Transmission Access Policy Study Group (Oct. 12, 2012) at 9.

[32] The CFTC further clarifies that its interpretations regarding full requirements and output contracts, as provided in the Products Release, remain relevant and unaffected by the discussion herein. *See* 77 FR at 48239-40. Similarly, the CFTC reiterates that, depending on the relevant facts and circumstances, capacity contracts, transmission (or transportation) service agreements, tolling agreements, and peaking supply contracts, as discussed in the Products Release, may qualify as forward contracts with embedded volumetric optionality provided they meet the elements of the CFTC's proposed interpretation. *See* 77 FR 48240.

optionality or an exempt trade option) and or recharacterize it in accordance with this final interpretation.[33]

The CFTC believes that these modifications are appropriately measured to clarify the meaning of certain language in the seventh element and should not be construed as a shift in the CFTC's longstanding precedent on the difference between forward contracts and options.

By the Securities and Exchange Commission.

Brent J. Fields
Secretary

Dated: May 12, 2015

[33] Letter from AGA (Dec. 22, 2104) at 12, 19 (requesting relief for market participants who reported transactions as trade options that, following adoption of the Proposed Interpretation, they would consider excluded forwards); Letter from EDFTNA (Dec. 22, 2014) at 5-7 (arguing that reassessment of the legal character of an existing contract is impractical) Letter from IECA (Dec. 22, 2014) at 3 (arguing that requiring parties to reclassify their existing contracts following adoption of the Proposed Interpretation would be unduly burdensome); Letter from Joint Associations (Dec. 22, 2014) at 11 (requesting that the CFTC allow counterparties to reclassify their transactions following adoption of the Proposed Interpretation).

Issued in Washington, DC, on May 12, 2015, by the Commodity Futures Trading Commission.

Christopher J. Kirkpatrick,

Secretary of the Commission.

Commodity Futures Trading Commission (CFTC) Appendices to Forward Contracts With Embedded Volumetric Optionality – Commission Voting Summary, Chairman's Statement, and Commissioner's Statement

Appendix 1 – Commodity Futures Trading Commission Voting Summary

On this matter, Chairman Massad and Commissioners Wetjen, Bowen, and Giancarlo voted in the affirmative. No Commissioner voted in the negative.

Appendix 2 – Statement of Support of CFTC Chairman Timothy G. Massad

I support the staff's recommendations to finalize a proposal we made in November regarding contracts with embedded volumetric optionality – a contractual right to receive more or less of a commodity at the negotiated contract price.

As I said in my statement on the proposal, with reforms as significant as these, it is inevitable that there will be a need for some minor adjustments. And that is what we are doing. The changes we are proposing today help ensure that as we regulate the potential for excessive risks in these markets, we make sure that the commercial businesses—whether they are farmers, ranchers, manufacturers or others—that rely on these markets to hedge routine risks can continue to do so efficiently and effectively.

Specifically, we proposed to clarify when a contract with embedded volumetric optionality will be excluded from being considered a swap. We received a number of comments on this and we have incorporated some of the concerns in the final clarification. Today, following action by the SEC last week, we are posting to the Federal Register the final interpretation. By clarifying how these agreements will be treated for regulatory purposes, the interpretation should make it easier for commercial companies to continue to use these types of contracts in their daily operations.

In certain situations, commercial parties are unable to predict at the time a contract is entered into the exact quantities of the commodity that they may need or be able to supply, and the embedded volumetric optionality offers them the flexibility to vary the quantities delivered accordingly. The CFTC put out an interpretation, consisting of seven factors, to provide clarity as to when such contracts would fall within the forward contract exclusion from the swap definition, but some market participants have felt this interpretation, in particular the seventh factor, was hard to apply. In some cases, the two parties would reach different conclusions about the same contract.

Today we are finalizing clarifications to the interpretation that I believe will alleviate this ambiguity and allow contracts with volumetric optionality that truly are intended to address uncertainty with respect to the parties' future production capacity or delivery needs, and not for speculative purposes or as a means to obtain one-way price protection, to fall within the exclusion.

Appendix 3 – Concurring Statement of CFTC Commissioner Sharon Y. Bowen

Today we are approving a final interpretation regarding forward contracts with embedded optionality. This interpretation is improved compared to the proposed interpretation and I am voting in favor of it. However, I am concerned that this interpretation does not provide the clarity that may be required.

Staff has done a remarkable job in considering the comments received and drafting this final interpretation and they deserve ample praise for their hard work. Yet, staff, and this Commission, face statutory restrictions regarding the definitions of forwards and options that place limits on the relief available through interpretations of the forward contract exclusion. There is no interpretation, by this Commission or its staff, which can turn an option into a forward.

Given the interpretive questions about the final rule defining "swap" and the difficulties in classifying forward contracts with embedded optionality, I think it is important to be clear on what this interpretation can and cannot do – I do not want people to make business decisions based upon a mistaken belief that they have received relief when they have not.

The central issue industry faces is that, in the manufacturing, agriculture and energy sectors, a wide variety of physically-delivered instruments are used to secure companies' commercial needs for a physical commodity. These instruments often contain elements of both a forward contract and a commodity option. These contracts, particularly in the energy sector, are all commonly referred to as physical contracts, and they, according to what I have been told, often receive similar treatment from both a business operations and an accounting standpoint within the entities that use them.

Furthermore, my understanding is that these physical contracts are often handled and accounted for separately from other derivatives, such as futures contracts or cash-settled swaps. Treating some portion of these physical contracts as swaps simply because they may contain some characteristics of commodity options can lead to significant costs and difficulties. For instance, companies may have to reconfigure their business systems to parse transactions where there was, before Dodd Frank, no need to undertake such a reconfiguration.

I have studied this issue closely, meeting with industry and the public and reviewing the comments we have received. In the case of these transactions which are used to address physical commodity needs, I have doubts about whether any public interest is served by requiring manufacturing, agricultural and energy companies to undertake such a burden and reconfigure processes to comply with Commission swap regulations.

The limits on relief through this interpretation flow from the statutory lines drawn between options and forward contracts. Under the CEA, options and forwards are discrete, mutually exclusive categories. Options are subject to the Commission's plenary, exclusive jurisdiction. Forward contracts, on the other hand, are almost entirely excluded from the Commission's jurisdiction. If a contract, or some portion of a contract, meets the definition of an "option," that portion which is an option inherently cannot be a forward contract.

Under the CEA, a critical difference between a physically-delivered option and a forward contract is the nature of the delivery obligation. A forward contract binds both parties to make and take delivery of a commodity at some date in the future. The contract may only be offset through a separate negotiation of the parties. In a physically-settled option contract, only the party offering the option is bound to make or take delivery at the time of contract.

The forward contract exclusion from the swap definition, applies only to a "[A] sale of a nonfinancial commodity or security for deferred shipment or delivery, so long as the transaction is intended to be physically settled." The key part of this definition is that it only applies to a "sale" of a commodity. A "sale" means that one party has agreed to make and the other to take delivery of that commodity.[1]

An option, in contrast, is only the option to undertake such a "sale", not the sale itself. The sale occurs only when the option is exercised. The option to buy or sell a commodity at some later point simply is not the same thing as the sale of that commodity itself. The Commission's Office of the General Counsel memorialized this interpretation in 1985:

> [T]he [forward] contract must be a binding agreement on both parties to the contract: one must agree to make delivery and the other to take

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[1] The phrase, "so long as the transaction is intended to by physically settled," has been interpreted by the Commission to be consistent with its traditional approach to determining whether an instrument is a forward contract. As was stated in the Commission's proposed rule,

> The CFTC believes that the forward contract exclusion in the Dodd-Frank Act with respect to nonfinancial commodities should be read consistently with th[e] established, historical understanding that a forward contract is a commercial merchandising transaction.
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> Many commenters discussed the issue of whether the requirement in the Dodd-Frank Act that a transaction be ''intended to be physically settled'' in order to qualify for the forward exclusion from the swap definition with respect to nonfinancial commodities reflects a change in the standard for determining whether a transaction is a forward contract. Because a forward contract is a commercial merchandising transaction, intent to deliver historically has been an element of the CFTC's analysis of whether a particular contract is a forward contract. In assessing the parties' expectations or intent regarding delivery, the CFTC consistently has applied a ''facts and circumstances'' test. Therefore, the CFTC reads the ''intended to be physically settled'' language in the swap definition with respect to nonfinancial commodities to reflect a directive that intent to deliver a physical commodity be a part of the analysis of whether a given contract is a forward contract or a swap, just as it is a part of the CFTC's analysis of whether a given contract is a forward contract or a futures contract. Proposed Rule on "*Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 76 FR 29818, 29828 (May 23, 2011) ("*Proposed Products Release*").

This interpretation was ratified in the final rule, "*Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 FR 48208, 48227-48228 (August 13, 2012) ("*Products Release*").

> delivery of the commodity. Second, because forward contracts are commercial, merchandizing transactions which result in delivery, the courts and the Commission have looked for evidence of the transactions' use in commerce. Thus, the courts and the Commission have examined whether the parties to the contracts are commercial entities that have the capacity to make or take delivery and whether delivery, in fact, routinely occurs under such contracts
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> ****
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> Thus, an option is a contract in which only the grantor is obligated to perform. As a result, the option purchaser has a limited risk from adverse price movements. This characteristic distinguishes an option from a forward contract in which both parties must routinely perform and face the full risk of loss from adverse price changes since one party must make and the other take delivery of the commodity. In contrast, in an option, only the grantor of a call (put) is required to sell (buy) a given quantity of a commodity (or a futures contract on that commodity) on or by a specified date in the future if the option is exercised. "*Characteristics Distinguishing Cash and Forward Contracts and 'Trade Options*'", 50 FR 39656-02 (September 30, 1985)

The Commission ratified this interpretation in 1990 in its "*Statutory Interpretation Concerning Forward Transactions*", 55 FR 39188-03 (September 25, 1990) ("*Brent Interpretation*") and again in 2012 its final rule, "*Further Definition of 'Swap,' 'Security-Based Swap,' and 'Security-Based Swap Agreement'; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 FR 48208, 48227-48235 (August 13, 2012) ("*Products Release*"). In doing so, the Commission explicitly rejected the argument that physically-delivered commodity options could fall within the forward contract exclusion.[2]

The interpretation being promulgated today does not change this, and therein lays my concern regarding this interpretation's limits.

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[2] *See also, Products Release* at 4236-37.

I think much of the confusion regarding the seven-part test has been based upon a failure to recognize the difference between forward and option contracts under the Commodity Exchange Act. The fact that a forward contract element and a commodity option are packaged together does not change the regulatory treatment of the different components. Hybrid or packaged instruments are common throughout the industry. There are hybrid or packaged instruments which may have characteristics of futures contracts and securities, swaps and security-based swaps, futures and forward transactions, and even forward contracts and commodity options. Each portion of the contract might be subject to different regulatory treatment. A security does not become a future, nor does a future become a security simply by virtue of being packaged in the same instrument.

Relevant to the instruments we are discussing today, forward contracts with embedded volumetric optionality, it seems that most of them, as described in the comments, have at least two separate, identifiable contractual obligations, each of which must be considered on their own merits. There is a forward contract element which binds the parties to make and take delivery of a set amount of a commodity. In addition, there is an embedded volumetric optionality element that binds the forward contract offeror to make or take delivery of an additional amount of the commodity if the embedded volumetric optionality is exercised by the forward contract offeree. The latter contractual obligation looks like a classic option.

The difficulty this interpretation faces in providing the relief industry seeks is this: even though the embedded optionality has the form of an option, can it somehow fit within the forward exclusion? The answer this interpretation gives is, essentially, yes, it can, if it can be demonstrated that, despite the embedded optionality having the form of an option, it is utilized, in practice, as a forward contract. While the seven-prong test and the interpretive guidance around it do not provide an exact roadmap for determining when embedded volumetric optionality included in a forward contract may or may not fall into the option definition, or when embedded volumetric optionality may undermine a forward contract, I think it does provide a good sense of the factors that parties must consider in making those determinations for themselves.

Such a test, however, is necessarily a facts and circumstances test with no bright lines. Ensuring compliance with this interpretation poses a challenge, and, therefore, that is an area where I would like to see greater legal certainty for these contracts.

In closing, I support this final interpretation, but I think industry would benefit from broader relief that provides greater legal certainty. I look forward to continuing to work with my fellow Commissioners and staff to make sure that commercial entities have access to the tools they need to manage the commercial risks of their operations.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9771 / May 12, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74940 / May 12, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4082 / May 12, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31600 / May 12, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16535

In the Matter of **PAUL TABET,** **Respondent.**	**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 Paul Tabet ("Tabet" or Respondent").

II.

In anticipation of the institution of these proceedings, Respondent Tabet 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, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933, 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 Respondent Tabet's Offer, the Commission finds[1] that:

SUMMARY

1. From approximately October 2010 through September 2012, Tabet and his business partner Craig Berkman ("Berkman") fraudulently raised at least $9.9 million from approximately 110 investors by selling membership interests in limited liability companies ("LLCs") that Berkman controlled, including several LLCs with the words "Ventures Trust" in their names.

2. Tabet made material misrepresentations to investors that he knew, or was reckless in not knowing, were false. For example, Tabet told investors in Ventures Trust II LLC ("Ventures II"), Ventures Trust III LLC ("Ventures III"), Ventures Trust IV LLC ("Ventures IV"), Ventures Trust V LLC ("Ventures V"), Ventures Trust VI LLC ("Ventures VI"), and Ventures Trust Asset Fund LLC ("Ventures Asset Fund") (collectively, the "Ventures LLCs") that their funds would be used to acquire highly coveted, pre-initial public offering ("pre-IPO") shares of Facebook, Inc., LinkedIn, Inc., Groupon, Inc., and Zynga Inc.

3. Instead of using the investor funds to acquire pre-IPO shares or fund technology ventures, Berkman and Tabet misappropriated most of the offering proceeds. Berkman used investor money to make payments to investors in his earlier investment schemes and to some of the victims of this fraud in Ponzi scheme fashion, including approximately $5.43 million to satisfy a prior judgment against him and another $4.8 million to investors who had invested either in this pre-IPO scheme or in other schemes. Berkman also used approximately $1.6 million to fund his own personal expenses, including large cash withdrawals and dining and travel expenses. Tabet used approximately $502,368 of investor proceeds to fund his own personal expenses.

4. Of the $9.9 million raised in the Ventures LLCs, Berkman used $600,000 to purchase a small interest in an unrelated fund that had acquired pre-IPO Facebook stock. That

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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.

purchase did not provide any of the Ventures LLCs, or any other company affiliated with Berkman, with ownership of Facebook shares. Berkman and Tabet nevertheless used a forged letter about that investment to falsely represent to investors that Ventures II owned nearly half a million shares of Facebook stock. Upon discovering the forgery, the fund informed Berkman that it was immediately terminating and liquidating the Ventures II interest.

RESPONDENT

5. **Tabet**, age 51, resides in Encinitas, California. At all relevant times, Tabet provided "day-to-day leadership" for the respective managing members of Ventures LLCs.

6. During the time of the events described herein, Tabet acted as an investment adviser and was associated with two investment advisers, Ventures Trust Management LLC ("Ventures Trust Management") and Ventures Trust Asset Management LLC ("Ventures Trust Asset Management"). Both Tabet and Berkman were responsible for, among other things, the selection of investments and the management of the Ventures LLCs funds.

OTHER RELEVANT PERSONS AND ENTITIES

7. Berkman, age 73, is currently incarcerated in a federal correctional institution in Estill, South Carolina. Berkman has pleaded guilty to criminal conduct relating to the findings in this Order. Specifically, in *United States v. Craig L. Berkman*, Crim. No. 13-CR-00732 (SAS) (S.D.N.Y.) ("Parallel Criminal Action"), Berkman pleaded guilty to violations of Section 10(b) of the Exchange Act [15 U.S.C. §78j(b)], and wire fraud [18 U.S.C. §1343]. In connection with that guilty plea, Berkman admitted, among other things, that:

(a) From around October 2010 through March 2013, he controlled a series of limited liability companies that solicited money from investors. He told investors that their investments would be used to purchase pre-IPO shares of companies, such as Facebook, LinkedIn, Zynga and others, and they were expected to go public soon;

(b) In the course of soliciting investments, he made false statements of material fact. For example, he knowingly over-represented the number of Facebook shares his companies controlled; and

(c) He engaged in further fraud and deceit. He used the money invested with his companies for purposes other than purchasing pre-IPO shares of companies, as he had promised investors. For example, he used close to $6 million to pay creditors in a bankruptcy proceeding.

Among other things, Berkman was sentenced to 72 months imprisonment, three years supervised release, and was ordered to forfeit $13,239,006.

On December 13, 2013, the Commission issued an Order finding that Berkman willfully violated, and willfully aided and abetted and caused violations of, Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, and Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

8. **John B. Kern** ("Kern"), age 50, resides in Charleston, South Carolina. Kern is an attorney licensed to practice law in South Carolina and also has an office in the Republic of San Marino. Kern is or was Ventures II's general counsel. Kern represented Ventures II in the staff's investigation of this matter.

9. **Ventures II** is a Delaware LLC formed on June 15, 2010. Ventures II purported to have offices in Tampa, Florida, Los Angeles, California, and New York, New York. Ventures II purported to be a private equity firm with a "unique opportunity to purchase discounted shares of Facebook." The majority of the investor funds at issue were deposited into Ventures II bank accounts and comingled with investor funds initially deposited into accounts held in the names of the other Ventures LLCs.

10. **Ventures Trust Asset Management** is a Delaware LLC formed on March 7, 2007.

11. **Ventures Trust Management** is a Delaware LLC formed on August 8, 2011.

12. **Ventures III** is a Delaware LLC formed on December 28, 2010. Ventures III purported to have offices in Los Angeles, California. It purported to be a private equity firm with a "unique opportunity to purchase discounted shares" and whose "first investment will be made in LinkedIn."

13. **Ventures IV** is a Delaware LLC formed on January 27, 2011. Ventures IV purported to have offices in Los Angeles, California. Ventures IV purported to be a private equity firm with a "unique opportunity to purchase discounted shares," whose "first investment will be made in Groupon." Ventures IV holds a bank account through which Berkman funneled investor funds and whose title is "Ventures Trust IV Groupon." Berkman was listed as a signatory on the bank account.

14. **Ventures V** is a Delaware LLC formed on January 27, 2011. It also held a bank account through which Berkman funneled investor funds.

15. **Ventures VI** is a Delaware LLC formed on January 27, 2011. It similarly held a bank account through which Berkman funneled investor funds.

16. **Ventures Asset Fund** is a State of Washington LLC formed on January 11, 2007. A portion of the misappropriated investor funds at issue were transferred to Ventures Trust Asset Fund.

17. **Actual Facebook Funds** are two single-purpose, pooled investment vehicles associated with a registered broker-dealer in New York City. The two Actual Facebook Funds both held pre-IPO Facebook stock during the relevant period.

FACTUAL BACKGROUND

Berkman's Prior Securities Violations and Bankruptcy

18. In 2001, the Oregon Division of Finance and Securities issued a cease-and-desist order against Berkman for offering and selling convertible promissory notes without a brokerage license to Oregon residents between 1983 and 1997. Berkman received a $50,000 fine.

19. In June 2008, an Oregon jury found Berkman liable in a private action for breach of fiduciary duty, conversion of investor funds, and misrepresentation to investors, among other things, arising from Berkman's involvement with a series of purported venture capital funds known as Synectic Ventures (collectively "Synectic"). Berkman's improper use of Synectic funds included more than $5 million in purported "personal loans" and the misuse of investor funds to cover personal expenses and execute personal stock purchases. The court entered a $28 million judgment against Berkman ("2008 Oregon Judgment").

20. In March 2009, Synectic filed an involuntary Chapter 7 bankruptcy petition against Berkman in the Middle District of Florida alleging that he owed more than $15.4 million in unpaid debts arising from the 2008 Oregon Judgment. On August 11, 2010, the court entered three judgments against Berkman totaling nearly $15 million, plus 9% interest and costs, deemed non-dischargeable in bankruptcy.

21. The parties to the bankruptcy proceeding then reached a settlement in which Berkman was required to pay $4.75 million in seven installments, beginning on November 30, 2010. After making the first four payments, totaling $1.5 million, Berkman failed to make the fifth payment, due on March 17, 2011. He defaulted on several subsequent revised payment schedules, which also included 5% annual interest. The Chapter 7 Trustee recommenced adversary proceedings, leading to a further revised settlement agreement with a final payment date of May 11, 2012. On May 9, 2012, Berkman paid the remaining balance of more than $3.2 million and the pending adversary proceedings against him were dismissed with prejudice.

22. As detailed below, Berkman used a substantial part of the proceeds of his pre-IPO offering fraud (and none of his own money) to pay the Florida bankruptcy claims.

The Ventures Fraud

23. Tabet met Berkman in 2010 and became aware of the circumstances surrounding the entry of the 2008 Oregon Judgment against Berkman. Nevertheless, Tabet entered into a business relationship with Berkman, and then participated in Berkman's fraud involving the Ventures LLCs.

24. From approximately October 2010 through February 2012, Tabet and Berkman made numerous misrepresentations to Ventures LLC investors when offering and selling

membership interests in the various Ventures LLCs, both orally and in writing, including in the formal offering documents.

25. Tabet and Berkman falsely told investors that each of the Ventures LLCs would use their funds to acquire highly coveted, pre-IPO shares in one or more social media companies that were planning IPOs at the time, including Facebook, LinkedIn, Groupon or Zynga. For example, Tabet and Berkman falsely told certain investors that Ventures II was going to purchase pre-IPO Facebook shares and falsely told other investors that Ventures II had already purchased such shares.

26. Tabet and Berkman sent prospective investors offering documents that contained a host of materially false statements.

27. Tabet and Berkman provided investors with at least three different versions of a private placement memorandum ("Memorandum") for Ventures II and other formal offering materials, all of which contained false statements about acquiring Facebook shares. For example, Tabet provided Memoranda dated November 2010 and September 2011 to certain investors, and Berkman provided a February 2012 Ventures II Memorandum to at least one potential investor. These Memoranda all represent that "investment proceeds will be used to purchase Facebook shares" and that "Facebook shares will be purchased" at various prices per share.

28. Tabet and Berkman also provided investors with the Ventures II operating agreement, which stated that "the purpose of the Company is to acquire Facebook stock." Tabet and Berkman signed Ventures LLC membership certificates falsely stating that the investor was a "registered holder of one unit invested in Facebook." Tabet provided these certificates to investors.

29. Berkman signed letters to Ventures II investors acknowledging receipt of their investment proceeds and falsely stating, among other things, that the "investment was used to purchase . . . shares of Facebook stock at a cost basis of [a certain amount] per share." In addition, Berkman signed Ventures II "Quarterly Reports" and a "Letter of Ownership," which Tabet provided to investors, falsely stating that their Ventures II investment purchased a specific number of shares of pre-IPO Facebook shares at a specific price. Tabet further provided investors with a Ventures II "Facebook Opportunity Fund Overview," which falsely stated that their "investment is solely allocated to the purchase of Facebook stock."

30. Berkman also lied to Ventures II investors about the annual interest rate they would receive. The Ventures II Memoranda and other documents represented that members "will receive a 5% annual simple interest return on the investment until 100% of their principal and accumulated interest has been returned." Berkman signed a quarterly report falsely stating that the value of the investment had increased, apparently due to the 5% annual interest. Tabet gave the quarterly report to Ventures II investors.

31. Tabet knew, or was reckless in not knowing, that these statements were false because none of the Ventures LLCs owned pre-IPO Facebook, LinkedIn, Groupon or Zynga shares and because he and Berkman were personally misappropriating the investors' funds.

32. In late 2010, Ventures II used $600,000 of investor funds to acquire an interest in the Actual Facebook Funds. This acquisition did not entitle Ventures II to the ownership of Facebook shares owned by the Actual Facebook Funds, but it did entitle Ventures II to an approximately 3.19% interest in the Actual Facebook Funds. At most, Ventures II's $600,000 interest in the Actual Facebook Funds represented an indirect interest equivalent to approximately 22,253 shares of Facebook.

33. In September 2011, Kern asked the Law Firm, counsel to the Actual Facebook Funds, for a letter on the firm's letterhead describing Ventures II's interest in the Actual Facebook Funds and Facebook. In response, an associate at the Law Firm sent a letter with his signature to a purported Ventures II office in Manhattan at an address Kern provided. The letter, dated October 19, 2011, was addressed to Berkman and Tabet. The letter accurately stated that Ventures II held a 3.1899% interest in the Actual Facebook Funds and that the Actual Facebook Funds held an unspecified amount of Facebook shares. The letter did not state that Ventures II actually owned any Facebook shares.

34. The letter was subsequently altered with Berkman's participation, knowledge and consent. The altered version was dated February 22, 2012. It was printed on the Law Firm's letterhead and had a forged version of the Law Firm associate's signature on it. The letter falsely represented that the Actual Facebook Funds "ha[ve] allocated 497,625 shares of Facebook, Inc. in Ventures Trust II LLC['s] capital account."

35. In or prior to February 2012, a prospective investor, who was also a securities attorney, asked Tabet for some assurance that Ventures II had acquired the pre-IPO Facebook shares that Tabet had claimed it acquired. In approximately February 2012, Tabet showed the forged letter to the investor, who then invested $108,000 in Ventures II. Tabet refused to let the investor retain a copy of the letter.

36. On February 27, 2012, Tabet sent an email to another prospective investor with a copy of the forged letter attached.

37. On March 1, 2012, the Law Firm wrote a letter addressed to Berkman and Tabet. The letter enclosed a copy of the forged letter and stated that the forged letter "constitutes a fraudulent misrepresentation of your participation and interest in" the Actual Facebook Funds, "since your investment represents only 22,253 shares of Facebook, Inc. stock." The letter continued: "[The forged letter] was not drafted, executed or distributed by this law firm, is an unlawful and unauthorized use of this law firm's name and letterhead and contains a forged signature of an attorney at this law firm." The letter further informed Berkman and Tabet that "[y]our misconduct is consistent with a general pattern of deceit" and therefore that Ventures II's interest in the Actual Facebook Funds "is hereby terminated effective as of the dates of your initial investments."

38. On March 9, 2012, Kern, "as counsel to Ventures [II]," wrote back to the Law Firm. Kern's letter claimed that Ventures II "is the victim of some other party's fabrication of the

letter" and "we do not know the source of that letter." Kern's letter took issue with the termination of "important legal and economic rights of Ventures [II]" and threatened to file an NASD complaint.

39. On approximately March 12, 2012, a partner at the Law Firm informed Kern by telephone that Ventures II's $600,000 interest in the Actual Facebook Funds had been rescinded and that the proceeds would be held in a segregated account to satisfy potential future claims. In other words, Ventures II no longer held even an indirect interest in Facebook shares.

40. Despite Kern's threats of legal action, neither Kern nor anyone else associated with Ventures II took legal action against the Actual Facebook Funds. The Actual Facebook Funds transferred Ventures II's interest to another investor and placed the cash proceeds in a segregated account.

41. In total, Tabet and Berkman raised more than $9.9 million from all the Ventures LLC investors. Of that amount, approximately $6.56 million was deposited in various Ventures II bank accounts, purportedly to be used to acquire pre-IPO Facebook shares; approximately $1.68 million was deposited in a Ventures III account, purportedly to be used to acquire pre-IPO LinkedIn shares; approximately $624,000 was deposited in a Ventures IV account, purportedly to be used to acquire pre-IPO Groupon shares; and approximately $1.07 million was deposited in a Ventures VI account, purportedly to be used to acquire pre-IPO Zynga shares.

42. Other than $600,000 that was used to purchase an interest in the Actual Facebook Funds that was subsequently terminated, none of the Ventures LLCs' investor funds were ever used to purchase pre-IPO shares of Facebook, LinkedIn, Groupon, Zynga, or any other company, as Tabet knew or was reckless in not knowing.

The Misappropriation of Investor Funds

43. None of the statements made by Tabet and Berkman about the use of the funds invested in the Venture LLCs were true. Other than the $600,000 investment in the Actual Facebook Funds, none of the offering proceeds were used to make any investments at all, much less the purchase of pre-IPO shares in Facebook, LinkedIn, Groupon or Zynga.

44. Tabet received approximately $502,368 from accounts into which investor funds were deposited. Berkman personally transferred approximately $5.1 million of investor funds to his personal bank account. Berkman used most of that $5.1 million, plus a $925,000 direct transfer from a Ventures LLC account, to pay his judgment creditors in the bankruptcy proceeding.

45. Berkman used the remaining money that he had transferred to his personal account (approximately $600,000) and another approximately $1 million taken directly from the Ventures LLC accounts to make large cash withdrawals, pay legal fees, fund his own travel and other personal expenses and make numerous other payments unrelated to the purported business of the Ventures LLCs. For example, Berkman spent approximately $300,000 on dining, travel, retail and healthcare expenses and withdrew at least another $165,000 in cash or cash equivalents.

46. The majority of the rest of the offering proceeds, approximately $4.8 million, was used to make payments to earlier investors in the pre-IPO scheme or, in some cases, to investors in Berkman's prior investment schemes. For example, in 2010 and 2011, Berkman transferred $400,000 from a Ventures LLC account to two individuals to whom Berkman owed money from investments they had made in unrelated Berkman ventures in approximately 2004.

Misrepresentations To Conceal The Scheme

47. As the end of the lock up period for pre-IPO Facebook stock approached and investors began making requests for their distributions, the fraud began to unravel. In response, Tabet, Berkman, Kern, and others knowingly or recklessly made, or caused to be made, misrepresentations to investors to keep them from learning of the fraud and demanding the return of their funds.

48. For example, in August 2012, Kern wrote and signed a "Memorandum to Investors About Ventures Trust II LLC Efforts to Secure and Protect Interests with Our Trading Counterparties." Kern's memorandum stated that he was writing "to advise [investors] on the status of our efforts to address concerns that have been raised about the integrity of the funds."

48. Kern's memorandum represented that "Ventures Trust II has utilized two separate counterparties in securing the investments in privately held Facebook stock," and that "we are in the process of attempting to secure the transfer of these shares to our own trading account in order to avoid any complications arising out of the counterparty's trading practices."

49. Kern's memorandum represented that with respect to the first counterparty, "which involves approximately 20% of the investment capital of Ventures Trust II in Facebook stock," the counterparty "and its counsel have repeatedly affirmed that it has the requisite shares and reconfirmed to us that we have the securities interests to which we subscribed." The memorandum then suggested that the counterparty may have "more-or-less fabricated" the price of the shares, creating a "collateral issue," but assured investors that Ventures II would "address this in due course on behalf of our investors," if necessary.

50. Kern's memorandum further represented that the second counterparty "holds approximately 80% of our investments in Facebook."

51. The memorandum also stated that Ventures II "is subject to non-disclosure agreements with [both] counterparties which prevent us from disclosing the identity of these New York based groups at this time" and that Ventures II "is not a Ponzi scheme and absolutely and affirmatively rejects this assertion as false and malicious."

52. These statements were false. Tabet knew, or was reckless in not knowing, that these statements were false.

53. In August 2012, Tabet emailed Kern's memorandum to certain investors, with a copy to Berkman. Berkman thereafter told investors that he had decided to liquidate the fund investments and that the funds would soon start making distributions. Tabet knew, or was reckless in not knowing, that such statements were false.

THE RESPONDENT'S LIABILITY

54. As a result of the conduct described above, Tabet, Ventures II, Ventures III, Ventures IV, Ventures V, Ventures VI, Ventures Asset Fund, Ventures Trust Management, and Ventures Trust Asset Management, committed violations of, and Tabet willfully violated, Sections 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

55. As a result of the conduct described above, Tabet, Ventures Trust Management and Ventures Trust Asset Management committed violations of, and Tabet willfully violated, Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8, which prohibit fraudulent conduct by an investment adviser.

56. As a result of the conduct described above, Tabet willfully aided and abetted and caused: (a) the violations committed by Ventures II, Ventures III, Ventures IV, Ventures V, Ventures VI, Ventures Trust Asset Fund, Ventures Trust Management, Ventures Trust Asset Management, of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder; and (b) the violations committed by Ventures Trust Management, Ventures Trust Asset Management, of Sections 206(1), 206(2) and 206(4) of the Advisers Act and Rule 206(4)-8.

IV.

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

Accordingly, pursuant to 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. Respondent Tabet shall 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 Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

B. Respondent Tabet 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.

C. Any reapplication for association by Respondent Tabet 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 Tabet shall, within 14 days of the entry of this Order, pay disgorgement of $502,368 which represents profits gained as a result of the violations described herein, and prejudgment interest of $30,945. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Respondent Tabet shall also, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $376,776 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment of the foregoing amounts 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 Tabet's name 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 Sanjay Wadhwa, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, New York, NY 10281.

V.

It is further Ordered that, solely 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9770 / May 12, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16534

In the Matter of **THE REGISTRATION STATEMENT OF PURPLEREAL.COM CORP.** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS, MAKING FINDINGS, AND ISSUING STOP ORDER**

I.

A. On March 4, 2014, Respondent filed a Form S-1 registration statement seeking to register a secondary offering by the minority shareholders who purportedly purchased their shares in January 2014 under the exemption provided by Section 4(a)(2) of the Securities Act of 1933 ("Securities Act"). The registration statement was amended on April 9, 2014, May 16, 2014, June 16, 2014, June 25, 2014 and July 1, 2014, and became effective on July 7, 2014. On July 21, 2014, Respondent filed a post-effective amendment to the registration statement which is pending.

B. The Securities and Exchange Commission (the "Commission") deems it appropriate and in the public interest that administrative proceedings be, and hereby are, instituted pursuant to Section 8(d) of the Securities Act to determine whether a stop order should issue suspending the effectiveness of Respondent's registration statement.

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 Proceedings, Making Findings, and Issuing Stop Order (the "Order"), as set forth below.

III.

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

1. Respondent is a Florida corporation headquartered in Sarasota, Florida.

2. On March 4, 2014, Respondent filed a Form S-1 registration statement seeking to register a secondary offering by the minority shareholders who purportedly purchased their shares in January 2014 under the exemption provided by Section 4(a)(2) of the Securities Act. The registration statement was amended on April 9, 2014, May 16, 2014, June 16, 2014, June 25, 2014 and July 1, 2014, and became effective on July 7, 2014 (together, the "Registration Statement"). On July 21, 2014, Respondent filed a post-effective amendment to the Registration Statement which is pending.

3. The Registration Statement includes untrue statements of material facts and omits to state material facts necessary to make the statements contained therein not misleading, for example:

a. The Registration Statement states that "[t]wenty-nine individual security holders invested $300 each for the purchase of their shares. . . . Each of the selling security holders . . . paid $300 for their shares" and "acquired their shares under the exemption provided by § 4(2) [sic] of the Securities Act of 1933." These disclosures are untrue and misleading because all shares were purportedly gifted to the selling security holders by an undisclosed control person.

b. The Registration Statement states that "[t]he selling security holders are offering a maximum of 840,000 shares of common stock." These disclosures are untrue and misleading because many of the selling security holders have never discussed selling their shares or had knowledge of the offering.

c. The Registration Statement states that "there are no transactions involving any Director, Executive Officer, or any security holder who is a beneficial owner or any member of the immediate family of the Officers and Directors except for our President who paid for our incorporation and website costs." These disclosures are untrue and misleading because a corporation controlled by one of Respondent's officers and one of Respondent's security holders fully capitalized Respondent and purportedly gifted all shares to the selling security holders.

d. The Registration Statement states that Respondent's business plan is "to import and sell silk products and costume jewelry from Hong Kong and the People's Republic of China," and that Respondent is "not a 'blank check' company as defined under Rule 419 of the Securities Act of 1933, as amended. Our business plan does not include a merger with, or acquisition of an unidentified company, entity or person." These disclosures are untrue and misleading because Respondent is an undisclosed "blank check company" as defined in Rule 419 under the Securities Act.

e. The Registration Statement states that Respondent's officers "are instrumental in setting our strategic direction, operating our business, identifying expansion opportunities and arranging any necessary financing," and "developed the business model for [Respondent] capitalizing on their expertise and experience from their prior business experience." These disclosures are untrue and misleading because Respondent's officers have not taken any actions with respect to strategic directions or expansion opportunities for Respondent, and have no business experience relevant to Respondent's purported business plan.

f. The Registration Statement states that Respondent is "currently seeking manufacturers from Hong Kong and the People's Republic of China that have distribution outlets in the U.S.," and is "currently in discussion with wholesalers for products to sell . . . that we have contacted." These disclosures are untrue and misleading because Respondent has never sought any manufacturers from Hong Kong or China, and has had no discussions or contact with any wholesaler.

g. The Registration Statement states that Respondent's officers work "approximately twenty-five to thirty (25-30) hours a week on an unpaid basis," have made trips to China and Hong Kong to research and develop relationships with manufacturers, and have spent in excess of two months on research and development. These disclosures are untrue and misleading because Respondent's officers have spent fewer than five (5) hours per week related to Respondent, have made no trips to China and Hong Kong for such purpose, have not developed any relationships with manufacturers from Hong Kong or China, and have collectively performed approximately 40 hours of research and development related to Respondent's purported business plan.

h. The Registration Statement states that "[m]anagement estimates that it will need approximately $6,000 over the next twelve months to fund all of the Company's current product development and marketing projects." These disclosures are untrue and misleading because Respondent's management has made no cost estimates related to any product development or marketing projects.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to issue a stop order suspending the effectiveness of the Registration Statement, as agreed to in Respondent's Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 8(d) of the Securities Act, that the effectiveness of the Registration Statement filed by Respondent be, and hereby is, suspended.

This Order shall be served on Respondent by certified mail forthwith.

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. 74925 / May 12, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16533

In the Matter of Computer Learning Centers, Inc., InferX Corp., and Sedona Corp., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Computer Learning Centers, Inc., InferX Corp., and Sedona Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Computer Learning Centers, Inc. (CIK No. 943206) is a void Delaware corporation located in Fairfax, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Computer Learning Centers is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended October 31, 2000, which reported a net loss of $6,005,000 for the prior nine months. As of May 4, 2015, the company's stock (symbol "CLCXQ") was traded on the over-the-counter markets. On January 25, 2001, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Eastern District of Virginia, which was still pending as of March 20, 2015.

2. InferX Corp. (CIK No. 1329548) is a void Delaware corporation located in Tysons Corner, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). InferX 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, 2012. As of May 4, 2015, the company's stock (symbol "NFRX") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Sedona Corp. (CIK No. 764843) is a Pennsylvania corporation located in King of Prussia, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sedona Corp. 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 $357,000 for the prior three months. As of May 4, 2015, the company's stock (symbol "SDNA") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

4. 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.

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

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74942 / May 13, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16536

In the Matter of **Big Sky Industries II, Inc.,** **Big Sky Industries III, Inc.,** **Big Sky Industries IV, Inc.,** **Big Sky Industries V, Inc.,** **Big Sky Industries VI, Inc.,** **Big Sky Industries VII, Inc.,** **Big Sky Industries VIII, Inc.,** **Big Sky Industries IX, Inc., and** **Big Sky Industries X, 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 Big Sky Industries II, Inc., Big Sky Industries III, Inc., Big Sky Industries IV, Inc., Big Sky Industries V, Inc., Big Sky Industries VI, Inc., Big Sky Industries VII, Inc., Big Sky Industries VIII, Inc., Big Sky Industries IX, Inc., and Big Sky Industries X, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Big Sky Industries II, Inc. (CIK No. 1121812) is a dissolved Florida corporation located in Orlando, Florida with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). Big Sky Industries II is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2008, which reported a net loss of $5,537 for the prior three months.

2. Big Sky Industries III, Inc. (CIK No. 1121813) is a dissolved Florida corporation located in Orlando, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Industries III is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2008, which reported a net loss of $5,537 for the prior three months.

3. Big Sky Industries IV, Inc. (CIK No. 1121814) is a dissolved Florida corporation located in Orlando, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Industries IV is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2008, which reported a net loss of $5,537 for the prior three months.

4. Big Sky Industries V, Inc. (CIK No. 1121816) is a dissolved Florida corporation located in Orlando, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Industries V is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2008, which reported a net loss of $8,611 from the company's January 31, 2000 inception to December 31, 2008.

5. Big Sky Industries VI, Inc. (CIK No. 1121827) is a dissolved Florida corporation located in Orlando, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Industries VI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended December 31, 2008, which reported a net loss of $8,611 from the company's January 31, 2000 inception to December 31, 2008.

6. Big Sky Industries VII, Inc. (CIK No. 1121829) is a dissolved Florida corporation located in Maitland, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Industries VII is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2003, which reported a net loss of $260 for the prior six months.

7. Big Sky Industries VIII, Inc. (CIK No. 1121831) is a dissolved Florida corporation located in Maitland, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Industries VIII is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2003, which reported a net loss of $260 for the prior six months.

8. Big Sky Industries IX, Inc. (CIK No. 1121833) is a dissolved Florida corporation located in Maitland, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Industries IX is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2003, which reported a net loss of $260 for the prior six months.

9. Big Sky Industries X, Inc. (CIK No. 1121834) is a dissolved Florida corporation located in Maitland, Florida with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Big Sky Industries X is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2003, which reported a net loss of $260 for the prior six months.

B. DELINQUENT PERIODIC FILINGS

10. 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.

11. 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.

12. 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31601 / May 14, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16537

In the Matter of **NATIONWIDE LIFE INSURANCE COMPANY** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

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 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against Nationwide Life Insurance Company ("Nationwide" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-And-Desist Order ("Order"), as set forth below.

III.

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

Summary

1. This matter involves Nationwide's processing of purchase and redemption orders for variable insurance contracts and underlying mutual funds (collectively "orders") in violation of Rule 22c-1 under the Investment Company Act.[1] Rule 22c-1 governs the pricing of orders and requires Nationwide to price orders received before 4:00 p.m. at the current day's price and orders received after 4:00 p.m. at the next day's price.

2. From October 1995 through September 2011, Nationwide processed hundreds of thousands of orders sent via U.S. First Class mail by owners of Nationwide's variable annuity and variable life insurance contracts. Nationwide received orders and other mail through various Post Office ("PO") Boxes located at a U.S. Post Office in Columbus, Ohio ("Post Office"). Most Nationwide First Class PO Box mail ("PO Box Mail") became available for retrieval by Nationwide in the early morning. However, during multiple morning trips to the Post Office, Nationwide only picked up the First Class PO Box mail that did not contain orders. Nationwide intentionally delayed retrieving the First Class PO Box mail containing orders until late in the afternoon and waited until after 4:00 p.m. to deliver this mail to Nationwide's home office.

3. Nationwide violated Rule 22c-1 by treating orders contained in this mail as being received after 4:00 p.m. and then processed these orders using the next day's price as opposed to the current day's price. By contrast, Nationwide complied with Rule 22c-1 in processing orders sent via U.S. Postal Service Priority Mail or Priority Express Mail ("Priority Mail"), both of which enabled contract owners to track an order's time of delivery.

Respondent

4. Nationwide Life Insurance Company is a stock life insurance company organized under Ohio law in 1929 and headquartered in Columbus, Ohio. Nationwide is owned by Nationwide Financial Services, Inc. ("Nationwide Financial"), which, in turn, is an indirect subsidiary of Nationwide Mutual Insurance Company and Nationwide Mutual Fire Insurance Company.

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[1] The findings in this Order relate only to Nationwide's processing of subsequent purchase payments and not initial purchase payments, which are separately governed by Rule 22c-1(c) under the Investment Company Act.

Background

A. Variable Insurance Products

5. Variable annuity and variable life insurance contracts (collectively "variable contracts") are two different types of contracts between a purchaser and an insurance company. A variable annuity provides for a cash value that can be paid to the contract owner and lifetime income payments to the annuitant or contract owner that typically begin at retirement. A variable life insurance contract provides for payment equal to the cash value of the policy and a death benefit that is a multiple of the cash value.

6. Variable contracts are redeemable securities issued by insurance company sponsored segregated asset accounts ("separate accounts"), which are registered investment companies. Investors typically purchase variable contracts from an insurance company through an initial purchase payment. If permitted under the variable contract, the contract owner may submit subsequent purchase payments.

7. The separate account uses the purchase payments to acquire shares of underlying mutual funds that are registered investment companies that have contracted with the insurance company to serve as investment options for the variable contract. The value received by the owner of the variable contract at the end of the contract typically depends on the performance of the underlying mutual funds designated by the contract owner. Mutual funds underlying the variable contracts are not sold to the general public, but instead are offered only to insurance company separate accounts. In some cases, the funds are patterned on and managed similarly to corresponding retail funds offered by the mutual fund complex. The underlying mutual fund(s) to which a variable contract's assets are allocated is determined by the contract owner.

B. Rule 22c-1 Under the Investment Company Act

8. Rule 22c-1 promulgated under the Investment Company Act governs the pricing of orders to purchase and redeem shares of redeemable securities issued by registered investment companies, including unit investment trusts (such as variable annuity and variable life separate accounts) ("UITs") and mutual funds.

9. Rule 22c-1(a) requires, among other things, a registered investment company issuing any redeemable security, persons designated in such issuer's prospectus as authorized to consummate transactions in any such security, and principal underwriters of, or dealers in any such security to sell, redeem, or repurchase any such security based on the net asset value ("NAV") of the security next computed after receipt of the order.

10. Rule 22c-1(b) requires that the current NAV be computed at least once daily, Monday through Friday, at a specific time or times as set by the investment company's board of directors. In practice, the NAV of virtually all such registered investment companies is computed once a day as of 4:00 p.m. ET. Thus, orders received prior to 4:00 p.m. ET must be priced at that day's price, *i.e.*, the price computed as of 4:00 p.m., while orders received after 4:00 p.m. ET must be priced at the next day's price, *i.e.*, the price computed as of 4:00 p.m. on the next business day.

C. **Nationwide is Subject to the Pricing Requirements of Rule 22c-1**

11. During the relevant time period, Nationwide was subject to the pricing requirements of Rule 22c-1 at two levels: 1) it was designated in the Nationwide variable contract prospectuses as authorized to consummate transactions in the variable contracts; and 2) it was designated in the prospectuses of the underlying mutual funds as authorized to consummate transactions in underlying mutual fund shares.

1. The Separate Account Level

12. Nationwide issued and/or serviced variable contracts through 35 separate accounts that were registered with the Commission as UITs under the Investment Company Act. Nationwide offered and its affiliates distributed its variable contracts to investors in the United States through prospectuses filed with the Commission.

13. The prospectuses of the variable contracts identified Nationwide as the depositor and sponsoring insurance company responsible for establishing and maintaining the separate accounts. In this capacity, Nationwide had continuing functions and responsibilities with respect to the administration of the affairs of the separate accounts. These disclosed responsibilities included, among other things, accepting redemption orders and purchase payments and investing the payments in variable contracts as directed by the contract owner.

2. The Mutual Fund Level

14. In addition, Nationwide entered into participation agreements with various mutual funds which agreed to serve as investment options for Nationwide's variable contracts. The participation agreements, among other things, designated Nationwide as a limited agent to act on behalf of the mutual funds to receive orders to purchase and redeem fund shares on behalf of Nationwide's separate accounts.

15. Consistent with Nationwide's agency role, the participation agreements further provided that Nationwide's receipt of any purchase or redemption order on any business day constituted receipt of that order by the underlying mutual fund itself.

16. The underlying mutual funds available as investment options within Nationwide's variable contracts disclosed in their prospectuses that the underlying mutual funds were only available through the variable contracts and these prospectuses directed investors to consult the insurance company's own variable contract prospectuses for information about the purchase and redemption of underlying mutual fund shares. In turn, Nationwide's variable contract prospectuses disclosed that Nationwide acted as a limited agent for the underlying mutual funds for purposes of accepting orders.

D. **The Prospectus Disclosures**

17. Nationwide variable contract prospectuses generally stated that orders received at Nationwide's Columbus, Ohio home office ("Home Office") before 4:00 p.m. would receive the

current day's accumulation unit value ("AUV"). The AUV is the measure of the contract owner's investment in a contract and is based on the NAVs of the underlying mutual funds, adjusted for contract charges. Nationwide's prospectuses further disclosed that orders received after 4:00 p.m. would receive the next day's AUV.

18. The prospectuses of the underlying mutual funds also disclosed the same 4:00 p.m. cut-off for determining whether an order was assigned the current day's NAV or the next day's NAV.

Nationwide Failed to Price Orders on a Timely Basis

19. As described below, despite having access to orders contained in the PO Box mail early each morning, Nationwide delayed the retrieval of the orders from the Post Office and waited until after 4:00 p.m. to deliver them to the Home Office. Nationwide then processed these orders using the next day's AUV and transmitted the orders to the mutual funds for processing using the next day's NAV.

20. Throughout the relevant period, Nationwide received orders related to its variable contracts through a variety of methods, including through mail sent to the Post Office or Nationwide's headquarters either by First Class or Priority Mail, electronic orders, telephone requests, and facsimile.

21. Beginning in 1995, Nationwide arranged to receive a variety of customer mail related to its variable contracts and other insurance products through PO Boxes at the Post Office located in Columbus, Ohio. By 2011, Nationwide was leasing at least 46 different PO Boxes at that facility. Through agreements with the Post Office, Nationwide bore the responsibility to retrieve the PO Box mail from the Post Office.

22. Nationwide used its multiple PO Boxes to segregate different types of mail from its customers. By as early as 1:00 a.m. each day, the Post Office received the mail for the current day's delivery and began processing the mail throughout the morning. The Post Office divided the mail into multiple PO Boxes, each of which was assigned to a different Nationwide business unit or product. At Nationwide's request, the Post Office further divided the mail into two groups: PO Box mail directed to Nationwide Financial businesses, which included Nationwide's variable products business ("Variable Contract Mail"), and mail directed to other Nationwide business units ("Other Mail").

23. Each day, the Variable Contract Mail contained, among other things, orders related to Nationwide's variable annuity and variable life insurance contracts subject to Rule 22c-1(a).

24. By 3:00 a.m. each day, the Post Office began placing the divided Variable Contract Mail and Other Mail in separate areas of the Post Office loading dock. This mail accumulated on the loading dock throughout the morning until the processing was completed, which was usually no later than 10:00 a.m. each day.

25. For most of the period, Nationwide hired a private courier to collect and deliver to Nationwide's Home Office the PO Box mail. By having the Post Office separate the Variable Contract Mail from the Other Mail, Nationwide was able to control the precise time that the orders related to its variable contracts were delivered to Nationwide's Home Office.

26. Nationwide instructed its courier to travel to the Post Office at 3:00 a.m., 5:00 a.m. and 7:00 a.m. each business day to retrieve the Other Mail, and specifically instructed the courier not to retrieve the Variable Contract Mail at these times.

27. In addition, Nationwide instructed its courier to travel to the Post Office at 10:00 a.m. each business day to retrieve Priority Mail. This Priority Mail included the same types of orders contained in the Variable Contract Mail except they were mailed differently, such that Priority Mail services generated a record of when a particular piece of mail was delivered to the addressee. Therefore, an investor could verify the Priority Mail's time of delivery to Nationwide's PO Boxes while an investor who used regular First Class mail could not. The courier typically delivered the trackable Priority Mail to Nationwide's Home Office by 11:00 a.m. Nationwide specifically instructed the courier not to retrieve the untrackable Variable Contract Mail when the courier came to retrieve the Priority Mail.

28. With respect to the Variable Contract Mail, Nationwide initially instructed its courier to travel to the Post Office after 4:00 p.m. each business day to retrieve it; and then, after approximately December 2006, to travel to the Post Office after 3:00 p.m. each business day to retrieve it, and deliver it after 4:00 p.m. that business day.

29. On occasion, Nationwide employees complained to members of the Post Office staff when portions of the Variable Contract Mail were inadvertently mixed together with the Other Mail and were therefore delivered to Nationwide before 4:00 p.m.

30. After one such incident, Nationwide requested a meeting with the Post Office, and stressed that it needed "late delivery" of Variable Contract Mail "due to regulations that require Nationwide to process any mail received by 4:00 p.m. the same day."

31. Nationwide also reminded the courier not to deliver the Variable Contract Mail to Nationwide's building before 4:01 p.m. Nationwide informed the courier that it deemed the Variable Contract Mail received when it arrived "in the building." Therefore, Nationwide directed that, even if the courier were to arrive in Nationwide's parking lot before 4:00 p.m., he must wait until 4:01 p.m. before entering the building with the Variable Contract Mail.

32. As a result, some couriers intentionally delayed their arrival time at Nationwide by stopping to purchase meals or fuel.

33. After taking those steps to ensure that delivery of orders contained in the Variable Contract Mail occurred after 4:00 p.m., Nationwide marked the variable contract orders with a post-4:00 p.m. time stamp. Nationwide then processed the orders for pricing at the next day's AUV and transmitted the orders to the underlying mutual funds for pricing at the next day's NAV.

34. By contrast, orders received through Priority Mail were promptly retrieved by the courier and processed by Nationwide before 4:00 p.m. for pricing at the current day's price.

35. Nationwide's intentional delay of the retrieval and delivery of orders contained in the Variable Contract Mail to its Home Office, as described in this Order, did not alter Nationwide's obligation to process the orders using the current day's AUV and to transmit orders to the underlying mutual funds for processing using the current day's NAV. By processing these orders, which were received before 4:00 p.m., using the next day's price, Nationwide violated Rule 22c-1.

Violations

36. As a result of the conduct described above, Nationwide willfully[2] violated Rule 22c-1 promulgated under Section 22(c) of the Investment Company Act. Rule 22c-1(a) requires investment companies, their principal underwriters, dealers, and any person designated in the fund's prospectus as authorized to consummate transactions in the fund's securities, to sell and redeem fund shares at a price based on the NAV next computed after receipt of an order to purchase or redeem.

Nationwide's Remedial Efforts

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

IV.

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

Accordingly, pursuant to Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Nationwide cease and desist from committing or causing any violations and any future violations of Rule 22c-1 under the Investment Company Act.

B. Respondent shall, within 14 days of the entry of this Order, pay a civil money penalty in the amount of $8,000,000 to the Securities and Exchange Commission for transfer to the general fund of 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. Payment must be made in one of the following ways:

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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)).

(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 Nationwide 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 G. Jeffrey Boujoukos, Associate Regional Director, Securities and Exchange Commission, Philadelphia Regional Office, 1617 JFK Boulevard, Suite 520, Philadelphia PA 19103.

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. 4084 / May 15, 2015

Admin. Proc. File No. 3-15581

In the Matter of

TODD NEWMAN

ORDER VACATING BAR

Todd Newman seeks reconsideration of an order ("Order") barring him from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.[1] The Order was issued in an administrative proceeding instituted against Newman under Section 203(f) of the Investment Advisers Act of 1940 based on his criminal conviction for insider trading and a related civil injunction.[2] On December 10, 2014, the United States Court of Appeals for the Second Circuit vacated Newman's criminal conviction and ordered dismissal of the indictment against him.[3] As a result, the civil injunction was also vacated.[4]

In seeking reconsideration of the Order, Newman argues that "there is no basis for the industry bar" because of the Second Circuit decision, and therefore requests that the bar be "removed." The Division of Enforcement does not oppose Newman's request. We have held that administrative bar orders will remain in place in the usual case and are vacated only in

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1 *Todd Newman*, Initial Decision Release No. 562, 2014 WL 507514 (Feb. 10, 2014), *declared final*, Advisers Act Release No. 3804, 2014 WL 1213741 (Mar. 24, 2014).

2 *See United States v. Newman*, No. 1:12-cr-00121 (S.D.N.Y. Dec. 17, 2012); *SEC v. Adondakis*, No. 1:12-cv-00409 (S.D.N.Y. Oct. 4, 2013). Advisers Act Section 203(f) permitted sanctions to be imposed against Newman based on either his conviction or injunction. 15 U.S.C. § 80b-3(f).

3 *United States v. Newman*, 773 F.3d 438, 455 (2d Cir. 2014), *petition for rehearing and rehearing en banc denied*, No. 13-1837 & No. 13-1917 (2d Cir. Apr. 3, 2015). The Second Circuit issued its mandate in the case on April 13, 2015.

4 *SEC v. Adondakis*, No. 1:12-cv-00409 (S.D.N.Y. Dec. 23, 2014).

"compelling circumstances."[5] We have previously found such compelling circumstances where, as here, the basis for the bar imposed has been vacated.[6]

In light of the foregoing, IT IS ORDERED that the Order entered against Todd Newman is hereby vacated.

By the Commission.

Brent J. Fields
Secretary

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

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[5] *Linus N. Nwaigwe*, Exchange Act Release No. 69967, 2013 WL 3477085, at *1 (July 11, 2013).

[6] *See, e.g.*, *id.* (vacating bar where criminal conviction that was the basis for the proceeding was reversed); *Kenneth E. Mahaffy, Jr.*, Exchange Act Release No. 68462, 2012 WL 6608201, at *1 (Dec. 18, 2012) (same). Newman cites no authority for his request that we "expunge" his "record" to remove any reference to the bar, and we are unaware of any such authority. Accordingly, we deny the request. *Cf. Michael Picozzi III*, Exchange Act Release No. 65569, 2011 WL 4889099, at *2 n.5 (Oct. 14, 2011) (denying respondent's request to expunge his CRD record).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4085 / May 15, 2015

Admin. Proc. File No. 3-15580

In the Matter of

ANTHONY CHIASSON

ORDER DISMISSING PROCEEDING

On May 9, 2014, Anthony Chiasson appealed an initial decision by an administrative law judge barring him from association with an investment adviser, broker, dealer, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.[1] The follow-on administrative proceeding was instituted against Chiasson under Section 203(f) of the Investment Advisers Act of 1940 based on his criminal conviction for insider trading and a related civil injunction.[2] On December 10, 2014, while his appeal was pending, the United States Court of Appeals for the Second Circuit vacated Chiasson's conviction and ordered dismissal of the indictment against him.[3] As a result, the injunction was also vacated.[4]

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1 *Anthony Chiasson*, Initial Decision Release No. 589, 2014 WL 1512024 (Apr. 18, 2014), *petition for review granted*, Advisers Act Release No. 3841, 2014 WL 2418767 (May 30, 2014).

2 *See United States v. Newman*, No. 1:12-cr-00121 (S.D.N.Y. Dec. 17, 2012); *SEC v. Adondakis*, No. 1:12-cv-00409 (S.D.N.Y. Oct. 4, 2013). Advisers Act Section 203(f) permitted sanctions to be imposed against Chiasson based on either his conviction or injunction. 15 U.S.C. § 80b-3(f).

3 *United States v. Newman*, 773 F.3d 438, 455 (2d Cir. 2014), *petition for rehearing and rehearing en banc denied*, Nos. 13-1837 & 1917 (2d Cir. Apr. 3, 2015). The Second Circuit issued its mandate on April 13, 2015.

4 *SEC v. Adondakis*, No. 1:12-cv-00409 (S.D.N.Y. Dec. 23, 2014).

Chiasson now requests that we convert his petition for review into a motion to dismiss in light of the vacated criminal and civil judgments.[5] He supports his request by asserting that "the underlying factual predicates that formed the basis for the . . . decision to bar [him] no longer exist." Chiasson also represents that the Division of Enforcement does not oppose his request. Given the subsequent judicial developments, dismissal of the proceeding is appropriate.[6]

Accordingly, it is ORDERED that the administrative proceeding against Anthony Chiasson is dismissed without prejudice.[7]

By the Commission.

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

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5 We previously have converted petitions for review into motions to dismiss in similar circumstances, *see, e.g., Richard L. Goble*, Exchange Act Release No. 68651, 2013 WL 150557, at *1 (Jan. 14, 2013), and do so again here.

6 *See, e.g., Jilaine H. Bauer, Esq.*, Exchange Act Release No. 70631, 2013 WL 5533144, at *2 (Oct. 8, 2013) (dismissing Rule 102(e) disciplinary proceeding after court of appeals reversed predicate district court judgment); *Goble*, 2013 WL 150557, at *2 (dismissing follow-on proceeding after court vacated predicate injunction); *Evelyn Litwok*, Advisers Act Release No. 3438, 2012 WL 3027914, at *1 (July 25, 2012) (dismissing follow-on proceeding after court reversed predicate convictions).

7 Although our Rules of Practice "do not distinguish between dismissing proceedings with or without prejudice," *Goble*, 2013 WL 150557, at*2 (citing *John M. Lucarelli*, Exchange Act Release No. 56075, 2007 WL 2031556, at *2 (July 13, 2007)), we have on occasion exercised our discretion to dismiss proceedings without prejudice where, as here, both parties have agreed to this disposition, and neither party claims any prejudice. *See, e.g., William J. Bosso*, Exchange Act Release No. 43779, 2000 WL 1879160, at *1 (Dec. 28, 2000) (order dismissing proceeding without prejudice); *City of Anaheim*, Securities Act Release No. 7794, 2000 WL 98186, at *1 (Jan. 31, 2000) (same).

Chiasson requested oral argument, but, "because the issues here have been thoroughly briefed, and given the resolution of this matter, we believe there is no prejudice" to Chiasson in denying his request. *D.E. Wine Invs., Inc.*, Exchange Act Release No. 43929, 2001 WL 98581, at *4 n.25 (Feb. 6, 2001). Chiasson also requested that we reverse the law judge's decision, but that decision "ceased to have any force or effect" once we granted his petition for review. *Steven Altman, Esq.*, Exchange Act Release No. 63665, 2011 WL 52087, at *2 (Jan. 6, 2011).

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74977 / May 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16538

In the Matter of **MITCHELL J. STEIN,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3)(i) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Mitchell J. Stein ("Respondent" or "Stein") pursuant to Rule 102(e)(3)(i)[1] of the Commission's Rules of Practice (17 C.F.R. § 200.102(e)(3)(i)).

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[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any attorney . . . who has been by name: (A) [p]ermanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating . . . any provision of the Federal securities laws or of the rules and regulations thereunder; 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) . . . any provision of the Federal securities laws or of the rules and regulations thereunder.

II.

The Commission finds that:

1. Mitchell J. Stein, 48, at all relevant times was an attorney who was admitted to practice in California.

2. On December 20, 2011, the Commission filed a complaint against Stein and others in the United States District Court for the Central District of California (the "Court") alleging that Stein engaged in multiple counts of securities fraud related to the offering and sale of the common stock of Heart Tronics, Inc. ("Heart Tronics") while acting as its outside counsel. *Securities and Exchange Commission v. Heart Tronics, Inc., et al.*, Case No. 8:09-CV-01962-JVS-AN (C.D. Cal.). Specifically, the complaint alleged that Stein orchestrated the repeated announcement of fictitious sales orders for Heart Tronics' products in public filings, press releases and other public broadcasts to inflate the price of Heart Tronics' stock; fabricated documents designed to make it appear that Heart Tronics had entered into viable sales offers; and defrauded an investor into making a substantial investment in Heart Tronics while pocketing the proceeds for his personal use. Through his conduct, the Commission alleged that Stein reaped millions in illegal profits.

3. On February 18, 2015, the Court granted, in part, the Commission's motion for summary judgment against Stein. The Court found that Stein violated Section 17(a) of the Securities Act, Sections 10(b) and 13(b)(5) of the Exchange Act, Rules 10b-5 and 13b2-1thereunder; that he aided and abetted violations of Section 17(a) of the Securities Act, Sections10(b), 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 10b-5, 12b-20, 13a-1, 13a-11, and 13a-13; permanently enjoined him from further violations of those provisions; ordered Stein to disgorge $5,378,581.61 in ill-gotten gains, together with $697,833.91 in prejudgment interest, for a total of $6,076,415.52, in addition to paying a $5,378,581.61 civil penalty; and permanently barred him from serving as an officer or director of a publicly reporting company and from trading in penny stock. *Id.*

III.

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

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

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

If a petition is received within thirty days after service of this Order, the Commission will, within thirty days after the filing of the petition, either lift the temporary suspension, or set the matter down for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

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

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 ACT OF 1933
Release No. 9772 / May 15, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 74976 / May 15, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3656 / May 15, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-15945

In the Matter of **THOMAS A. NEELY, JR.** **Respondent.**	ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS, CEASE-AND-DESIST ORDER, AND PENALTIES PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934

I.

On June 25, 2014, the Securities and Exchange Commission ("Commission") instituted proceedings 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 Thomas A. Neely, Jr. ("Neely" or "Respondent").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions, Cease-and-Desist Order and Penalties Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934, as set forth below.

III.

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

SUMMARY

This proceeding arises from the misconduct of Thomas A. Neely, Jr., ("Neely") and others while employed by Regions Bank and its parent holding corporation, Regions Financial Corporation ("Regions"). During the quarter ended March 31, 2009, in accordance with Regions' policies and procedures, personnel within Regions Bank's Special Asset Department ("SAD") initiated the procedures to place approximately $168 million of certain commercial loans (the "Loans") into non-accrual status. In March 2009, Neely and others, without adequate justification and supporting documentation, took steps to keep the Loans in accrual status. Such steps by Neely and others to evade existing policies and procedures prevented Regions from appropriately measuring impairment in accordance with Generally Accepted Accounting Principles ("GAAP"), rendered Regions' financial statements for the quarter ended March 31, 2009 materially misstated and not prepared in conformity with GAAP, and evidenced a failure by Regions to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the Loans were recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

RESPONDENT

1. Thomas A. Neely, Jr., 54, was formerly an Executive Vice President for Regions' Risk Management Credit Division where he reported to the Chief Credit Officer. Beginning in July 2009, Neely also oversaw Regions' Risk Analytics Group. Together with the titular head of SAD, Neely functionally controlled Regions' SAD. Neely's employment with Regions concluded on November 30, 2010.

RELATED ENTITY

2. Regions Financial Corporation is a Delaware financial holding corporation headquartered in Birmingham, Alabama. Regions conducts its banking operations through its subsidiary Regions Bank, which is a member of the Federal Reserve System. Regions' common stock is registered with the Commission pursuant to Section 12(b) of the Securities Act and trades on the New York Stock Exchange under the symbol "RF." As of December 31, 2013, Regions had approximately $117 billion in assets.

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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.

FACTS

Regions' Tracking of Non-Accrual Loans

3. Throughout the relevant time-period, including the quarter ended March 31, 2009, Regions tracked and recorded its non-performing loans ("NPLs") as part of both internal performance metrics and its regular financial reporting. NPLs at Regions primarily consisted of loans in a non-accrual status.[2]

4. Regions' policies and procedures required that loans be placed on non-accrual status when it was determined that payment of all contractual principal and interest was in doubt, or the loan was past due 90 days or more as to principal and interest, unless the loan was well-secured and in the process of collection. When a loan was placed in non-accrual status, uncollected interest accrued during the current year would be reversed and reduce Regions' interest income. In addition, placing a loan on non-accrual status served as a trigger for Regions to consider whether the specific loan was impaired and thus how to determine an allowance for loan and lease losses in accordance with GAAP.

5. Regions' policies and procedures provided that the decision to recommend a loan for non-accrual status was to be made by Relationship Managers ("RMs") within SAD. RMs were responsible for reviewing loan file details, monitoring payments, and communicating with borrowers. Under Regions' policies and procedures, RMs typically had the greatest degree of knowledge within SAD of the relevant loan status and a borrower's ability to make payments of principal and interest.

6. Regions' policies and procedures required that when RMs initiated an action to place a loan on non-accrual status, they would submit a supporting form to their regional manager that showed their conclusion and justified how they determined a loan should be placed in non-accrual status. Regions' policies and procedures then provided for the regional manager to conduct a detailed review of the loan with the responsible RM, after which, if appropriate, the approval was granted by the regional manager.

7. Once approval for non-accrual classification was granted by the regional manager, Regions' policies and procedures specified that any subsequent exception to classifying the loan in non-accrual status was required to be fully documented and justified on an approved "Recommendation to Continue Accrual Status" form.

8. Once the RM and the regional manager recommended that a loan should be moved to non-accrual status, it was then listed by SAD managers in the Asset Quality Forecast report ("AQF"). The AQF identified which loans had been recommended by the RM and the regional manager for being placed on non-accrual status, and it forecasted charge-offs and non-performing assets for the quarter.

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2 GAAP does not provide guidance regarding placing loans on a non-accrual status.

9. The AQF was a principal forecasting tool of SAD that was prepared under the direction of the Respondent and others. The AQF was discussed weekly at meetings regularly conducted and attended by the Respondent, the head of SAD, and the Chief Credit Officer. Respondent and others also regularly discussed the NPL forecast in presentations to Regions' Executive Council, which consisted of, among others, Regions' Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), in discussing current trends in NPLs.

10. SAD, under the control of Respondent and others, had authority over the preparation, content, and dissemination of the AQF. Once a loan recommended for non-accrual status by the RMs and regional managers was included on the AQF, the responsible RMs would complete information required for a processing list and submit it to Regions' Risk Analytics Group. The processing list was designed as an electronic record documenting the specific actions for individual loans to be formally taken by Regions and reflected in Regions' accounting systems. Following Neely's approval, his subordinates would submit the processing list for the identified loans to be recorded as non-accrual in Regions' accounting systems.

Respondent's Misclassification of Loans and Evasion
of Regions' Policies and Procedures during the Quarter Ended March 31, 2009

11. As of the beginning of March 2009, Regions' AQF identified NPLs of approximately $1.6 billion. Neely and others had discussed between themselves the then current AQF and NPLs. The AQF and related NPLs tracking for the quarter were made available to Regions' CEO and CFO.

12. On or about March 13, 2009, Neely and others in senior management were informed by a subordinate that an error had resulted in an underreporting of NPLs by an amount approximating $200 million, or 13% of the quarter end NPL target that had been communicated to Regions' CEO and CFO.

13. On or about March 17, 2009, the Chief Credit Officer was actively tracking and calculating how NPLs could be decreased by approximately $200 million so as to more closely approach the previously identified NPL target.

14. On or about March 17, 2009, Neely suggested to the Chief Credit Officer and the head of SAD that a $6.8 million commercial loan be recorded as an accruing loan despite being recommended for non-accrual status by the assigned RM and regional manager. This loan was prevented by Neely, without objection from the head of SAD and the Chief Credit Officer, from being placed on the AQF or a processing list and was classified by Regions as being in accrual status as of March 31, 2009. Contrary to Regions' policies and procedures, Neely and others prevented the subject loan from being classified as non-accrual without any documentation or justification.

15. On or about March 18, 2009, Neely and others instructed subordinates to take specific actions to remove from the AQF approximately $150 million of commercial loans that had been recommended by the assigned RMs and regional managers, in accordance with Regions' policies and procedures, as being classified as non-accrual. Neely and others issued such instructions to their subordinates without any documentation or justification supporting the

removal of these loans from the AQF. The head of SAD thereafter was made aware of and did not object to this action by Neely and others. The ultimate effect of these instructions was the improper classification of the Loans, representing approximately $168 million, as being in accrual status. Had Regions classified the relevant loans on non-accrual status in accordance with its policies, it would have prompted a determination that the identified loans were impaired in accordance with GAAP. That determination would have resulted in Regions recording a higher allowance for loan and lease losses.

16. On or about March 23, 2009, the Chief Credit Officer and Neely attended a meeting at which they provided inaccurate information regarding NPLs for the quarter to certain senior executives, including Regions' CFO.

17. In taking the undocumented and unjustified steps above, Neely and others collectively circumvented Regions' policies and procedures regarding the classification of loans into non-accrual status. The actions by Neely and others directly resulted in the improper classification of the Loans pursuant to Regions' policies, and further prevented Regions from appropriately determining those Loans were impaired in accordance with GAAP at the quarter ended March 31, 2009.

18. In accordance with Regions' policies and procedures, the Loans were required to have been classified in non-accrual status at the quarter ended March 31, 2009. Had Regions classified the Loans in non-accrual status in compliance with its policies, it would have prompted a determination that the Loans were impaired in accordance with Statement of Financial Accounting Standard No. 114, Accounting by Creditors for Impairment of a Loan ("SFAS No. 114").[3]

Impact of Respondent's Misconduct on Regions' Financial Statements

19. Respondent circumvented Regions' internal accounting controls through his recording and reporting of the Loans in a manner that was not in accordance with Regions' policies and procedures. As a result, Regions failed to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the Loans were recorded as necessary to permit preparation of financial statements in conformity with GAAP.

20. Respondent's misconduct resulted in Regions' failing to make and keep books, records and accounts in reasonable detail, which accurately and fairly reflected the Loans. Further, Regions' accounts were made inaccurate through the misconduct of the Respondent.

21. The books, records and accounts reflecting the Loans were incorporated into Regions' consolidated financial statements for the quarter ended March 31, 2009. As a result of failing to properly account for the Loans in accordance with GAAP, for the quarter ended March 31, 2009, Regions' income before income taxes was overstated by $16 million, its net income applicable to common shareholders was overstated by approximately $11 million, and its earnings

[3] See SFAS No. 114, which states that "a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement" and it requires lenders to measure impairment based on the present value of expected cash flows or an observable fair value of the collateral (*i.e.*, an appraisal) if the loan is collateral dependent.

per common share was overstated by approximately $.02 per share.

22. The above misstatements were included in Regions' April 21, 2009 press release included in its Form 8-K dated April 21, 2009 and filed with the Commission on April 21, 2009, in its exhibits to its Form 8-K dated May 20, 2009 and filed with the Commission on May 20, 2009, in its March 31, 2009 Form 10-Q filed May 11, 2009, and two subsequent amendments to its March 31, 2009 Form 10-Q filed on May 13, 2009 and June 9, 2009, in a Form S-4 filed on May 20, 2009 and in three subsequent amendments to this registration statement on May 22, 2009, June 4, 2009, and June 9, 2009, and in a Form S-8 filed on August 28, 2009 (collectively, the "Public Filings").

23. The Public Filings did not include other information as was necessary to ensure that the statements made in the Public Filings were not, under the circumstances, materially misleading.

24. The Respondent, in a sub-certification letter signed in April 2009 in connection with the preparation of the reports on Form 10-Q above, misled Regions' Controller and Chief Accounting Officer and its Director of Internal Audit, both accountants, regarding Regions' books, records, accounts, and internal controls.

VIOLATIONS

25. Section 17(a) of the Securities Act prohibits any person, in the offer or sale of any security, from using the means and instrumentalities of interstate commerce and of the mails, directly or indirectly, to: (a) employ any device, scheme, or artifice to defraud; (b) 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 (c) engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

26. Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibit fraudulent conduct in connection with the purchase or sale of securities.

27. Section 20(b) of the Exchange Act makes it unlawful for any person, directly or indirectly, to do any act or thing which it would be unlawful for such person to do under the Exchange Act or any rule or regulation thereunder through or by means of any other person.

28. Section 13(a) of the Exchange Act and Rules 13a-11, 13a-13 and 12b-20 thereunder, requires every issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission information, documents, and current and quarterly reports as the Commission may require, and mandate that current and periodic reports contain such further material information as may be necessary to make the required statements not misleading.

29. Section 13(b)(2)(A) of the Exchange Act requires reporting companies to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

30. Section 13(b)(2)(B) of the Exchange Act requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP.

31. Section 13(b)(5) of the Exchange Act prohibits any person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls, and from knowingly falsifying any book, record, or account, required under Section 13(b)(2) of the Exchange Act.

32. Rule 13b2-1 of the Exchange Act prohibits any person from directly or indirectly falsifying or causing to be falsified any book, record or account subject to Section 13(b)(2)(A) of the Exchange Act.

33. Rule 13b2-2 of the Exchange Act prohibits, among other things, officers of issuers from directly or indirectly making or causing to be made a materially false or misleading statement, or omitting to state any material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to an accountant in connection with any quarterly review or the preparation or filing of any document or report required to be filed with the Commission.

34. As a result of the Respondent's misclassification of Loans as in accrual status as of the quarter ended March 31, 2009, the Respondent violated Section 17(a) of the Securities Act, which prohibits fraudulent conduct in the offer or sale of securities, and Exchange Act Section 10(b) and Rule 10b-5 thereunder, which prohibits fraudulent conduct in connection with the purchase or sale of securities.

35. As a result of the conduct described above, the Respondent acted through Regions to make material misrepresentations in the Public Filings, and as a result, violated Sections 20(b) and 10(b) of the Exchange Act, and Rule 10b-5 thereunder.

36. As a result of the conduct described above, the Respondent caused Regions to violate Section 13(a) of the Exchange Act and Rules 13a-11, 13a-13 and 12b-20 thereunder because its financial statements for the quarter ended March 31, 2009, included in current and quarterly reports, failed to record the Loans in conformity with GAAP.

37. As a result of the conduct described above, the Respondent caused Regions to violate Section 13(b)(2)(A) of the Exchange Act because it did not keep books, records or accounts that accurately reflected the Loans.

38. As a result of the conduct described above, the Respondent caused Regions to violate Section 13(b)(2)(B) of the Exchange Act because it failed to maintain a system of internal accounting controls sufficient to provide reasonable assurances that the Loans were recorded as necessary to permit preparation of its financial statements in accordance with GAAP.

39. As a result of the conduct described above, the Respondent violated Section 13(b)(5) of the Exchange Act when he knowingly circumvented Regions' system of internal accounting controls and knowingly falsified Regions' books, records, and accounts related to the Loans.

40. As a result of the conduct described above, the Respondent violated Rule 13b2-1 of the Exchange Act by directly or indirectly falsifying or causing to be falsified Regions' books, records and accounts relating to the Loans, which were subject to Section 13(b)(2)(A) of the Exchange Act.

41. As a result of the conduct described above, the Respondent violated Rule 13b2-2 of the Exchange Act when he directly or indirectly made or caused to be made materially false or misleading statements, or omitted to state material facts necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading to accountants in connection with the preparation or filing of documents and reports which were required to be filed with the Commission.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Respondent Neely 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, including committing or causing any such violations directly or indirectly through or by means of any other person, as prohibited by Section 20(b) of the Exchange Act, and cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 13(a), 13(b)(2)(A), 13(b)(2)(B), and 13(b)(5) of the Exchange Act and Rules 12b-20, 13a-11, 13a-13, 13b2-1, and 13b2-2 thereunder.

B. Respondent Neely be, and hereby is prohibited for a period of five (5) years from entry of this Order, from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

C. Respondent Neely shall pay a civil money penalty in the amount of $100,000 to the Securities and Exchange Commission. Payment shall be made in the following installments: $10,000 is due on the first of the month following entry of this Order, followed by $5,000 within the next 60 day, $5,000 within an additional 60 days, $5,000 within an additional 60 days, and the remaining $75,000 within one year from the issuance of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance, plus any additional interest accrued pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

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

Payments by check or money order must be accompanied by a cover letter identifying Thomas A. Neely, 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 M. Graham Loomis, Division of Enforcement, Securities and Exchange Commission, 950 East Paces Ferry Road, N.E., Atlanta, GA 30326-1382.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74981; File No. SR-OCC-2014-811)

May 15, 2015

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to an Advance Notice, as Modified by Amendment No. 1 and Amendment No. 2, to Establish Procedures Regarding the Monthly Resizing of its Clearing Fund and the Addition of Financial Resources

On December 1, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-OCC-2014-811 ("Advance Notice") 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)(i) under the Securities Exchange Act of 1934 ("Exchange Act").[2] On December 16, 2014, OCC filed amendment number 1 to the Advance Notice ("Amendment No. 1"), which amended and replaced, in its entirety, the Advance Notice as originally filed on December 1, 2014.[3] The Advance Notice, as modified by Amendment No. 1, was published for comment in the Federal Register on January 26,

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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 Clearing Supervision Act and file advance notices with the Commission. See 12 U.S.C. 5465(e).

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

3 In Amendment No. 1, OCC amended the Advance Notice to include the Monthly Clearing Fund Sizing Procedure and the Financial Resource Monitoring and Call Procedure as exhibits to the filing, both defined hereinafter, as Exhibit 5A and Exhibit 5B, respectively. OCC requested confidential treatment for Exhibit 5A and Exhibit 5B pursuant to the Rule 24b-2 under the Exchange Act.

2015.[4] On January 27, 2015, pursuant to section 806(e)(1)(D) of the Payment, Clearing and Settlement Supervision Act,[5] the Commission required OCC to provide additional information concerning the Advance Notice.[6] On March 4, 2015, OCC filed amendment number 2 to the Advance Notice ("Amendment No. 2"), which amended and replaced, in its entirety, Amendment No. 1.[7] Notice of Amendment No. 2 was published for comment in the Federal Register on April 16, 2015.[8] The Commission did not receive any

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4 Securities Exchange Act Release No. 74091 (January 20, 2015), 80 FR 4001 (January 26, 2015) (SR-OCC-2014-811).

5 12 U.S.C. 5465(e)(1)(D).

6 The Commission received a response from OCC with the further information for consideration on March 17, 2015, which, pursuant to Sections 806(e)(1)(E) and (G) of the Payment, Clearing and Settlement Supervision Act, initiated a new 60 day period of review. See 12 U.S.C. 5465(e)(1)(E) and 12 U.S.C. 5465(e)(1)(G).

7 Amendment No. 2 amended and replaced, in its entirety, Amendment No. 1. OCC filed Amendment No. 2 to clarify the operation of a Margin Call Event, as that term is defined and used hereinafter. To accommodate these clarifications, OCC made conforming changes to Exhibit 5B, the Financial Resources Monitoring and Call Procedure, and added the Clearing Fund Intra-Month Re-sizing Procedure as Exhibit 5C to provide additional clarity regarding the resizing of the clearing fund. OCC requested confidential treatment for Exhibit 5A, Exhibit 5B, and Exhibit 5C pursuant to the Rule 24b-2 under the Exchange Act. In Amendment No. 2, OCC also clarified that the definition of Financial Resources, hereinafter defined, takes into account the margin deposits of a Clearing Member or a Clearing Member Group, as applicable.

8 Securities Exchange Act Release No. 74713 (April 10, 2015), 80 FR 20534 (April 16, 2015) (SR-OCC-2014-811). OCC also filed the proposal contained in the Advance Notice as a proposed rule change under Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder. See Securities Exchange Act Release No. 73853 (December 16, 2014), 79 FR 76417 (December 22, 2014) (SR-OCC-2014-22). On March 13, 2015, OCC withdrew SR-OCC-2014-22 and filed the proposal previously contained therein as SR-OCC-2015-009. See Securities Exchange Act Release No. 74603 (March 27, 2015), 80 FR 17808 (April 2, 2015) (SR-OCC-2015-009). The Commission did not receive any comments on the proposed rule change.

comments on the Advance Notice or any of the amendments thereto. This publication serves as a notice of no objection to the Advance Notice.

I. Description of the Advance Notice

The proposal establishes new procedures to govern: (i) OCC's resizing of the clearing fund on a monthly basis pursuant to OCC Rule 1001(a) ("Monthly Clearing Fund Sizing Procedure"); and (ii) the addition of Financial Resources[9] through an intra-day margin call on one or more Clearing Members[10] pursuant to OCC Rule 609 and, if necessary, an intra-month increase of the clearing fund pursuant to OCC Rule 1001(a) to ensure that OCC maintains adequate Financial Resources in the event of a default of a Clearing Member or Clearing Member Group[11] presenting the largest exposure to OCC ("Financial Resource Monitoring and Call Procedure").[12]

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9 For purposes of this Advance Notice, "Financial Resources" means, with respect to a projected loss that is attributable to a particular Clearing Member or Clearing Member Group, as defined hereinafter, the sum of (i) the margin deposits (less any excess margin a Clearing Member or Clearing Member Group may have on deposit at OCC) and deposits in lieu of margin with respect to the accounts of such Clearing Members or Clearing Member Groups, and (ii) the value of OCC's clearing fund, including both the Base Amount, as defined hereinafter, and the prudential margin of safety, as described below.

10 "Clearing Member" is defined, in relevant part, as a person or organization that has been admitted to membership in the Corporation pursuant to the provisions of the By-Laws and Rules. See OCC By-Laws, Article I.

11 "Clearing Member Group" is defined as a Clearing Member and any Member Affiliates of such Clearing Member. "Member Affiliate" is defined as an affiliated entity of a Clearing Member that controls, is controlled by, or under common control with, the Clearing Member. See OCC By-Laws, Article I.

12 According to OCC, the procedures described herein will be in effect until the development of a new standard clearing fund sizing methodology and a revised methodology for the intra-month increase of Financial Resources. Following such development, OCC has stated that it will file a separate rule change and advance notice with the Commission that will include a description of the new

a. Monthly Clearing Fund Sizing Procedure

According to OCC, under the Monthly Clearing Fund Sizing Procedure, OCC will continue to use its daily stress test exposures under simulated default scenarios (as described in the first sentence of OCC Rule 1001(a)) to calculate the size of the clearing fund and resize the clearing fund on the first business day of each month. However, instead of resizing the clearing fund based on the *average of the daily calculations* during the preceding calendar month, OCC intends to resize the clearing fund using a new formula, which is the sum of: (i) an amount equal to the peak five-day rolling average of clearing fund draws observed over the preceding three calendar months using the daily idiosyncratic default and minor systemic default scenario calculations based on OCC's daily Monte Carlo simulations ("Base Amount"); and (ii) a prudential margin of safety determined by OCC that is currently set at $1.8 billion.[13] OCC believes that the Monthly Clearing Fund Sizing Procedure provides a sound and prudent approach to ensure that it maintains adequate Financial Resources to protect against a default of a Clearing Member or Clearing Member Group presenting the largest exposure to OCC. By sizing the Base Amount of the clearing fund using the peak five-day rolling average over the preceding three month look-back period, rather than an average over the preceding month, OCC

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and revised methodologies as well as a revised Monthly Clearing Fund Sizing Procedure and Financial Resource Monitoring and Call Procedure.

13 According to OCC, it computes its exposure under the idiosyncratic default scenario and minor systemic default scenario on a daily basis. The greater of these two exposures will be that day's peak exposure. To calculate the rolling five-day average, OCC will compute the average of the peak exposure for each consecutive five-day period observed over the prior three-month period. To determine the Base Amount, OCC will use the largest five-day rolling average observed over the past three-months.

believes that the new resizing formula should be more responsive to sudden increases in exposure and less sensitive to short-run reductions in exposures that could inappropriately reduce the overall size of the clearing fund. OCC further asserts that the prudential margin of safety provides an additional buffer to absorb potential future exposures not previously observed during the look-back period. The Monthly Clearing Fund Sizing Procedure will be supplemented by the Financial Resource Monitoring and Call Procedure, which is described below, to provide further assurance that the Financial Resources are adequate to protect against such risk of loss.

b. Financial Resource Monitoring and Call Procedure

According to OCC, under the Financial Resource Monitoring and Call Procedure, OCC will use the same daily idiosyncratic default calculation that is currently used under the Monthly Clearing Fund Sizing Procedure to monitor daily the adequacy of the Financial Resources to withstand a default by the Clearing Member or Clearing Member Group presenting the largest exposure under extreme but plausible market conditions.[14] If such a daily idiosyncratic default calculation projected a draw on the clearing fund ("Projected Draw") that is at least 75% of the clearing fund maintained by OCC, OCC will be required to issue an intra-day margin call pursuant to OCC Rule 609 against the Clearing Member or Clearing Member Group that caused such a draw

14 According to OCC, since the minor systemic default scenario contemplates the simultaneous default of two Clearing Members and OCC maintains Financial Resources sufficient to cover a default by a Clearing Member or Clearing Member Group presenting the greatest exposure to OCC, OCC does not use the minor systemic default scenario to determine the adequacy of the Financial Resources under the Financial Resource Monitoring and Call Procedure.

("Margin Call Event").[15] The amount of the intra-day margin call made pursuant to a Margin Call Event will be the difference between the Projected Draw and the Base Amount of the clearing fund ("Exceedance Above Base Amount").

In the case of a Clearing Member Group that causes the Exceedance Above Base Amount, the Exceedance Above Base Amount will be pro-rated among the individual Clearing Members that compose the Clearing Member Group based on each individual Clearing Member's proportionate share of the total risk for such Clearing Member Group as defined in OCC Rule 1001(b) (i.e., the margin requirement with respect to all accounts of the Clearing Member Group exclusive of the net asset value of the positions in such accounts aggregated across all such accounts). In the case of an individual Clearing Member or a Clearing Member Group, the intra-day margin call will be subject to a limitation under which it cannot exceed the lower of: (a) $500 million; or (b) 100% of the net capital of a Clearing Member (the "500/100 Limitation").[16] This limitation will apply in aggregate to all Margin Call Events within the same monthly period. Therefore,

15 OCC Rule 609 authorizes OCC to require the deposit of additional margin in any account at any time during any business day by any Clearing Member for, among other reasons, the protection of OCC, other Clearing Members or the general public. Under OCC Rule 609, a Clearing Member must meet a required deposit of intra-day margin in immediately available funds at a time prescribed by OCC or within one hour of OCC's issuance of debit settlement instructions against the bank account of the applicable Clearing Member.

16 According to OCC, implementing the 500/100 Limitation on the intra-day margin call avoids placing a "liquidity squeeze" on the subject Clearing Member or Clearing Member Group based on exposures presented by a hypothetical stress test, which otherwise could cause a default on the intra-day margin call. OCC back-testing results determined that intra-day margin calls resulting from a Margin Call Event would have been made against Clearing Members or Clearing Member Groups that are large, well-capitalized firms, with more than sufficient resources to satisfy the call for additional margin subject to the 500/100 Limitation.

if the same Clearing Member or Clearing Member Group is subject to more than one Margin Call Event in the same month, the total amount of funds that are collected cannot exceed the 500/100 Limitation. The 500/100 Limitation will remain in place until OCC has collected all funds to satisfy the next monthly clearing fund resizing.[17]

Additionally, OCC will rely on OCC Rule 608 to preclude the withdrawal of such additional margin amount until all of the funds from the next monthly clearing fund resizing have been collected. Based on three years of back-testing data, OCC determined that a Margin Call Event would have occurred in 10 of the months during this period. During each of these 10 months, the maximum call amount would have been equal to \$500 million.[18] After giving effect to the intra-day margin calls (i.e., increasing the Financial Resources by \$500 million), there was only one Margin Call Event where there was still an observed stress test exceedance of Financial Resources.

To address this one observed instance, the Financial Resource Monitoring and Call Procedure will require OCC to increase the size of the clearing fund, if a Projected Draw exceeds 90% of the clearing fund ("Clearing Fund Intra-month Increase Event"), after applying any funds then on deposit with OCC from the applicable Clearing Member or Clearing Member Group pursuant to a Margin Call Event. The amount of such increase ("Clearing Fund Increase") will be the greater of: (a) \$1 billion; or (b) 125% of the difference between (i) the Projected Draw, as reduced by the deposits resulting from

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17 The Risk Committee of the Board of Directors ("Risk Committee") will be notified, and can take action to address potential Financial Resource deficiencies, in the event that a Projected Draw resulted in a Margin Call Event and, as a result of the 500/100 Limitation, the intra-day margin call is less than the Exceedance Above Base Amount, but the Projected Draw is not large enough to result in an increase in the clearing fund as discussed below.

the Margin Call Event, and (ii) the clearing fund. Each Clearing Member's proportionate share of the Clearing Fund Increase will equal its proportionate share of the variable portion of the clearing fund for the month in question as calculated pursuant to OCC Rule 1001(b).

According to OCC, it will notify the Risk Committee, Clearing Members and appropriate regulatory authorities of the Clearing Fund Increase on the business day that the Clearing Fund Intra-month Increase Event occurs. OCC believes that this will ensure that OCC management maintains authority to address any potential Financial Resource deficiencies when compared to its Projected Draw estimates. The Risk Committee will then determine whether the Clearing Fund Increase is sufficient, and will retain authority under the Risk Committee charter to increase the Clearing Fund Increase or the intra-day margin call made pursuant to a Margin Call Event in its discretion. Clearing Members will be required to meet the call for additional clearing fund assets by 9:00 AM CT on the second business day following the Clearing Fund Intra-Month Increase Event. OCC believes that this collection process ensures that additional clearing fund assets are promptly deposited by Clearing Members following notice of a Clearing Fund Increase, while also providing Clearing Members with a reasonable period of time to source such assets. According to OCC, based on its back-testing results, after giving effect to the intra-day margin call in response to a Margin Call Event plus the prudential margin of safety, the Financial Resources would have been sufficient upon implementing the one instance of a Clearing Fund Intra-month Increase Event.

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[18] The back-testing analysis performed by OCC assumed that a single Clearing Member caused the Exceedance Above Base Amount.

OCC believes the Financial Resource Monitoring and Call Procedure strikes a prudent balance between mutualizing the burden of requiring additional Financial Resources and requiring the Clearing Member or Clearing Member Group causing the increased exposure to bear such burden. In the event a Projected Draw exceeds 75% of the clearing fund, the Clearing Member or Clearing Member Group that triggers the exceedance will be assessed an intra-day margin call to address the increase in exposure.. However, where a Projected Draw exceeds 90% of OCC's clearing fund, OCC determined that it should mutualize the burden of the additional Financial Resources at this threshold through a Clearing Fund Increase. OCC believes that this balance will provide OCC with sufficient Financial Resources without increasing the likelihood that its procedures, based solely on stress testing results, will cause a liquidity strain that could result in the default of a Clearing Member or Clearing Member Group.

II. Discussion and Commission Findings

Although Title VIII does not specify a standard of review for an advance notice, the Commission believes that the stated purpose of Title VIII is instructive.[19] The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically-important financial market utilities and strengthening the liquidity of systemically important financial market utilities.[20]

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

20 Id.

Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act[21] 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[22] 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 ("Clearing Agency Standards").[23] 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.[24] As such, it is appropriate for the

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

22 12 U.S.C. 5464(b).

23 17 CFR 240.17Ad-22.

24 The Clearing Agency Standards are substantially similar to the risk management standards established by the Board of Governors of the Federal Reserve System governing the operations of designated financial market utilities that are not

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.[25]

The Commission believes that the proposal in this Advance Notice is designed to further the objectives and principles of Section 805(b) of the Payment, Clearing and Settlement Supervision Act.[26] The Commission believes that the Monthly Clearing Fund Sizing Procedure and Financial Resource Monitoring and Call Procedure promote robust risk management by setting forth a process that ensures OCC is able to collect funds, in a timely manner, to effectively manage a potential default of a Clearing Member or Clearing Member Group to which it has the greatest exposure. Given that OCC is designated as a systemically-important financial market utility, OCC's ability to effectively manage a default contributes to promoting safety and soundness, reducing systemic risks, and supporting the stability of the broader financial system.

The Commission believes that the proposal in this Advance Notice is consistent with Clearing Agency Standards, in particular, Rule 17Ad-22(b)(3) under the Exchange Act,[27] which, in relevant part, requires registered clearing agencies that perform central counterparty services to establish, implement, maintain and enforce written policies and

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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).

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

26 12 U.S.C 5464(b).

27 17 CFR 240.17Ad-22(b)(3).

procedures reasonably designed to maintain sufficient financial resources to withstand, at a minimum, a default by the participant family to which it has the largest exposure in extreme but plausible market conditions. The Commission believes that this proposal is consistent with Exchange Act Rule 17Ad-22(b)(3)[28] because the Monthly Clearing Fund Sizing Procedure and Financial Resource Monitoring and Call Procedure should ensure that OCC can obtain sufficient financial resources in a timely manner to withstand a default of the Clearing Member or Clearing Member Group presenting it the largest exposure.

By using a peak five-day rolling average and extending the look-back period from one to three calendar months, the Monthly Clearing Fund Sizing Procedure should be more responsive than OCC's existing resizing formula to sudden increases in exposure and less sensitive to short-run reductions in exposure that could inappropriately reduce the overall size of the clearing fund. Furthermore, the prudential margin of safety, which is currently $1.8 billion, will provide an additional buffer to absorb potential future exposures that may not be observed during the look-back period. In addition, the Financial Resource Monitoring and Call Procedure will establish a process by which OCC will be able to respond to increases in exposure on an intra-month basis. In doing so, the Commission believes the Financial Resource Monitoring and Call Procedure should ensure that a balance is struck between mutualizing the burden of the additional financial resources across all Clearing Members, while also requiring the Clearing Member or Clearing Member Group causing the increased exposure to bear the burden.

III. Conclusion

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[28] Id.

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-OCC-2014-811) and that 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 this advance notice proposal (SR-OCC-2015-009), whichever is later.

By the Commission.

Robert W. Errett
Deputy Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74983 / May 18, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16541

In the Matter of **Carter Acquisition Corp. I,** **Carter Acquisition Corp. II,** **Carter Acquisition Corp. III,** **Chatsworth Acquisitions II, Inc., and** **Chatsworth Acquisitions III, 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 Carter Acquisition Corp. I, Carter Acquisition Corp. II, Carter Acquisition Corp. III, Chatsworth Acquisition II, Inc., and Chatsworth Acquisitions III, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Carter Acquisition Corp. I (CIK No. 1377824) is a forfeited Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Carter Acquisition Corp. I is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended September 30, 2007, which reported a net loss of $59,028 from the company's September 11, 2006 inception to September 30, 2007.

2. Carter Acquisition Corp. II (CIK No. 1377825) is a forfeited Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Carter Acquisition Corp. II is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended September 30, 2007, which reported a net loss of $58,772 from the company's September 11, 2006 inception to September 30, 2007.

3. Carter Acquisition Corp. III (CIK No. 1377826) is a Delaware corporation located New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Carter Acquisition Corp. III is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended September 30, 2007, which reported a net loss of $58,898 from the company's September 11, 2006 inception to September 30, 2007.

4. Chatsworth Acquisitions II, Inc. (CIK No. 1372617) 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). Chatsworth Acquisitions II, 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 December 31, 2008, which reported a net loss of $65,616 from the company's July 22, 2005 inception to December 31, 2008.

5. Chatsworth Acquisitions III, Inc. (CIK No. 1372618) 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). Chatsworth Acquisitions III, 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 December 31, 2008, which reported a net loss of $70,832 from the company's July 22, 2005 inception to December 31, 2008.

B. DELINQUENT PERIODIC FILINGS

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

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

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 4087 / May 18, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16542

In the Matter of **TRUST & INVESTMENT ADVISORS, INC., LARRY K. PITTS, AND GEORGE M. PRUGH** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Trust & Investment Advisors, Inc. and Sections 203(f) and 203(k) of the Advisers Act against Larry K. Pitts and George M. Prugh (Trust & Investment Advisors, Inc., Larry K. Pitts and George M. Prugh referred to collectively as "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of the failure of Trust & Investment Advisors, Inc. ("TIA"), a registered investment adviser based in Indiana, its principal, Larry K. Pitts ("Pitts"), and its Senior Vice President/CFO, George M. Prugh ("Prugh"), to correct ongoing securities violations at the advisory firm. During on-site examinations in 2005 and 2007, the Office of Compliance Inspections and Examinations ("OCIE") cited numerous deficiencies, including TIA's failure to complete an annual compliance review or develop a compliance manual and TIA's continued use of misleading statements in its marketing materials. Despite OCIE's warnings of deficiencies resulting in possible securities law violations, and assurances from TIA that its errors would be corrected after the 2005 and 2007 exams, OCIE identified the same deficiencies in its 2011 exam. In addition, Enforcement staff uncovered additional misleading statements in TIA's marketing materials during its investigation. Based on the foregoing, TIA willfully violated, and Pitts and Prugh willfully aided, abetted, and caused TIA's violations of, Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 thereunder.

Respondents

1. Trust & Investment Advisors, Inc. ("TIA") is an Indianapolis-based registered investment adviser that has been registered with the Commission since 1987. TIA provides discretionary portfolio management services to approximately 270 clients with assets under management of approximately $150 million.

2. Larry Keith Pitts, age 76 and a resident of Indianapolis, is the CEO, sole owner, and Portfolio Manager of TIA. Pitts is a Chartered Financial Analyst and has no disciplinary history.

3. George Michael Prugh, age 64 and a resident of Indianapolis, is Senior Vice President, CFO, and Chairman of the Investment Committee for TIA. Prugh is a Certified Public Accountant and also holds Series 7 and Series 63 licenses. Prugh has no disciplinary history.

Facts

4. OCIE conducted three on-site examinations of TIA's advisory business between 2005 and 2011 (first in 2005, second in 2007, and third in 2011). These examinations revealed repeated deficiencies by TIA in the areas of performance advertising and compliance.

5. During the 2005 exam, OCIE discovered and alerted TIA that it had failed to develop compliance policies required by Rule 206(4)-7. Following the 2005 exam, TIA reported that it had "made progress with our written policies and procedures designed to prevent violation

[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.

of the Advisers Act and rules. We will forward you a copy with the typed version of this response." Notwithstanding TIA's promise to remedy its compliance deficiency, OCIE found during its 2007 exam that: (i) TIA still had not yet completed its compliance manual; (ii) TIA had not conducted an annual compliance review; and (iii) TIA's designated Chief Compliance Officer ("CCO A") did not have appropriate knowledge of the Advisers Act (*e.g.*, CCO A was not aware of the requirement to conduct an annual review of TIA's compliance program). OCIE alerted TIA that it was concerned that TIA employed a "cavalier approach to compliance" that called into question TIA's commitment to operate its business in accordance with the federal securities laws. In response to this exam, TIA again assured OCIE that it would remedy its compliance shortcomings. TIA said it would engage a compliance consulting firm ("Firm A") to assist TIA's development of a compliance manual, and that it would provide compliance education to CCO A and other advisory personnel at TIA. However, when OCIE staff returned for the 2011 exam, they discovered TIA had made no progress on its compliance deficiency. At that time, Prugh told OCIE staff that TIA's compliance committee had become inactive, and TIA had not had time since the last exam three years ago to work with Firm A to develop a compliance manual and implement a compliance program. Prugh also told OCIE staff that he was acting as the *de facto* Chief Compliance Officer of TIA because CCO A was unable to complete the requirements of the Series 65 exam.

6. In its 2005 and 2007 exams, OCIE identified several instances where TIA provided misleading performance information to clients in its marketing materials. For example, in its 2007 exam, OCIE found that TIA's one-on-one performance presentations to clients were misleading. The presentations included gross of fee performance returns over an extended period of time; yet, the same presentations did not explain the impact that advisory fees could have on the value of a client's portfolio. Following the 2007 exam, TIA indicated it had corrected this issue. However, when staff returned for the 2011 exam, they discovered that TIA continued to distribute marketing pieces showing bar charts with cumulative returns that did not explain the impact that advisory fees could have on the value of a client's portfolio.

7. OCIE identified additional misleading advertisements in its 2011 exam. In particular, Pitts appeared on a local public access television show (called "Investing Today") and used PowerPoint presentations with charts comparing TIA's cumulative returns over a ten-year period to the S&P 500 returns over that same period. These comparisons were misleading because they neglected to deduct applicable advisory fees from TIA's cumulative returns. Moreover, the charts did not include a disclosure stating that TIA's cumulative returns did not reflect the deduction of advisory fees, and that such fees would reduce client returns. These TV show appearances led to client referrals for TIA.

8. Not only did TIA have the deficiencies OCIE discovered during its exams, but TIA also distributed misleading performance information in weekly summary marketing emails from at least 2009 through 2012. In particular, TIA distributed a table on a weekly basis to some of its current clients and to its solicitors (who are responsible for soliciting new investment advisory business for TIA) that compared percentage increases in the S&P 500 index to percentage increases in TIA's portfolios. The table materially overstated the performance of the TIA portfolios vis-à-vis the S&P 500 index because the TIA performance included the reinvestment of dividends, while the S&P 500 index number did not. At least one of the recipients of one of these

summary emails found the table misleading, emailing Prugh that: "[the] performance table is a bit misleading, though. It really should reflect the total return of the S&P 500 (including the dividends) for a more apples-to-apples comparison vs. the TIA strategies, which include the reinvestment of dividends . . . ." Notwithstanding this critique, TIA continued to send out the same misleading performance information in its weekly marketing emails.

9. Pitts and Prugh were the ultimate decision-makers at TIA. Pitts was and is CEO and Portfolio Manager of TIA. In that position, Pitts managed and supervised TIA's staff (including Prugh) and took primary responsibility for meetings with clients and prospective clients as well as TIA's TV show "Investing Today." Prugh was and is Senior Vice President, CFO, and Chairman of the Investment Committee for TIA. In that position, Prugh assisted in picking the stocks that made up TIA's portfolios and was responsible for TIA's accounting function and tax returns. Both Pitts and Prugh were heavily involved in OCIE's examinations and both failed to prioritize compliance with the Advisers Act.

10. After receiving deficiency letters from OCIE, Pitts and Prugh repeatedly failed to ensure that TIA was in compliance with Advisers Act rules. Neither Pitts nor Prugh took an active role in ensuring compliance with the Advisers Act rules or making sure TIA did not repeat violations identified by OCIE.

11. After OCIE's 2011 examination, TIA began taking steps to rectify the unresolved issues from OCIE's prior examinations. In particular, after that examination, TIA hired a Chief Compliance Officer ("CCO B") who has experience with the Advisers Act, completed its compliance manual, and engaged a compliance consulting firm ("Firm B") to perform annual compliance reviews. Firm B performed compliance reviews in 2012 and 2013. In addition, CCO B reviews all marketing pieces, including the slide deck presentations for "Investing Today," before they are distributed to clients or otherwise used.

Violations

12. As a result of the conduct described above, TIA willfully violated Section 206(2) of the Advisers Act, which prohibits registered investment advisers from, directly or indirectly, engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

13. As a result of the conduct described above, TIA willfully violated Section 206(4) of the Advisers Act, which prohibits registered investment advisers from, directly or indirectly, engaging in any act, practice, or course of business which is fraudulent, deceptive, or manipulative.

14. As a result of the conduct described above, TIA willfully violated Rule 206(4)-1(a)(5), which prohibits registered investment advisers from, directly or indirectly, publishing, circulating, or distributing any advertisement which contains any untrue statement of a material fact, or which is otherwise false or misleading.

15. As a result of the conduct described above, TIA willfully violated Rule 206(4)-7, which requires that a registered investment adviser: (1) adopt and implement written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules; (2) review

at least annually the adequacy of such written policies and procedures and the effectiveness of their implementation; and (3) designate a Chief Compliance Officer.

16. As a result of the conduct described above, Pitts and Prugh willfully aided, abetted, and caused TIA's violation of Section 206(2) of the Advisers Act.

17. As a result of the conduct described above, Pitts and Prugh willfully aided, abetted, and caused TIA's violation of Section 206(4) of the Advisers Act.

18. As a result of the conduct described above, Pitts and Prugh willfully aided, abetted, and caused TIA's violation of Rule 206(4)-1(a)(5).

19. As a result of the conduct described above, Pitts and Prugh willfully aided, abetted, and caused TIA's violation of Rule 206(4)-7.

Remedial Efforts

20. In deciding to accept the offers of settlement of TIA, Pitts, and Prugh, the Commission considered the remedial acts promptly undertaken by TIA, Pitts, and Prugh and the cooperation afforded the Commission staff.

Undertakings

TIA, Pitts, and Prugh have undertaken to:

21. Compliance Training. By December 31, 2015, Pitts and Prugh shall each complete thirty (30) hours of compliance training related to the Advisers Act.

22. Compliance Consultant. TIA shall engage, at its expense, an independent compliance consultant, not unacceptable to the Commission staff, to render compliance services for a period of at least three (3) years from the entry of this Order. The scope of the engagement of the independent compliance consultant must include comprehensive annual compliance reviews. To the extent the independent compliance consultant makes recommendations for changes in or improvements to TIA's policies and procedures and/or disclosures to clients, TIA shall adopt and implement all such recommendations. The independent compliance consultant engaged by TIA shall 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 compliance consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with TIA, 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 compliance consultant will require that any firm with which it is affiliated or of which it is a member, and any person engaged to assist the independent compliance consultant in performance of its duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with TIA, 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.

23. Recordkeeping. TIA shall preserve for a period of no less than six (6) years from the end of the fiscal year last used, the first two (2) years in an easily accessible place, any record of TIA's compliance with the undertakings set forth in this Order.

24. Deadlines. For good cause shown, the Commission staff may extend any of the procedural dates relating to the undertakings. Deadlines for procedural dates shall be counted in calendar days, except that if the last day falls on a weekend or federal holiday, the next business day shall be considered to be the last day.

25. Certification of Compliance. TIA, Pitts and Prugh shall certify, in writing, compliance with the undertakings set forth above in paragraphs 21-22. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and TIA, Pitts, and Prugh agree to provide such evidence. The certification and supporting material shall be submitted to Brian Fagel, Assistant Regional Director, Securities and Exchange Commission, 175 West Jackson Blvd., Suite 900, Chicago, Illinois 60604, or such other address as the Commission staff may provide, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of each of the undertakings in paragraphs 21-22.

IV.

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

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

A. Respondents cease and desist from committing or causing any violations and any future violations of Sections 206(2) and 206(4) of the Advisers Act and Rules 206(4)-1(a)(5) and 206(4)-7 promulgated thereunder.

B. Respondents are censured.

C. TIA and Pitts, jointly and severally, shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $50,000 to the Securities and Exchange Commission for transfer to the general fund of U.S. Treasury in accordance with Exchange Act section 21F(g)(3). Prugh shall, within ten (10) days of the entry of this Order, pay a civil money penalty in the amount of $10,000 to the Securities and Exchange Commission for transfer to the general fund of U.S. 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. 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 TIA, Pitts and Prugh 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 Brian Fagel, Assistant Regional Director, Chicago Regional Office, Securities and Exchange Commission, 175 W. Jackson Blvd., Suite 900, Chicago, Illinois 60604.

D. Respondents shall comply with the undertakings enumerated in Section III., paragraphs 21-25 above.

V.

It is further Ordered that, solely 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 Pitts and Prugh, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Pitts and Prugh 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 Pitts and Prugh 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

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 232

[Release Nos. 33-9773; 34-74982; 39-2503; IC-31604]

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 submission form types for Regulation A. The EDGAR system is scheduled to be upgraded to support this functionality on May 11, 2015.

DATES: Effective [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 Corporate Finance, for questions concerning Regulation A submission form types, contact Heather Mackintosh at (202) 551-8111, 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 and Volume II. The Filer Manual describes the technical formatting requirements for the preparation and submission of electronic filings through the EDGAR system.[1] It also

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[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 April 13, 2015. See Release No. 33-9746 (April 20, 2015) [80 FR 21649].

describes the requirements for filing using EDGARLink Online and the Online Forms/XML Web site.

The revisions to the Filer Manual reflect changes within Volume I entitled EDGAR Filer Manual, Volume I: "General Information," Version 21 (May 2015), and Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 31 (May 2015). 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 15.1.1 on May 11, 2015 and will introduce the following changes:

EDGAR will be updated to add Regulation A submission form types DOS, DOS/A, DOSLTR, 1-A, 1-A/A, 1-A POS, 1-A-W, 1-A-W/A, 253G1, 253G2, 253G3, 253G4, 1-K, 1-K/A, 1-SA, 1-SA/A, 1-U, 1-U/A, 1-Z, 1-Z/A, 1-Z-W, and 1-Z-W/A.

New filers will now be able to select the "Regulation A" option on the Form ID application to indicate that they are submitting an application for EDGAR access to file draft offering statements. If filers have an assigned Central Index Key (CIK), they must use the existing CIK to file draft offering statements.

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

[3] See Release No. 33-9746 in which we implemented EDGAR Release 15.1. For additional history of Filer Manual rules, please see the cites therein.

Regulation A submission form types can be accessed from the "File Regulation A Forms" screen. This screen can be accessed by selecting the 'Regulation A' or 'Draft Offering Statement' link on the EDGAR Filing Web site. Alternatively, this screen can be accessed by selecting the 'REG A' link on the "EDGARLink Online Submission Type Selection" screen.

Issuers who qualify to submit draft offering statements under Regulation A must prepare and submit their draft offering statements using submission form types DOS and DOS/A. Issuers must submit correspondences related to draft offering statements using the submission type, "Draft Offering Statement Letter" (DOSLTR).

Issuers who submit draft offering statements for non-public review will have the ability to publicly disseminate previously submitted drafts by selecting the 'Disseminate Draft Offering Statement' link on the "File Regulation A Forms" screen of the EDGAR Filing Web site.

Issuers may construct XML submissions for Regulation A submission form types with the exception of DOS, DOS/A, and DOSLTR. Issuers must follow the "EDGARLink Online XML Technical Specification" document to construct XML submissions for submission form types 1-A-W, 1-A-W/A, 1-SA, 1-SA/A, 1-U, 1-U/A, 253G1, 253G2, 253G3, 253G4, 1-Z-W, and 1-Z-W/A. Issuers must follow the "EDGAR REG A XML Technical Specification" document to construct XML submissions for submission form types 1-A, 1-A/A, 1-A POS, 1-K, 1-K/A, 1-Z, and 1-Z/A. The Technical Specification documents are available on the SEC's Public Web site (*http://www.sec.gov/info/edgar.shtml*).

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 15.1.1 is scheduled to become available on May 11, 2015. The Commission believes that establishing an effective date less than 30 days after publication of these rules is necessary to coordinate the effectiveness of the updated Filer Manual with the system upgrade.

Statutory Basis

We are adopting the amendments to Regulation S-T under Sections 6, 7, 8, 10, and 19(a) of the Securities Act of 1933,[7] Sections 3, 12, 13, 14, 15, 23, and 35A of the Securities Exchange

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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).

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

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:

§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 21 (May 2015). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer

[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.

Manual, Volume II: "EDGAR Filing," Version 31 (May 2015). 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.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

May 18, 2015

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74995 / May 19, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16544

In the Matter of **Barclay Road Inc.,** **Elsinore Services, Inc.,** **Homeskills, Inc.** **(n/k/a OTC Wireless, Inc.),** **IFU Acquisition Corporation,** **Inca Global Inc.,** **Krause's Furniture, Inc.,** **NxGen Networks, Inc., and** **Teknowledge Corporation,,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS[1]

1. Barclay Road Inc. ("BCLR") (CIK No. 1381873) is a dissolved Wyoming corporation located in Barbourville, Kentucky with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). BCLR is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the

[1]In cases where the short form of the issuer's name is in all capital letters, the short form is also its stock symbol.

period ended September 30, 2012, which reported a net loss of $112,906 for the prior nine months. As of May 18, 2015, the common stock of BCLR was not publicly quoted or traded.

2. Elsinore Services, Inc. ("Elsinore") (CIK No. 1488420) is a void Delaware corporation located in Washington, District of Columbia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Elsinore 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, 2012, which reported a net loss of $80,921 for the prior nine months. As of May 18, 2015, the common stock of Elsinore was not publicly quoted or traded.

3. Homeskills, Inc. (n/k/a OTC Wireless, Inc.) ("OTCL") (CIK No. 1113294) is a delinquent Colorado corporation located in Freemont, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). OTCL is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2005, which reported a net loss of $7,300 for the prior three months. As of May 18, 2015, the common stock of OTCL was traded on the over-the-counter markets.

4. IFU Acquisition Corporation ("IFU Acquisition") (CIK No. 1540701) is a void Delaware corporation located in Daly City, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IFU Acquisition 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, 2012, which reported a net loss of $75,140 for the prior nine months. As of May 18, 2015, the common stock of IFU Acquisition was not publicly quoted or traded.

5. Inca Global Inc. ("Inca") (CIK No. 1497917) is a void Delaware corporation located in Chula Vista, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Inca 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, 2012, which reported a net loss of $7,623,000 for the prior six months. As of May 18, 2015, the common stock of Inca was not publicly quoted or traded.

6. Krause's Furniture, Inc. ("KAUSQ") (CIK No. 701974) is a void Delaware corporation located in Brea, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). KAUSQ 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 24, 2001, which reported a net loss of $28,249,000 for the prior twenty-six weeks. On July 20, 2001, KAUSQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which was converted to a Chapter 7 proceeding on April 4, 2002, and was closed on August 24, 2011. As of May 18, 2015, the common stock of KAUSQ was not publicly quoted or traded.

7. NxGen Networks, Inc. ("NXNW") (CIK No. 1100787) is a revoked Nevada corporation located in Hertford, North Carolina with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). NXNW is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB

for the period ended September 30, 2000, which reported a net loss of $6,895,601 for the prior nine months. As of May 18, 2015, the common stock of NXNW was traded on the over-the-counter markets.

8. Teknowledge Corporation ("TEKCQ") (CIK No. 716214) is a void Delaware corporation located in Palo Alto, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). TEKCQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2007, which reported a net and comprehensive loss of $739,634 for the prior nine months. On October 7, 2010, TEKCQ filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of California, which was closed on June 5, 2013. As of May 18, 2015, the common stock of TEKCQ was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

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. 74994 / May 19, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31609 / May 19, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16543

In the Matter of **Richard Krill,** **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, 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 against Richard Krill ("Krill" or "Respondent") 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").

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 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, Imposing Remedial Sanctions and a Cease-and-Desist Order, and Notice of Hearing, as set forth below.

III.

The Commission's public official files disclose that, at all relevant times, Lighthouse Financial Group, LLC ("Lighthouse" or "the firm") was registered with the Commission as a broker-dealer.

IV.

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

SUMMARY

1. These proceedings arise out of materially inaccurate financial statements filed with the Commission by a former registered broker-dealer, Lighthouse. In preparing Lighthouse's financial statements for the year ended December 31, 2009 and calculating Lighthouse's net capital as of that date, Respondent Krill, Lighthouse's Financial and Operations Principal ("FinOp"), made several errors that caused the firm's reported net capital to be overstated by nearly $5 million, or approximately 350%. These errors were the result of Krill's failure to exercise due care. Specifically, the financial statements were materially inaccurate in that they overstated the firm's assets, because its securities inventory as recorded in its financial statements was based on erroneous and inflated figures for the size of its positions in certain securities, and understated the firm's liabilities by omitting its liabilities to one of the broker-dealers through which it engaged in proprietary trading.

RESPONDENT

2. **Richard Krill**, age 57, of Whitehouse Station, New Jersey, was the FinOp and CFO of Lighthouse from November 2007 to August 2010. At all relevant times and currently, Krill has held a Series 27 license.

OTHER RELEVANT ENTITY

3. **Lighthouse** was registered with the Commission as a broker-dealer from August 2, 2000 until October 23, 2010. In December 2010, Lighthouse filed a petition for liquidation under the U.S. Bankruptcy Code. At all relevant times, Lighthouse's principal place of business was New York, New York. During the relevant period Lighthouse acted as an introducing broker for retail and institutional customers, engaged in proprietary trading and market-making, and acted as

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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.

an underwriter or placement agent for equity and bond issuances. Lighthouse had clearing arrangements with several clearing brokers, including Penson Financial Services, Inc. ("Penson"), which at all relevant times was a registered broker-dealer with its principal place of business in Dallas, Texas.

LIGHTHOUSE'S MATERIALLY MISLEADING FINANCIAL REPORTS

Background

4. Beginning in November 2007, Krill served as Lighthouse's FinOp and CFO and was responsible for preparing and filing Lighthouse's financial and operational information on Form X-17A-5 (Financial and Operational Combined Uniform Single Reports ("FOCUS reports")) and its annual audited financial statements. FOCUS reports and the annual audited reports contain, among other things, the broker-dealer's financial statements and a computation of its net capital.

5. Section 15(c)(3) of the Exchange Act [15 U.S.C. § 78o(c)(3)] and Rule 15c3-1 thereunder [17 CFR 240.15c3-1] require that broker-dealers generally effecting transactions in securities "at all times have and maintain net capital." The rule is designed to require a broker-dealer to maintain sufficient liquid assets to meet all obligations to customers and counterparties and have adequate additional resources to wind down its business in an orderly manner without the need for a formal proceeding if the firm fails financially. The net capital rule requires different minimum amounts of net capital based on the nature of a firm's business and the method a firm uses in computing its net capital.

6. To compute its net capital for purposes of Rule 15c3-1, a broker-dealer first calculates its net worth, computed in accordance with generally accepted accounting principles, deducts the value of certain illiquid assets, and then adds back certain qualifying subordinated loans. The final step is to deduct certain specified percentages, or haircuts, from the market value of the securities or other inventory it holds in its proprietary accounts. Rule 15c3-1 prescribes differing haircut amounts for a variety of classes of securities and other allowable assets.

7. Section 17(e) of the Exchange Act [15 U.S.C. § 78q(e)] and Rule 17a-5 thereunder [17 CFR 240.17a-5] require registered broker-dealers to file with the Commission annual audited reports containing, among other things, the broker-dealer's financial statements for the fiscal year, a calculation of its net capital at fiscal year-end, and a report of an independent auditor on the financial statements.

8. On February 24, 2010, Lighthouse filed an amended FOCUS report for the period ended December 31, 2009 ("December 09 FOCUS report"). On February 28, 2010, Lighthouse filed its audited annual report ("2009 Annual Audited Report"), which contained Lighthouse's financial statements for the year ended December 31, 2009. The 2009 Annual Audited Report also contained Krill's affirmation that, to the best of his knowledge and belief, the accompanying financial statements were true and correct.

9. The financial statements contained in both the December 09 FOCUS report and the 2009 Annual Audited Report (collectively, "December 09 Filings") included the same misstated figures for Lighthouse's assets, liabilities, and haircut deductions and overstated the firm's net capital by approximately $4.9 million, or approximately 350%. The overstatement of Lighthouse's net capital in the December 09 Filings was primarily attributable to the following errors by Krill:

a. First, Krill overstated the value of Lighthouse's assets by incorrectly including approximately $2,052,257 in long securities positions in the firm's proprietary accounts at Penson,[2] and

b. Second, Krill understated Lighthouse's liabilities by omitting approximately $2.3 million owed to Penson.[3]

10. Krill also erred in calculating the haircuts applicable to Lighthouse's assets by using an incorrect formula for the haircut on the firm's equity holdings and failing to take the correct haircuts on certain of the firm's holdings, most significantly its holdings of foreign currency and foreign-denominated securities. These errors resulted in the application of understated haircuts to the firm's overstated assets and thus further inflated the firm's reported net capital.

Errors that Led to Krill's Overstatement of the Firm's Long Securities Positions and Understatement of its Liabilities to Penson

11. Krill's overstatement of the total market value of Lighthouse's long securities positions in its accounts at Penson was the result of his use of erroneous – and overstated – numbers of shares of fifteen securities held in five accounts. Krill calculated the total market value of Lighthouse's inventory in those accounts to be $3,489,971, whereas based on the actual size of the positions as shown in Penson's records, the total market value of Lighthouse's inventory in its Penson accounts was only $1,437,714. Krill thus overstated the value of Lighthouse's long securities positions by approximately $2,052,257. Krill took no steps to verify the accuracy of the share quantities he was using.

12. The December 09 Filings also understated, by approximately $2.3 million, Lighthouse's payables to brokers as a result of Krill's failure to include negative balances in a Lighthouse account at Penson. The account, named "Lighthouse Financial Group F/X Account" ("F/X account"), was one of several Lighthouse accounts at Penson that were used to hold deposits,

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2 The $2,052,257 figure also takes into account a $251,317 understatement of the firm's long securities position that resulted from Krill's failure to include any of the inventory in one of the firm's proprietary accounts.

3 In addition to the amounts due to Penson discussed at paragraphs 11-16 below, this figure includes a $113,002 understatement of Lighthouse's exposure on short positions in Penson accounts.

resolve failed settlement transactions, and pay clearing balances. Positive balances in those accounts represented amounts *due from* Penson to Lighthouse while negative balances represented amounts *due to* Penson from Lighthouse.

13. The balances in the F/X account and other accounts described above appeared on a variety of Penson reports, including reports available through Penson's website. For the amounts due to and from Penson on December 31, 2009, Krill relied on a report titled "balances" that he obtained from Penson's website. That report ("Penson balances report") showed only positive trade date balances, *i.e.* amounts *due from* Penson to Lighthouse. For the F/X account, the Penson balances report showed positive trade date balances, totaling $2,284,644, associated with five currencies (the Danish Krone, the Euro, the Malaysian Ringgit, the Thai Baht, and the U.S. Dollar).

14. Krill knew or should have known that the Penson balances report omitted negative trade date balances – amounts due to Penson from Lighthouse – because the report on its face contained several indications that it did not reflect all of Lighthouse's balances. First, the Penson balances report included a "Total Account Value" for the F/X account of negative $29,840. The negative $29,840 Total Account Value was the net value of the account, meaning that there were negative balances in the account that exceeded the total amount of the positive balances in the account by that amount. Specifically, the existence of a negative figure in the Total Account Value column for the F/X account indicated that in addition to the positive balances, there were negative balances in the account, *i.e.* monies due to Penson from Lighthouse totaling approximately $2.3 million.

15. Second, the Penson balances report also showed the criteria by which it was generated. Those criteria included the account type, date, and "Amount." The entry for "Amount" was "> = 0.00," *i.e.* greater than zero. The Amount criteria thus showed that the inquiry used to generate the report was set to identify only those accounts which had trade date balances greater than zero, that is, amounts *due from* Penson to Lighthouse as of December 31, 2009. As a result of the greater-than-zero criteria, the inquiry excluded amounts *due to* Penson from Lighthouse on that date, *i.e.* Lighthouse liabilities.

16. Third, some of the securities Krill included in his erroneous calculation of the value of Lighthouse's long securities positions traded in currencies that did not appear on the Penson balances report (*e.g.* the British Pound, the Japanese Yen, and the Indonesian Rupiah). This discrepancy should have alerted Krill to the possibility that Lighthouse's F/X account might have balances in currencies that were not reflected on the Penson balances report he relied upon.

Krill's Errors in the Haircut Calculations

17. Krill also made several errors in calculating the required haircut deductions for certain of the holdings in Lighthouse's proprietary accounts that he included in the firm's assets. These errors resulted in the application of understated haircuts to the firm's overstated assets and thus further inflated the firm's net capital reported in the December 09 Filings.

18. First, Krill erroneously calculated the haircut on Lighthouse's equity positions. Under the net capital rule, the haircut on equities for a broker-dealer such as Lighthouse is a function of the greater and lesser of the market value of the broker-dealer's long and short positions in equities.[4] Krill calculated the total market value of Lighthouse's long equity positions to be $4,184,057 and the total market value of its short equity positions to be $1,672,544. Krill's worksheet shows that he incorrectly used the lesser market value in a portion of the calculation where he should have used the greater market value. As a result of this error, the haircut on Lighthouse's reported (and overstated) equities holdings was less than half of what it should have been.

19. Second, Krill failed to take required haircuts on Lighthouse's holdings in foreign-denominated securities and foreign currencies, among other assets, because he failed to apply the additional haircut applicable to foreign-denominated securities and failed to take any haircut at all on the firm's holdings of foreign currencies.[5]

20. Krill knew or should have known that foreign-denominated securities and foreign currencies were among the assets he included when calculating Lighthouse's reported net capital. The Penson balances report showed that some of the amounts Lighthouse was owed by Penson were in specified foreign currencies, and Krill knew or should have known that those balances were

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4 Section 15(c)(3) of the Exchange Act [15 U.S.C. § 78o(c)(3)] and Rule 15c3-1(2)(vi)(J) thereunder [17 CFR 240.15c3-1(2)(vi)(J)] provide:

> In the case of all securities or evidences of indebtedness, except those described in Appendix A, § 240.15c3-1a, which are not included in any of the percentage categories enumerated in paragraphs (c)(2)(vi)(A) through (H) of this section or paragraph (c)(2)(vi)(K)(ii) of this section, the deduction shall be 15 percent of the market value of the greater of the long or short positions and to the extent the market value of the lesser of the long or short positions exceeds 25 percent of the market value of the greater of the long or short positions, the percentage deduction on such excess shall be 15 percent of the market value of such excess.

5 Lighthouse was required to take a haircut of 6% of the U.S dollar equivalent of its holdings of the five major world currencies, including Euros. In addition, it was required to take a 20% haircut on the U.S dollar equivalent of its holdings of other currencies. *See* FINRA Interpretations of Financial and Operational Rules, Rule 15c3-1(c)(2)(vi)/(08), FINRA Regulatory Notice 13-44 (publishing a staff interpretation). The firm was also required to take haircuts (in addition to the required haircut for all equities) of the same percentages on its holdings of securities that traded in foreign currency. FINRA Interpretations of Financial and Operational Rules, Rule 15c3-1(c)(2)(vi)/(9), FINRA Regulatory Notice 13-44 (publishing a staff interpretation).

the result of Lighthouse's trading in foreign-denominated securities. Moreover, some of the securities Krill included in his erroneous calculation of the value of Lighthouse's long securities position were foreign-denominated, including a $295,912 long position in a security denominated in Thai Baht and a $208,190 short position in the same security; a $182,899 long position in a security denominated in the Canadian Dollar; and positions of lesser value in securities denominated in the British Pound, the Euro, the Indonesian Rupiah, and the Japanese Yen. Despite these indicators, Krill failed to take required haircuts on Lighthouse's holdings in foreign-denominated securities and foreign currencies.

21. As a result of Krill's negligence in calculating the required haircut deductions, the haircuts on Lighthouse's holdings were understated, further inflating Lighthouse's net capital reported in the December 09 filings.

22. Lighthouse's FOCUS reports for the months of January, February, and May 2010 were also materially inaccurate because Krill failed to take the required haircuts on Lighthouse's holdings of foreign currency and its positions in foreign-denominated securities.

LEGAL ANALYSIS

Lighthouse's Violations

23. Section 17 of the Exchange Act requires registered broker-dealers to make and disseminate certain financial and operational reports. Rule 17a-3(a)(11) requires that every broker-dealer, among other things, make and keep a record of the computation of aggregate indebtedness and net capital, as of the trial balance date. "The requirements to make and keep required records encompass the requirement that such records be accurate." *Application of PennMont Securities*, Exchange Act Release No. 54434 (Sept. 13, 2006) (Commission opinion sustaining findings concerning violations of books and records and financial reporting provisions). Rule 17a-5(a) requires that certain broker-dealers file an annual audited report that contains the broker-dealer's year-end financial statements and a report on those statements by an independent auditor. Implicit in the requirement that a registered broker-dealer file financial reports is the requirement that the information contained in those reports be accurate. *See Nikko Securities Co. International, Inc.*, Exchange Act Release No. 32331 (May 19, 1993).

24. As described above, Lighthouse failed to make and keep certain accurate records pertaining to its net capital computations and failed to file accurate FOCUS reports for the months of December 2009 and January, February, and May 2010, and also failed to file an accurate annual audited report for the year ended December 31, 2009. The firm therefore violated Section 17 of the Exchange Act and Rules 17a-3(a) and 17a-5(a) thereunder.

Krill's Failure to Exercise Due Care Contributed to Lighthouse's Violations and Caused Lighthouse to Make Materially Inaccurate Statements in Reports Filed with the Commission

25. As a FinOp, Krill was charged, under FINRA Rule 1022, with the following duties, among others:

- final approval and responsibility for the accuracy of financial reports submitted to any duly established securities industry regulatory body;
- final preparation of such reports; and
- supervision and/or performance of the member's responsibilities under all financial responsibility rules promulgated pursuant to the provisions of the [Exchange] Act.

Krill failed to meet his responsibility for the accuracy of Lighthouse's FOCUS reports and annual audited reports. He was, at a minimum, negligent in preparing those reports.

26. As a result of the conduct alleged above, Krill was a cause of Lighthouse's violations of Section 17 of the Exchange Act and Rules 17a-3(a) and 17a-5(a) thereunder.

27. As a result of the conduct alleged above, Krill willfully[6] made, or caused Lighthouse to make, material misstatements in reports required to be filed with the Commission and thus committed acts enumerated in Exchange Act Section 15(b)(4)(A).

V.

Pursuant to this Order, Respondent agrees to additional proceedings in this proceeding to determine what, if any, disgorgement, prejudgment interest, and civil penalties against the Respondent, pursuant to Sections 21B and 21C of the Exchange Act, are in the public interest; and further, Respondent agrees to additional proceedings in this proceeding to determine whether, pursuant to Section 15(b) of the Exchange Act, it is in the public interest to bar the Respondent 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 the purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock. 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

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6 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)).

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 agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 15(b) and Section 21C of the Exchange Act and Section 9(b) of the Investment 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 of the Exchange Act and Rules 17a-3(a) and 17a-5(a) thereunder.

B. Respondent be, and hereby is:

> suspended from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and
>
> 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 12 months, effective on the second Monday following the entry of this Order.

VII.

IT IS FURTHER 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 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.

VIII.

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, prehearing conference or Rules 155(a), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 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 "rulemaking" 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

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No. 31606 / May 19, 2015

In the Matter of

DEUTSCHE BANK AG
Taunusanlage 12
60325 Frankfurt am Main, Germany

DEUTSCHE INVESTMENT MANAGEMENT
AMERICAS INC.
DBX ADVISORS LLC
DBX STRATEGIC ADVISORS LLC
345 Park Avenue
New York, NY 10154

DEUTSCHE ASSET & WEALTH MANAGEMENT
INTERNATIONAL GMBH
Mainzer Landstrasse 178-190
60327 Frankfurt am Main, Germany

DEUTSCHE INVESTMENTS AUSTRALIA LIMITED
Deutsche Bank Place, Level 16
CNR Hunter and Phillip Streets
Sydney, NSW 2000

RREEF AMERICA L.L.C.
DEAWM DISTRIBUTORS, INC.
222 South Riverside Plaza
Chicago, IL 60606

DEUTSCHE ALTERNATIVE ASSET MANAGEMENT
(GLOBAL) LIMITED
Winchester House
1 Great Winchester Street
London, United Kingdom EC2N 2DB

HARVEST GLOBAL INVESTMENTS LIMITED
31/F One Exchange Square
8 Connaught Place
Central, Hong Kong

DB GROUP SERVICES (UK) LTD.
23 Great Winchester Street
London, EC2P 2AX
United Kingdom

812-14448

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 GRANTING A PERMANENT EXEMPTION FROM SECTION 9(a) OF THE ACT

Deutsche Investment Management Americas, Inc., Deutsche Asset & Wealth Management International GmbH, Deutsche Investments Australia Limited, RREEF America L.L.C., Deutsche Alternative Asset Management (Global) Limited, DBX Advisors LLC, DBX Strategic Advisors LLC, DeAWM Distributors, Inc., Harvest Global Investments Limited (the "Fund Servicing Applicants") and DB Group Services (UK) Ltd. (the "Settling Firm" and with the Fund Servicing Applicants, the "Applicants"), and Deutsche Bank AG, filed an application on April 23, 2015 requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting the Fund Servicing Applicants and any other company of which the Settling Firm is or hereafter becomes an affiliated person (together with the Fund Servicing Applicants, the "Covered Persons") from section 9(a) of the Act with respect to a guilty plea entered on April 23, 2015 by the Settling Firm in the United States District Court for the District of Connecticut.

On April 23, 2015, the Commission simultaneously issued a notice of the filing of the application and a temporary conditional order exempting the Covered Persons from section 9(a) of the Act (Investment Company Act Release No. 31577) until the Commission takes final action on the application for a permanent order. The notice gave interested persons an opportunity to request a hearing and stated that an order disposing of the application would be issued unless a hearing was ordered. No request for a hearing has been filed, and the Commission has not ordered a hearing.

The matter has been considered and it is found that the conduct of the applicants has been such as not to make it against the public interest or protection of investors to grant the permanent exemption from the provisions of section 9(a) of the Act.

Accordingly,

IT IS ORDERED, pursuant to section 9(c) of the Act, on the basis of the representations and conditions contained in the application filed by Deutsche Bank AG, et al. (File No. 812-14448) that Covered Persons be and hereby are permanently exempted from the provisions of section 9(a) of the Act, operative solely as a result of the guilty plea, described in the application, entered on April 23, 2015 by the Settling Firm in the United States District Court for the District of Connecticut.

By the Commission.

Robert W. Errett

Robert W. Errett
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 74998 / May 20, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16546

In the Matter of **BHP Billiton Ltd. and BHP Billiton Plc,** **Respondents.**	**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 BHP Billiton Ltd. and BHP Billiton Plc (collectively, "BHPB" or "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting 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 Respondents' Offers, the Commission finds[1] that:

[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.

Summary

1. This matter concerns BHPB's failure to devise and maintain sufficient internal controls over a global hospitality program that the company hosted in connection with its sponsorship of the 2008 Beijing Summer Olympic Games. BHPB invited approximately 176 government officials and employees of state-owned enterprises (collectively, "government officials") to attend the Olympics at BHPB's expense. The majority of these invitations were extended to government officials from countries in Africa and Asia that had well-known histories of corruption. The three to four day hospitality packages included event tickets, luxury hotel accommodations, meals, other hospitality, and, in many instances, offers of business-class airfare for government officials and their guests. BHPB informed its employees that "[o]ne of the core objectives [of the Olympic sponsorship] is to maximize the commercial investment made in the Games through assisting [BHPB] to strengthen relationships with key local and global stakeholders, e.g.: Government Ministers, Suppliers and Customers," and that the hospitality program was "a primary vehicle to ensure this goal is achieved."

2. BHPB recognized that inviting government officials to the Olympics created a heightened risk of violating anti-corruption laws and the company's own Guide to Business Conduct, but the internal controls it developed and relied upon in an effort to address this risk were insufficient. As a result, BHPB invited government officials who were directly involved in, or in a position to influence, pending contract negotiations, efforts to obtain access rights, regulatory actions, or business dealings affecting BHPB in multiple countries. In addition, BHPB's books and records, namely certain internal forms that employees prepared in order to invite a government official to the Olympics, did not, in reasonable detail, accurately and fairly reflect BHPB's pending negotiations or business dealings with the government official at the time of the invitation.

3. As a result of this conduct, BHPB violated the internal controls and books and records provisions of the Foreign Corrupt Practices Act ("FCPA").

Respondent

4. **BHP Billiton ("BHPB")** is a combination of two companies: BHP Billiton Limited, which is headquartered in Melbourne, Australia, and BHP Billiton Plc, which is headquartered in London, England. Since 2001, BHPB has operated under a Dual Listed Company structure, under which BHP Billiton Limited and BHP Billiton Plc operate as a single economic entity, run by a unified Board of Directors and management team. BHP Billiton Limited American Depositary Shares ("ADSs") and BHP Billiton Plc ADSs are registered with the Commission pursuant to Section 12(b) of the Exchange Act and listed on the New York Stock Exchange under the tickers "BHP" and "BBL" respectively.

Background

5. BHPB is a global resources company that is among the world's leading producers of major commodities, including iron ore, coal, oil and gas, copper, aluminum, manganese, uranium, nickel, and silver. As of June 30, 2014, the end of its most recently completed fiscal year, BHPB had a market capitalization of approximately $190 billion, with over 140 locations, operations in 25 countries, and a workforce of more than 128,000 employees and contractors.

6. During the relevant period, BHPB operated through different business divisions, called Customer Sector Groups ("CSGs"). These CSGs included Iron Ore, Aluminium, Petroleum, Base Metals, Diamonds and Specialty Products, Stainless Steel Materials, Manganese,

Metallurgical Coal, and Energy Coal. Each CSG had its own president, which reported to a member of BHPB's Group Management Committee.[2] BHPB also had a Minerals Exploration Group ("MinEx") that assisted the CSGs with exploration activities.

7. Under BHPB's operating model during the relevant period, each CSG President was responsible for ensuring their businesses' compliance with the company's Guide to Business Conduct. Every CSG President also was required to certify annually that they had read and understood the Guide, confirmed that their direct reports had done the same, and discussed it with their direct reports. BHPB had a centralized legal department. In addition, it had an advisory body with internal and external membership called the Global Ethics Panel ("Ethics Panel"), which advised business leaders on compliance with the Guide to Business Conduct and other business ethics issues. BHPB did not have an independent, centralized compliance group within its legal department, or otherwise.

BHPB's Hospitality Program for the 2008 Beijing Summer Olympic Games

A. The Scope and Goals of BHPB's Olympic Hospitality Program

8. In December 2005, BHPB and the Beijing Organizing Committee announced their agreement for BHPB to become an official sponsor of the 2008 Beijing Olympic Games. Under this agreement, BHPB paid a sponsorship fee and supplied the raw materials used to make the Olympic medals. In exchange, BHPB received the rights to use the Olympic trademark and other intellectual property in public announcements and advertisements, as well as priority access to tickets, hospitality suites, and accommodations in Beijing during the August 2008 Games.

9. BHPB established an Olympic Sponsorship Steering Committee ("OSSC") to plan, oversee, and implement its sponsorship program, which involved multiple different branding, promotion, and relationship-building initiatives. The chair of the OSSC, who also was the chair of the Ethics Panel, reported directly to BHPB's CEO.

10. One of BHPB's objectives for the sponsorship was "to reinforce and develop relationships with key stakeholders" in China and in "product and investor markets, and regions where we have or would like to have operations." BHPB's strategy for accomplishing its objectives included "[u]tiliz[ing] Olympic hospitality to motivate China-based stakeholders, including customers, suppliers, government and media, to enhance business opportunities for BHP Billiton in China" and "[u]tiliz[ing] Olympic hospitality to build relationships with stakeholders from product and investor markets, and regions where we have or would like to have operations."

11. One of the company's sponsorship-related initiatives was a global hospitality program under which BHPB invited guests from around the world, including foreign government officials and representatives of state-owned enterprises, to attend the Beijing Olympics on three to four day hospitality packages. The hospitality packages included luxury hotel accommodations, meals, event tickets, and sightseeing excursions, at a cost of approximately $12,000 to $16,000 per package. In addition, BHPB executives approved the offer of round trip business class airfare to approximately 51 foreign government officials, as well as the airfares for 35 of these government

[2] In 2012 and 2013, BHPB re-organized to consolidate the CSGs into five business units: Petroleum and Potash; Copper; Iron Ore; Coal; and Aluminium, Manganese and Nickel.

officials' spouses or guests. Apart from BHPB's desire to enhance business opportunities by strengthening relationships with its guests, these trips had no other business purpose.

12. An internal e-mail to CSG presidents and other senior BHPB business managers emphasized the importance of the hospitality program to the success of BHPB's sponsorship, stating, "[a]s you know we have made a commitment to support the Beijing Olympic Games in 2008. One of the core objectives is to maximise the commercial investment made in the Games through assisting [BHPB] to strengthen relationships with key local and global stakeholders, e.g.: Government Ministers, Suppliers and Customers. The BHP Billiton Hospitality Program is a primary vehicle to ensure this goal is achieved."

13. In early 2007, BHPB employees prepared country-specific Olympic Leverage Plans, which summarized BHPB's business and Olympic-related objectives. In a number of instances, these plans discussed inviting key stakeholders, including government officials, to help BHPB develop relationships with a view to increasing or maintaining its business opportunities. For example, the Olympic Leverage Plan prepared for one country stated that BHPB's business objectives in that country included "gaining access to regions that will provide growth for [BHPB's] business" and "gaining port access." The plan further stated that the hospitality program would "provide useful relationship building opportunity for . . . stakeholders" and that the invitees would include the country's Minister of Mines and Minister of Transport. The Olympic Leverage Plan for another country, while not specifically addressing the hospitality program, stated that one of the goals for the sponsorship was "us[ing] Olympics program to strengthen and build the govt's confidence and relationship with [BHPB], to help facilitate approvals for future projects."

14. After Olympic Leverage Plans were prepared for each country, BHPB business managers submitted lists of potential invitees and were instructed to rank them in order of importance, with "Category A" being those "most critical to the business." Internal BHPB presentations discussed the need to establish "the business benefit" of an Olympic invitation.

15. Eventually, BHPB invited approximately 650 people to attend the Beijing Olympics, including 176 government officials, 98 of whom were representatives of state-owned enterprises that were BHPB customers or suppliers. BHPB also invited the spouses of 102 of these government officials. Most of the invited government officials were from countries in Africa and Asia where there was a known risk of corruption. Sixty of these government officials ultimately attended, 24 of them with their spouses or guests. A number of other invited government officials accepted their invitations, but then cancelled before the Olympics began.

B. BHPB's Insufficient Internal Controls over the Olympic Hospitality Program

16. Early in its planning for the Olympics, BHPB identified the risk that inviting government officials to the Olympics could potentially violate anti-corruption laws and the company's own Guide to Business Conduct. The company relied on its existing operating model and an Olympic-specific internal approval process to address this risk. However, these internal controls, and BHPB's implementation of them, were insufficient.

17. BHPB developed a hospitality application which business managers were required to complete for any individuals, including government officials, whom they wished to invite. These applications included the following questions:

> 9. What business obligation exists or is expected to develop between the proposed invitee and BHP Billiton?

10. Is BHP Billiton negotiating or considering any contract, license agreement or seeking access rights with a third party where the proposed invitee is in a position to influence the outcome of that negotiation?

11. Do you believe that the offer of the proposed hospitality would be likely to create an impression that there is an improper connection between the provision of the hospitality and the business that is being negotiated, considered or conducted, or in any way might be perceived as breaching the Company's Guide to Business Conduct?

If yes, please provide details.

12. Are there other matters relating to the relationship between BHP Billiton and the proposed invitee that you believe should be considered in relation to the provision of hospitality having regard to BHP Billiton's *Guide to Business Conduct*?

18. BHPB required each such application to be filled out and signed by an employee with knowledge of the invitee's relationship with the company, and approved in writing by the president of the relevant CSG or the BHPB country president.[3] A cover sheet that accompanied the blank forms included a short description of anti-bribery provisions in the Guide to Business Conduct and urged employees to re-read the section of the Guide concerning travel, entertainment, and gifts before completing the form. However, the controls did not adequately address the anti-bribery risks associated with offering expensive travel and entertainment packages to government officials.

19. First, BHPB did not require independent legal or compliance review of hospitality applications by someone outside the CSG that was submitting the application, and did not clearly communicate to its employees the fact that the Ethics Panel was not reviewing and approving each invitation to a government official. On the one hand, BHPB's internal website stated that the hospitality applications were subject to "scrutiny by the Ethics Panel [steering committee]," and the hospitality applications themselves stated that, "[r]equests for travel and accompanying spouses will be approved by the Olympic Sponsorship Steering Committee and the Global Ethics Panel Sub-Committee." E-mails sent to some BHPB business managers by a member of the OSSC staff stated that the Ethics Panel had "approved" their applications.

20. However, other than reviewing approximately 10 hospitality applications for government officials in mid-2007 in order to assess the invitation process, the OSSC and the Ethics Panel subcommittee did not review the appropriateness of individual hospitality applications or airfare requests. The Ethics Panel's charter stated that its role simply was to provide advice on ethical and compliance matters, and that "accountability rest[ed] with business leaders." Members of the Ethics Panel understood that, consistent with their charter, their role with respect to implementation of the hospitality program was purely advisory. As a result, business managers had sole responsibility for reconciling the competing goals of inviting guests – including

[3] In countries where multiple CSGs operated, BHPB had employees designated as "country presidents" or "country managers" to coordinate the activities of the various business units.

government officials – who would "maximize [BHPB's] commercial investment made in the Olympic Games" without violating anti-bribery laws.

21. Second, some hospitality applications were not accurate or complete. Many applications identified an employee of a state-owned enterprise as a "Customer," but failed to identify the invitee as a "Representative of Government." In addition, a number of applications contained "No" responses to Question 10, even when BHPB had pending negotiations, efforts to obtain access rights, regulatory actions, or other business dealings in which the government official was directly involved or in a position to influence. Furthermore, in a number of instances, BHPB business people were provided with examples of language that had been used by other employees when responding to Questions 10 and 11 in order to explain why an invitation was appropriate, even when there was a "Yes" response to Questions 10-12. As a result, many hospitality applications contained the exact same statements in response to Questions 10 and 11, rather than a description of the specific facts and circumstances relating to that government official.[4]

22. Third, while BHPB had an annual Guide to Business Conduct review and certification process, and generalized training, it did not provide its employees and executives with any specific training on how to fill out the hospitality forms or how to evaluate whether an invitation to a government official complied with the Guide. During the relevant period, this portion of the Guide included a case example concerning a negotiation between BHPB and a Ministry for Planning in a particular country, in which the Minister indicated that it would help his consideration of the company's application if the Minister and his wife could visit BHPB's operations in Australia. The example stated that "this kind of situation requires the utmost caution and you must consult senior management. You must not offer to provide anything that could be reasonably regarded as an attempt to unduly influence the Minister's decision. This means that you must not pay for travel by the Minister's wife." However, BHPB did not provide any guidance to its senior managers on how they should apply this portion of the Guide when determining whether to approve invitations and airfares for government officials' spouses.

23. Fourth, although the form asked whether any business was "expected to develop" with the invitee, BHPB did not institute a process for updating hospitality applications or reassessing the appropriateness of invitations to government officials if conditions changed. Almost all of the hospitality applications relating to government officials were approved and submitted in mid-2007. However, BHPB did not require hospitality forms to be updated, or invitations to be reconsidered, in those situations when government officials subsequently became involved in negotiations, attempts by BHPB to obtain access rights, or other pending matters.

24. Fifth, hospitality applications were submitted by individual CSGs, and generally only reflected negotiations between the government official and that CSG. While lists of invitees were circulated among senior BHPB business managers, BHPB had no process in place to

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[4] For example, a number of hospitality forms included the following response to Question 10: "Yes, the invitee is in a position to influence the outcome of the pending contract, however, this is an organization that we have been conducting business with for over five years. Negotiations and contract outcomes are a regular occurrence but due to the lengthy relationship with BHP Billiton there is evidence [of] a long term commitment that would not necessarily be influenced by this gesture. It is a way of rewarding the business that has previously been conducted with BHP Billiton."

determine whether the invited government official also was involved in other CSGs' negotiations, efforts to obtain access rights, or other business dealings.

C. As a Result of its Insufficient Internal Controls, BHPB Invited Government Officials who were Directly Involved in, or in a Position to Influence, Pending Negotiations, Regulatory Actions, or Business Dealings with BHPB

25. As a result of its failure to design and maintain sufficient internal controls over the Olympic global hospitality program, BHPB invited a number of government officials who were directly involved with, or in a position to influence, pending negotiations, efforts by BHPB to obtain access rights, or other pending matters.

Republic of Burundi

26. In mid-2007, BHPB's MinEx group submitted a hospitality application form to invite the as-yet-unidentified Burundi Minister of Mines and spouse to the Olympics, with airfare included. Because BHPB was not currently in negotiations with the Minister of Mines at the time, the hospitality application form contained a "No" response to Question 10. However, BHPB had a joint venture ("JV") in Burundi with an entity that was in danger of losing a nickel exploration permit unless it made a substantial near-term financial investment in the project or negotiated a renewal or amendment of the permit. Under Burundi law, the Minister of Mines was responsible for reviewing an application to renew or amend a mining permit and presenting the application to the country's Council of Ministers for final approval.

27. In late 2007 and early 2008, BHPB began to negotiate directly with the newly-appointed Minister of Mines to extend and modify the JV's nickel exploration permit. However, BHPB employees did not update the hospitality application or take steps to re-review the appropriateness of the invitation after these negotiations began. As noted above, no such re-review was required by the internal controls that BHPB relied upon for the Olympic hospitality program. The Minister of Mines and his wife attended the Olympics as BHPB's guests for four days.

Republic of the Philippines

28. In July 2007, BHPB became embroiled in a dispute with a local JV partner concerning a prospective nickel mining operation in the Philippines. The JV partner sued BHPB in local court and filed requests with the country's Secretary of Department of Environment and Resources ("DENR"), requesting reversion of the mining rights that the JV partner had assigned to the JV.

29. In October 2007, a BHPB employee from the Stainless Steel Materials CSG submitted a hospitality application to invite the Secretary and his spouse to attend the Olympics, with airfare included. The completed application contained a "Yes" response to Question 10, but only described a technical services agreement that BHPB was considering submitting to the DENR for the Secretary's approval. Question 10 of the hospitality form did not explicitly require, and the employee's response did not provide, any information about the Secretary's role in reviewing the JV partner's reversion request or the fact that the President of the Philippines had designated the Secretary to mediate the dispute between BHPB and its JV partner. The form included a "No" response to Question 11.

30. The Secretary accepted BHPB's invitation in December 2007. In March 2008, he issued a decision denying the JV partner's reversion request and continued during the ensuing months to mediate the parties' dispute. In late July, BHPB became concerned that the company's

JV partner had learned about the Olympics invitation. As a result, BHPB withdrew the invitation shortly before the Olympics began.

Democratic Republic of the Congo

31. In mid-2007, MinEx submitted a hospitality application form to invite the Governor of the Katanga Province in the Democratic Republic of the Congo (the "DRC") and his spouse, with airfare included. Following its June 2007 review of 10 invitations to government officials, the Ethics Panel subcommittee advised MinEx to provide more detail about whether the invitation involved Gecamines, a state-owned entity with which BHPB was attempting to negotiate a copper exploration deal. In response, MinEx submitted a revised application that contained a "No" response to Question 10, stating, "[t]he issuing and management of mineral titles and negotiations with third parties in DRC have nothing to do with the Governor's roles and responsibilities. Although [BHPB] are currently engaged in negotiations with State copper company, Gecamines, the Governor of Katanga will have no influence in these dealings."

32. Later in 2007, however, BHPB employees held several meetings with the Governor. Internal summaries of these meetings noted that the Governor was "a close ally of [the DRC] President" and that having the Governor as BHPB's ally "could be the key to unlock a successful entry in a deal with Gecamines." In spite of obtaining this information after making the initial decision to invite the Governor of Katanga and his wife to the Olympics, BHPB employees did not update the hospitality application form or take steps to re-review the appropriateness of the invitation. No such re-review was required under the internal controls that BHPB relied upon for the Olympic hospitality program. The Governor accepted the invitation, but then cancelled before the Olympics.

Republic of Guinea

33. In May 2007, MinEx submitted a hospitality application to invite the Guinea Minister of Mines and his spouse to the Olympics, with airfare included. The application contained a "No" response to Question 10, and in response to Question 11 it stated, "No. A sound professional relationship with the Guinea Ministry of Mines is key for the success of the [BHPB] exploration and mining business in this country." Following its June 2007 review of 10 invitations to government officials, the Ethics Panel subcommittee advised MinEx to provide additional information concerning this invitation. The MinEx employee who had prepared the original form asked BHPB's Guinea country president to respond to the request for information concerning any pending negotiations with the Minister. The country president replied that "of course" there would be "further negotiations" regarding the upcoming renewal of a bauxite mining concession held by BHPB and the government's intention to review all existing mining concessions, but that the response to Question 11 was "key in that regard."

34. This information was not passed along to the Ethics Panel subcommittee, however, and the form was not updated to accurately reflect the pending negotiations across all of the CSGs operating in Guinea. Because they received no response to the Guinea country president's email, MinEx officials mistakenly understood that the Ethics Panel had approved the invitation. The Minister accepted the invitation on behalf of himself and his wife in January 2008, but cancelled shortly before the Olympics began.

Legal Standards and FCPA Violations

35. Under Section 21C(a) of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act or any rule or regulation thereunder, and upon any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation.

36. Under Section 13(b)(2)(A) of the Exchange Act, issuers are required 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.

37. Under Section 13(b)(2)(B) of the Exchange Act, issuers are required 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.

38. As a result of the conduct described above, BHPB violated Section 13(b)(2)(A) because its books and records, namely certain Olympic hospitality applications, did not, in reasonable detail, accurately and fairly reflect pending negotiations or business dealings between BHPB and government officials invited to the Olympics. BHPB violated Section 13(b)(2)(B) because it did not devise and maintain internal accounting controls over the Olympic hospitality program that were sufficient to provide reasonable assurances that access to assets and transactions were in executed in accordance with management's authorization.

BHPB's Cooperation and Remedial Efforts

39. In response to the Commission's investigation, BHPB retained outside counsel to assist it with conducting an extensive internal investigation into potential improper conduct in the jurisdictions that were the subject of the staff's inquiry. BHPB provided significant cooperation with the Commission's investigation by voluntarily producing large volumes of business, financial, and accounting documents from around the world in response to the staff's requests, and by voluntarily producing translations of key documents. BHPB's counsel conducted scores of interviews and provided the staff with regular reports on the findings of its internal investigation.

40. BHPB also has undertaken significant remedial actions. BHPB has created a compliance group within its legal department that is independent from the business units. This compliance group is responsible for FCPA compliance, among other things, and reports directly to BHPB's general counsel and Audit Committee. In addition, it has reviewed its existing anti-corruption compliance program and implemented other changes. These include embedding independent anti-corruption managers into its businesses and further enhancing its policies and procedures concerning hospitality, gift giving, use of third party agents, business partners, and other high-risk compliance areas. BHPB also has enhanced its financial and auditing controls, including policies to specifically address conducting business in high-risk markets. BHPB has

conducted extensive employee training on anti-corruption issues and overhauled its processes for conducting internal investigations of potential violations of anti-corruption laws.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents BHP Billiton Ltd.'s and BHP Billiton Plc's Offers.

Accordingly, it is hereby ORDERED that:

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

B. Respondents shall, within 10 days of the entry of this Order, pay a civil money penalty totaling $25,000,000 to the Securities and Exchange Commission for remission to the United States Treasury, subject to Exchange Act Section 21F(g)(3). 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 BHP Billiton Ltd. and BHP Billiton Plc as Respondents in these proceedings, and the file number of these proceedings. A copy of the cover letter and check or money order must be sent to Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

C. During a one-year term as set forth below, Respondents shall report to the Commission staff on the operation of BHPB's FCPA and anti-corruption compliance program. If Respondents discover credible evidence, not already reported to the Commission staff, that: (1) questionable or corrupt payments or questionable or corrupt transfers of property or interests may have been offered, promised, paid, or authorized by Respondents, or any entity or person while working directly for Respondents, to any government official; (2) that related false books and records have been maintained; or (3) that Respondents' internal controls failed to detect and prevent such conduct, Respondents shall promptly report such conduct to the Commission staff. During this one-year period:

(1) Respondents shall submit to the Commission staff a written report within 180 calendar days of the entry of this Order on the operation of BHPB's FCPA and anti-corruption compliance program (the "Initial Report"). The Initial Report shall be transmitted to Alexander Koch, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5041. Respondents may extend the time period for issuance of the Initial Report with prior written approval of the Commission staff.

(2) Respondents shall undertake one follow-up review, incorporating any comments provided by the Commission staff on the Initial Report, to further monitor and assess the operation of its FCPA and anti-corruption compliance program and whether Respondents' policies and procedures are reasonably designed to detect and prevent violations of the FCPA and other applicable anti-corruption laws (the "Final Report").

(3) The Final Report shall be completed by no later than 180 days after the Initial Report, and shall be transmitted to Alexander Koch, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5041. Respondents may extend the time period for issuance of the Final Report with prior written approval of the Commission staff.

(4) The reports submitted by Respondents 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 and responsibilities, or (d) is otherwise required by law.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 210, 230, 232, 239, 240, 249, 270, 274

Release Nos. 33-9776; 34-75002; IC-31610; File No. S7-08-15

RIN 3235-AL42

INVESTMENT COMPANY REPORTING MODERNIZATION

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing new rules and forms as well as amendments to its rules and forms to modernize the reporting and disclosure of information by registered investment companies. The Commission is proposing new Form N-PORT, which would require certain registered investment companies to report information about their monthly portfolio holdings to the Commission in a structured data format. In addition, the Commission is proposing amendments to Regulation S-X, which would require standardized, enhanced disclosure about derivatives in investment company financial statements, as well as other amendments. The Commission is also proposing new rule 30e-3, which would permit but not require registered investment companies to transmit periodic reports to their shareholders by making the reports accessible on a website and satisfying certain other conditions. The Commission is proposing new Form N-CEN, which would require registered investment companies, other than face amount certificate companies, to annually report certain census-type information to the Commission in a structured data format. Finally, the Commission is proposing to rescind current Forms N-Q and N-SAR and to amend certain other rules and forms. Collectively, these amendments would, among other things, improve the information that the Commission receives from

investment companies and assist the Commission, in its role as primary regulator of investment companies, to better fulfill its mission of protecting investors, maintaining fair, orderly and efficient markets, and facilitating capital formation. Investors and other potential users could also utilize this information to help investors make more informed investment decisions.

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

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

Electronic comments:

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/proposed.shtml*);
- Send an email to *rule-comments@sec.gov*. Please include File No. S7-08-15 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-08-15. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (*http://www.sec.gov/rules/proposed.shtml*). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information you wish to make available publicly.

Studies, memoranda, or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by email.

FOR FURTHER INFORMATION CONTACT: Daniel K. Chang, Senior Counsel, J. Matthew DeLesDernier, Senior Counsel, Jacob D. Krawitz, Senior Counsel, Andrea Ottomanelli Magovern, Senior Counsel, Michael C. Pawluk, Branch Chief, or Sara Cortes, Senior Special Counsel, at (202) 551-6792, Investment Company Rulemaking Office, Alan Dupski, Assistant Chief Accountant, Chief Accountant's Office, at (202) 551-6918, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission (the "Commission") is proposing for comment new Form N-PORT [referenced in 17 CFR 274.150], new Form N-CEN [referenced in 17 CFR 274.101] under the Investment Company Act of 1940 [15 U.S.C. 80a-1 *et seq.*] ("Investment Company Act"); new rules 30a-4 [17 CFR 270.30a-4], 30b1-9 [17 CFR 270.30b1-9] and 30e-3 [17 CFR 270.30e-3] under the Investment Company Act; rescission of rules 30b1-1

[17 CFR 270.30b1-1], 30b1-2 [17 CFR 270.30b1-2], 30b1-3 [17 CFR 270.30b1-3], and 30b1-5 [17 CFR 270.30b1-5] under the Investment Company Act; amendments to rules 8b-16 [17 CFR 270.8b-16], 8b-33 [17 CFR 270.8b-33], 10f-3 [17 CFR 270.10f-3], 30a-1 [17 CFR 270.30a-1], 30a-2 [17 CFR 270.30a-2], 30a-3 [17 CFR 270.30a-3], and 30d-1 [17 CFR 270.30d-1] under the Investment Company; amendments to Forms N-1A [referenced in 17 CFR 274.11A], N-2 [referenced in 274.11a-1], N-3 [referenced in 274.11b], N-4 [referenced in 17 CFR 274.11c], and N-6 [referenced in 17 CFR 274.11d] under the Investment Company Act and the Securities Act of 1933 [15 U.S.C. 77a *et seq.*] ("Securities Act"); amendments to rule 498 [17 CFR 230.498] and Form N-14 [referenced in 17 CFR 239.23] under the Securities Act; rescission of Form N-SAR [referenced in 17 CFR 274.101 and Form N-Q [referenced in 17 CFR 274.130] and amendments to Form N-CSR [referenced in 17 CFR 274.128] under the Investment Company Act and Securities Exchange Act of 1934 [15 U.S.C. 78a *et seq.*] ("Exchange Act"); amendments to rules 10A-1 [17 CFR 240.10A-1], 12b-25 [17 CFR 240.12b-25], 13a-10 [17 CFR 240.13a-10], 13a-11 [17 CFR 240.13a-11], 13a-13 [17 CFR 240.13a-13], 13a-16 [17 CFR 240.13a-16], 14a-16 [17 CFR 240.14a-16]; 15d-10 [17 CFR 240.15d-10], 15d-11 [17 CFR 240.15d-11], 15d-13 [17 CFR 240.15d-13], and 15d-16 [17 CFR 240.15d-16] under the Exchange Act; rescission of section 332 [17 CFR 249.332] and amendments to sections 322 [17 CFR 249.322] and 330 [17 CFR 249.330] of 17 CFR Part 249; amendments to Article 6 [17 CFR 210.6-01 *et seq.*] and Article 12 [17 CFR 210.12-01 *et seq.*] of Regulation S-X [17 CFR 210]; amendments to section 800 of 17 CFR Part 200 [17 CFR 200.800]; and amendments to rules 105 [17 CFR 232.105], 301 [17 CFR 232.301], and 401 [17 CFR 232.401] of Regulation S-T [17 CFR 232].

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I. BACKGROUND

A. Changes in the Industry and Technology

As the primary regulator of the asset management industry, the Commission relies on information included in reports filed by registered investment companies ("funds")[1] and investment advisers for a number of purposes, including monitoring industry trends, informing policy and rulemaking, identifying risks, and assisting Commission staff in examination and enforcement efforts. Over the years, however, as assets under management and complexity in the industry have grown, so too has the volume and complexity of information that the Commission must analyze to carry out its regulatory duties.

Commission staff estimates that there were approximately 16,619 funds registered with the Commission, as of December 2014.[2] Commission staff further estimates that there were about 11,500 investment advisers registered with the Commission, along with another 2,845 advisers that file reports with the Commission as exempt reporting advisers, as of January 2015.[3] At year-end 2014, assets of registered investment

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1 For purposes of the preamble of this release, we use "funds" to mean registered investment companies other than face amount certificate companies and any separate series thereof—*i.e.*, management companies and unit investment trusts. In addition, we use the term "management companies" or "management investment companies" to refer to registered management investment companies and any separate series thereof. We note that "fund" may be separately and differently defined in each of the proposed new forms or rules, or proposed rule or form amendments.

2 Based on data obtained from the Investment Company Institute. *See* www.ici.org/research/stats.

3 Based on Investment Adviser Registration Depository system data. In 2010, Congress charged the Commission with implementing new reporting and registration requirements for certain investment advisers to private funds (known as "exempt reporting advisers"). *See* Pub. L. No. 111-203, 124 Stat. 1376, 1570–80.

companies exceeded $18 trillion, having grown from about $4.7 trillion at the end of 1997.[4] At the same time, the industry has developed new product structures, such as exchange-traded funds ("ETFs")[5], new fund types, such as target date funds with asset allocation strategies,[6] and increased its use of derivatives and other alternative strategies.[7]

Form ADV is used by registered investment advisers to register with the Commission and with the states and by exempt reporting advisers to report information to the Commission. Information on Form ADV is available to the public through the Investment Adviser Public Disclosure System, which allows the public to access the most recent Form ADV filing made by an investment adviser and is available at http://www.adviserinfo.sec.gov. Today, in a contemporaneous release, we are proposing a limited set of amendments to Form ADV and certain rules under the Advisers Act to fill certain data gaps and to enhance current reporting requirements, to incorporate "umbrella registration" for private fund advisers, and to make clarifying, technical and other amendments. *See* Amendments to Form ADV and Investment Advisers Act Rules, Investment Advisers Act Release No. 4091 (May 20, 2015).

4 *See* INVESTMENT COMPANY INSTITUTE, 2015 INVESTMENT COMPANY FACT BOOK 9 (55th ed., 2015) ("2015 ICI Fact Book"), *available at* http://www.ici.org/research/stats/factbook.

5 *See generally* Exchange-Traded Funds, Securities Act Release No. 8901 (Mar. 11, 2008) [73 FR 14618, 14619 (Mar. 18, 2008)] ("ETF Proposing Release"); *see also* http://www.ici.org/etf_resources/research/etfs_03_15 (discussing March 2015 statistics on ETFs). As of March 2015, there were over 1400 ETFs with over $2 trillion in assets. In the period of March 2014 to March 2015, assets of ETFs increased $352.43 billion or 20.6%. *See id.*

6 *See generally* Investment Company Advertising: Target Date Retirement Fund Names and Marketing, Securities Act Release No. 9126 (June 16, 2010) [75 FR 35920 (June 23, 2010)] ("Investment Company Advertising Release").

7 *See generally* Use of Derivatives by Investment Companies Under the Investment Company Act of 1940, Investment Company Act Release No. 29776 (Aug. 31, 2011) [76 FR 55237 (Sept. 7, 2011)] ("Derivatives Concept Release"); International Swaps and Derivatives Association ("ISDA") Study, *Size and Uses of the Non-Cleared Derivatives Market* (Apr. 2014), *available at* http://www2.isda.org/attachment/NjQ0MA==/FINAL%20-%20Size%20and%20Uses%20of%20the%20Non-Cleared%20 Derivatves%20Market.pdf (noting increases in the use of inflation swaps by asset managers and other investors); ISDA Research Study, *Dispelling Myths: End-User Activity in OTC Derivatives* (Aug. 2014), *available at* http://www2.isda.org/attachment/Njc2Nw==/ISDA-Dispelling%20myths-final.pdf (noting levels of derivative usage by surveyed American and French asset managers of 27% in 2011 and 53% in 2013, respectively, with 98% of total gross notional exposure of surveyed UK hedge funds related to derivatives in 2013; Sam Diedrich, *'Alternative' or 'Hedged' Mutual Funds: What Are They, How Do They Work, and Should You Invest?,* (Feb. 28, 2014), *available at* http://www.forbes.com/sites/ samdiedrich/2014/02/28/alternative-or-hedged-mutual-funds-what-are-they-how-do-they-

These products and strategies can offer greater opportunities for investors to achieve their investment goals, but they can also add complexity to funds' investment strategies, amplify investment risk, or have other risks, such as counterparty credit risk.

While these changes have been taking place in the fund industry, there has also been a significant increase in the use of the Internet as a tool for disseminating information and advances in the technology that can be used to report and analyze information. As discussed below, we have allowed the use of the Internet as a platform for providing required disclosure to investors. We have also started to use structured and interactive data formats to collect, aggregate, and analyze data reported by registrants and other filers. These data formats for information collection have enabled us and other data users, including investors and other industry participants, to better collect and analyze reported information and have improved our ability to carry out our regulatory functions.

We have historically acted to modernize our forms and the manner in which information is filed with the Commission and disclosed to the public in order to keep up with changes in the industry and technology. For example, in 1985, the Commission replaced five different reporting forms with Form N-SAR, which was designed to require reporting of data in a structured manner so that the Commission could construct a comprehensive database of information about the fund industry.[8] In 2000, we adopted new rules and rule amendments under the Investment Advisers Act of 1940 ("Advisers Act") to require advisers registered with the Commission to make filings under the

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work-and-should-you-invest/ (noting that "alternative mutual fund products grew at a neck-breaking 43% [in 2013]….").

8 *See* Semi-Annual Report Form for Registered Investment Companies, Exchange Act Release No. 21633 (Jan. 4, 1985) [50 FR 1442 (Jan. 11, 1985)]. Reports on Form N-SAR are publicly available on the Commission's EDGAR website.

Advisers Act with the Commission electronically through the Investment Adviser Registration Depository (IARD).[9] In 2007, we sought to enhance the ability of investors to make informed voting decisions and to expand the use of the Internet to ultimately lower the costs of proxy solicitations by requiring Internet availability of proxy materials.[10]

In 2009, we amended Form N-1A, the registration form for open-end funds, to enhance the information provided to investors by requiring these funds to include a summary of key information in the front of their prospectuses.[11] The 2009 amendments to Form N-1A also sought to harness the benefits of technological advances and increased Internet usage by allowing mutual funds to satisfy their prospectus delivery obligations by delivering a summary prospectus to investors and posting the statutory prospectus and other materials on an Internet website.

Also in 2009, the Commission sought to take advantage of new technology by adopting amendments requiring open-end funds to file their prospectus risk/return summaries in eXtensible Business Reporting Language ("XBRL").[12] In doing so, the

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9 *See* Electronic Filing by Investment Advisers; Amendments to Form ADV, Investment Advisers Act Release No. 1897 (Sept. 12, 2000) [65 FR 57438 (Sept. 22, 2000)].

10 *See* Shareholder Choice Regarding Proxy Materials, Investment Company Act Release No. 27911 (July 26, 2007) [72 FR 42222 (Aug. 1, 2007)].

11 *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) [74 FR 4546 (Jan. 26, 2009)].

12 *See* Interactive Data for Mutual Fund Risk/Return Summary, Investment Company Act Release No. 28617 (Feb. 11, 2009) [74 FR 7748 (Feb. 19, 2009)]. Just prior to adopting the XBRL requirements for mutual fund risk/return summaries, the Commission also adopted amendments requiring operating companies to provide their financial statement information in XBRL format. *See* Interactive Data to Improve Financial Reporting, Securities Act Release No. 33-9002 (Jan. 30, 2009) [74 FR 6776 (Feb. 10, 2009)]. In adopting these requirements, the Commission noted that "[i]n this format, financial statement information

Commission noted that this interactive data format would make "risk/return summary information easier for investors to analyze [and] assist in automating regulatory filings and business information processing." Additionally, in 2010, the Commission adopted Form N-MFP, which requires money market funds to report detailed portfolio holdings information on a monthly basis in Extensible Markup Language ("XML").[13] Because these disclosures and reports are filed in a structured data format using XBRL or XML, Commission staff, investors and other potential users are able to aggregate and analyze the data in a much less labor-intensive manner than plain text or hypertext filing formats would allow. The Commission also now uses the XML data format to collect and analyze certain information from advisers to private funds on Form PF[14] and has modernized the reporting of securities holdings by institutional investment managers on Form 13F,[15] which we believe resulted in efficiencies for data users.[16]

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could be downloaded directly into spreadsheets, analyzed in a variety of ways using commercial off-the-shelf software, and used within investment models in other software formats." *Id.*

[13] *See* Money Market Fund Reform, Investment Company Act Release No. 29132 (Feb. 23, 2010) [75 FR 10060, 10082 (Mar. 4, 2010)] ("Money Market Fund Reform 2010 Release"); *see also* Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31166 (July 23, 2014) [79 FR 47736 (Aug. 14, 2014)] ("Money Market Fund Reform 2014 Release") (adopting amendments to Form N-MFP). The information in Form N-MFP allows the Commission, investors, and other potential users to monitor compliance with rule 2a-7 and to better understand and monitor the underlying risks of money market fund portfolios. Additionally, pursuant to the 2010 and 2014 amendments, money market funds are required to disclose certain information, including portfolio holdings, on their websites.

[14] *See* Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF, Investment Advisers Act Release No. 3308 (Oct. 31, 2011) [76 FR 71228 (Nov. 16, 2011)] ("Form PF Adopting Release").

[15] *See* Adoption of Updated EDGAR Filer Manual, Securities Act Release No. 9403 (May 14, 2013) [78 FR 29616 (May 21, 2013)].

[16] The Commission has also proposed and adopted XML data reporting requirements in other contexts. *See, e.g.,* Mandated Electronic Filing and Website Posting For Forms 3, 4 and 5,

As these industry changes and technological advances have occurred over the years, we recognize a need to improve the type and format of the information that funds provide to us and to investors. We also recognize the need to improve the information that the Commission receives from funds in order to improve the Commission's monitoring of the fund industry in its role as the primary regulator of funds and investment advisers. As discussed below, today we are proposing a set of reporting and disclosure reforms designed to take advantage of the benefits of advanced technology and to modernize the fund reporting regime in order to help the Commission, investors, and other market participants better assess different fund products and to assist us in carrying out our mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. Our proposed reforms seek to (1) increase the transparency of fund portfolios and investment practices both to the Commission and to investors, (2) take advantage of technological advances both in terms of the manner in which information is reported to the Commission and how it is provided to investors and other potential users, and (3) where appropriate, reduce duplicative or otherwise unnecessary reporting burdens on the industry.

Securities Act Release No. 8230 (May 7, 2003) [68 FR 27588 (May 13, 2003)]; Electronic Filing and Revision of Form D, Securities Act Release No. 8891 (Feb. 6, 2008) [73 FR 10592 (Feb. 27, 2008)]; Electronic Filing of Transfer Agent Forms, Securities Exchange Act Release No. 54864 (Dec. 4, 2006) [71 FR 74698 (Dec. 12, 2006)]; Asset-Backed Securities Disclosure and Registration, Securities Act Release No. 9638 (Sept. 4, 2014) [79 FR 57184 (Sept. 24, 2014)]; Crowdfunding Securities Act Release No. 9470 (Oct. 23, 2013) [78 FR 66428 (Nov. 5, 2013)]; Proposed Rule Amendments for Small and Additional Issues Exemptions Under Section 3(b) of the Securities Act, Securities Act Release No. 9497 (Dec. 18, 2013) [79 FR 3926 (Jan. 23, 2014)]. *See generally* Recommendations of the Investor Advisory Committee Regarding the SEC and the Need for the Cost Effective Retrieval of Information by Investors (July 25, 2013), *available at* http://www.sec.gov/spotlight/investor-advisory-committee-2012/data-tagging-resolution-72513.pdf.

We also note that in December 2014, the Financial Stability Oversight Council ("FSOC") issued a notice requesting comment on aspects of the asset management industry, which includes, among other entities, registered investment companies.[17] The notice included requests for comment on additional data or information that would be helpful to regulators and market participants. Although this rulemaking proposal is independent of FSOC, several commenters responding to the notice discussed issues concerning data that are relevant to the rules we are proposing today, including data regarding derivatives, global identifiers, and securities lending activities and are cited in the discussions below, as relevant.[18]

B. Changes to Current Reporting Regime

1. Form N-PORT, Amendments to Regulation S-X, and Option for Website Transmission of Shareholder Reports

Currently, management investment companies (other than small business investment companies ("SBICs")) are required to report their complete portfolio holdings to the Commission on a quarterly basis.[19] These funds are required to provide this

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17 Financial Stability Oversight Council, Notice Seeking Comment on Asset Management Products and Activities, Docket No. FSOC-2014-0001 ("FSOC Notice"), *available at* http://www.treasury.gov/initiatives/fsoc/rulemaking/Documents/Notice%20Seeking%20Comment%20on%20Asset%20Management%20Products%20and%20Activities.pdf.

18 Comments submitted in response to the FSOC Notice are available at http://www.regulations.gov/#!docketDetail;D=FSOC-2014-0001. We also note that, in addition to commenters that argued for additional specific disclosures by funds, several commenters asserted, as a general matter, that registered funds are currently subject to robust disclosure requirements. *See, e.g.,* Comment Letter of the Investment Company Institute to the FSOC Notice (Mar. 25, 2015); Comment Letter of Federated Investors, Inc. to the FSOC Notice (Mar. 10, 2015); Comment Letter of the Capital Group Companies to the FSOC Notice (Mar. 25, 2015).

19 *See* Shareholder Reports and Quarterly Portfolio Disclosure of Registered Management Investment Companies, Securities Act Release No. 8393 (Feb. 27, 2004) [69 FR 11244 (Mar. 9, 2004)] ("Quarterly Portfolio Holdings Adopting Release").

information in reports on Form N-Q under the Investment Company Act and the Exchange Act as of the end of each first and third fiscal quarter,[20] and in reports on Form N-CSR under those Acts as of the end of each second and fourth fiscal quarter.[21]

As discussed in Parts II.A and II.B of this release, we propose to rescind Form N-Q and adopt a new portfolio holdings reporting form, Form N-PORT, which would be filed by all registered management investment companies and unit investment trusts ("UITs") that operate as ETFs,[22] other than money market funds and SBICs.[23] We are proposing that reports on Form N-PORT would be filed with the Commission on a monthly basis, with every third month available to the public 60 days after the end of the fund's fiscal quarter. The reports on Form N-PORT would include a fund's complete portfolio holdings in a structured data format. Additionally, as discussed below, proposed Form N-PORT would include additional information concerning fund portfolio holdings that are not currently provided on Forms N-Q and N-CSR, but that would facilitate risk analyses and other Commission oversight. For example, Form N-PORT would require reporting of additional information relating to derivative investments. It would also include certain risk metric calculations that would measure a fund's exposure

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20 Rule 30b1-5 under the Investment Company Act [17 CFR 270.30b1-5]. While SBICs file reports on Form N-CSR, SBICs are not required to file reports on Form N-Q.

21 *See* rule 30b2-1 under the Investment Company Act [17 CFR 270.30b2-1].

22 Under the proposal, all ETFs would be required to file reports on Form N-PORT, regardless of whether they are organized as management companies or UITs. UITs are a type of investment company which (a) are organized under a trust indenture contract of custodianship or agency or similar instrument, (b) do not have a board of directors, and (c) issue only redeemable securities. *See* section 4(2) of the Investment Company Act.

23 Money market funds file reports on Form N-MFP on a monthly basis and, thus, would not be required to file reports on Form N-PORT.

and sensitivity to changing market conditions, such as changes in asset prices, interest rates, or credit spreads.

We believe that more timely and frequent reporting of portfolio holdings information, as well as the additional information we are proposing to require, would enable the Commission to further its mission to protect investors by assisting the Commission and Commission staff in carrying out its regulatory responsibilities related to the asset management industry. These responsibilities include its examination, enforcement, and monitoring of funds, the Commission's formulation of policy, and the staff's review of fund registration statements and disclosures.

While Form N-PORT is primarily designed to assist the Commission and Commission staff, we believe that information in Form N-PORT would be beneficial to investors and other potential users. In particular, we believe that both sophisticated institutional investors and third-party users that provide services to investors may find the information we propose to require on Form N-PORT useful. For example, Form N-PORT's structured format would allow the Commission, investors, and other potential users to better collect and analyze portfolio holdings information. The portfolio holdings information currently filed on Form N-Q, in contrast, is filed in a plain text or hypertext format, which often requires labor-intensive manual reformatting by Commission staff and other potential users in order to prepare the reported data for analysis. While we do not anticipate that many individual investors would analyze data using Form N-PORT, although some may, we believe that individual investors would benefit indirectly from the information collected on reports on Form N-PORT, through enhanced Commission monitoring and oversight of the fund industry and through analyses prepared by third-party service providers.

In addition, we are proposing amendments to Regulation S-X that would require standardized enhanced derivatives disclosures in fund financial statements, as well as other amendments. Currently, Regulation S-X does not prescribe specific information for most types of derivatives, including swaps, futures, and forwards. While we recognize that many fund groups provide disclosures regarding the terms of their derivatives contracts, the lack of standard disclosure requirements has resulted in inconsistent disclosures in fund financial statements.

We believe our proposed amendments to Regulation S-X to enhance and standardize derivatives disclosures in financial statements would allow comparability among funds and help all investors better assess funds' use of derivatives. We are proposing to require reports on Form N-PORT to contain similar derivatives disclosures to facilitate analysis of derivatives investments across funds. Because Form N-PORT is not primarily designed for individual investors, the proposed amendments to Regulation S-X would require disclosures concerning the fund's investments in derivatives, as well as other disclosures related to liquidity and pricing of investments, in the financial statements that are provided to investors. We have endeavored to mitigate burdens on the industry by conforming the derivatives disclosures that would be required by both Regulation S-X and Form N-PORT.

Finally, we are also proposing a rule that would provide funds with an optional method to satisfy shareholder report transmission requirements by posting such reports online if they meet certain conditions. In order to rely on the rule, funds would be required to make the report and other required materials publicly accessible and free of charge at a website address specified in a notice to shareholders, and meet certain conditions relating to shareholder consent, and notice to shareholders of the website availability of shareholder reports and of the methods by which shareholders would be able to request a paper copy of the materials. This optional method is intended to modernize the manner in which periodic information is transmitted to shareholders, which we believe would improve the information's overall accessibility while reducing burdens such as the costs associated with printing and mailing shareholder reports.

2. Form N-CEN

Currently, the Commission collects census-type information on management investment companies and UITs on reports on Form N-SAR.[24] As discussed above, Form N-SAR was adopted in 1985 and, at that time, was intended to reduce reporting burdens and better align the information that was required to be reported with the characteristics of the fund industry. While Commission staff has indicated that the census-type information reported on Form N-SAR is useful in its support of the Commission's regulatory functions, staff has also indicated that in the thirty years since Form N-SAR's adoption, changes in the industry have reduced the utility of some of the currently required data elements. Additionally, the filing format that is required for reports on Form N-SAR limits our ability to use the reported information for analysis. Commission staff also believes that obtaining certain additional census-type information

[24] *See* rules 30a-1 and 30b1-1 under the Investment Company Act [17 CFR 270.30a-1 and 17 CFR 270.30b1-1].

not currently collected by Form N-SAR would improve the staff's ability to carry out regulatory functions, including risk monitoring and analysis of the industry.

Accordingly, we are proposing to rescind Form N-SAR and replace it with Form N-CEN, a new form on which funds will report census-type information to the Commission. Form N-CEN would include many of the same data elements as Form N-SAR, but, in order to improve the quality and utility of information reported, would replace those items that are outdated or of limited usefulness with items that we believe to be of greater relevance today. Where possible, we are also proposing to eliminate items that are reported on other Commission forms, or are available elsewhere. In addition, we are proposing to require that reports on Form N-CEN be filed in a structured XML format, which, we believe, could reduce reporting burdens for current Form N-SAR filers and yield data that can be used more effectively by the Commission and other potential users. Finally, we are proposing that reports on new Form N-CEN be filed annually, rather than semi-annually as is required for reports on Form N-SAR by management companies, which would further reduce current burdens on funds.

II. DISCUSSION

A. Form N-PORT

As discussed above, we are proposing to create a new monthly portfolio reporting form, Form N-PORT. Our proposal would require registered management investment companies and ETFs organized as UITs, other than money market funds and SBICs, to electronically file with the Commission monthly portfolio investments information on new Form N-PORT in an XML format no later than 30 days after the close of each month.[25] As discussed below in Part II.A.4, only information reported for the third month of each fund's fiscal quarter on Form N-PORT would be publicly available, and that information would not be made public until 60 days after the end of the fiscal quarter.[26]

As the primary regulator of the fund industry, the Commission relies on information that funds file with us, including their registration statements, shareholder reports, and various reporting forms such as Form N-SAR, Form N-CSR, and Form N-Q. The Commission and its staff use this information to understand trends in the fund industry and carry out regulatory responsibilities, including formulating policy and guidance, reviewing fund registration statements, and assessing and examining a fund's regulatory compliance with the federal securities laws and Commission rules thereunder.

Information on fund portfolios is currently filed with the Commission quarterly with up to a 70-day delay.[27] Moreover, the reports are currently filed in a format that does not allow for efficient searches or analyses across portfolios, and even limits the

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25 *See* proposed rule 30b1-9.

26 As used throughout this section, the term "fund" generally refers to investment companies that would file reports on Form N-PORT.

27 Funds currently file with the Commission portfolio schedules for the fund's first and third fiscal quarters on Form N-Q, and shareholder reports, including portfolio schedules for the fund's second and fourth fiscal quarters, on Form N-CSR. These reports are available to the public and the Commission with either a 60- or 70-day delay. *See* rule 30b1-5 (requiring management companies, other than SBICs, to file reports on Form N-Q no more than 60 days after the close of the first and third quarters of each fiscal year); rule 30b2-1 (requiring management companies to file reports on Form N-CSR no later than 10 days after the transmission to stockholders of any report required to be transmitted to stockholders under rule 30e-1). *See also* rules 30e-1 and 30e-2 under the Investment Company Act [17 CFR 270.30e-1 and 17 CFR 270.30e-2] (requiring management companies and certain UITs to transmit to stockholders semi-annual reports containing, among other things, the fund's portfolio schedules, no more than 60 days after the close of the second and fourth quarters of each fiscal year). These reports include portfolio holdings information as required by Regulation S-X. *See* rule 12-12 of Regulation S-X [17 CFR 210.12-12], *et seq.*

ability to search or analyze a single portfolio. Based on staff experience with data analysis of funds, including staff experience using Form N-MFP, we believe that more frequent and timely information concerning fund portfolios than we currently receive through registration statements, shareholder reports on Form N-CSR, and reports on Form N-Q will assist the Commission in its role as the primary regulator of funds, as discussed further below.

The information we are proposing to collect on Form N-PORT would be important to the Commission in analyzing and understanding the various risks in a particular fund, as well as risks across specific types of funds and the fund industry as a whole. These risks can include the investment risk that the fund is undertaking as part of its investment strategy, such as interest rate risk, credit risk, volatility risk, other market risks, or risks associated with specific types of investments, such as emerging market debt or commodities. Additionally, the information is helpful to understanding liquidity risks and counterparty risks, and determining whether a fund's exposure to price movements is leveraged, either through borrowings or the use of derivatives. We believe that information we are proposing to require on Form N-PORT will assist the Commission in better understanding each of these risks in the fund industry. We believe that the ability to understand the risks that funds face will help our staff better understand and monitor risks and trends in the fund industry as a whole, facilitating our informed regulation of the fund industry.

We also believe that information obtained from Form N-PORT filings would facilitate our oversight of funds and assist Commission staff in examination, enforcement, and monitoring, as well as in formulating policy and in its review of fund registration statements and disclosures. In this regard, we expect that Commission staff would use the data reported on Form N-PORT for many of the same purposes as Commission staff has used data reported on Form N-MFP by money market funds. The data received on Form N-MFP has been used extensively by Commission staff, including for purposes of assessing regulatory compliance, identifying funds for examination, and risk monitoring. Form N-MFP data has also informed Commission policy; for example, staff used Form N-MFP data in analyses that informed the Commission's considerations when it proposed and adopted money market fund reform rules in 2013 and 2014.[28]

We recognize that, unlike money market funds, which as cash management vehicles generally share common investment objectives and strategies and thus invest in a relatively small number of common security types, other funds invest in a much more diverse manner. Accordingly, Form N-PORT, as proposed, would require reporting of additional information relative to Form N-MFP, in order to facilitate understanding and analysis of the investment strategies that funds pursue, as well as the large variety of securities, commodities, currencies, derivatives, and other investments that funds may invest in.

In addition to assisting the Commission in its regulatory functions, we believe that investors and other potential users could benefit from the periodic public disclosure of the information reported on Form N-PORT. Proposed Form N-PORT is primarily designed

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[28] *See, e.g.*, Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 30551 (June 5, 2013) [78 FR 36834 (June 19, 2013)]; Money Market Fund Reform 2014 Release, *supra* note 13 at n.502 and accompanying text (citing use of Form N-MFP data in discussing the Commission's decision to require basis point rounding); and at n.651 and accompanying text (citing use of Form N-MFP data in discussing the Commission's decision regarding the size of the non-government securities basket for government money market funds).

for use by the Commission and its staff, and not for disclosing information directly to individual investors. This is because the form's structured format, while needed for quantitative analysis within a fund and across funds, is not an easily human-readable format. Additionally, the information we are proposing to require on Form N-PORT is more voluminous than on a schedule of investments. We believe, however, that some investors, particularly institutional investors, could directly use the data from the information on proposed Form N-PORT for their own quantitative analysis of funds, including to better understand the funds' investment strategies and risks, and to better compare funds with similar strategies. Additionally, we believe that entities providing services to investors, such as investment advisers, broker-dealers, and entities that provide information and analysis for fund investors, could also utilize and analyze the information that would be required by proposed Form N-PORT to help all investors make more informed investment decisions. Accordingly, whether directly or through third parties, we believe that the periodic public disclosure of the information on proposed Form N-PORT could benefit all fund investors. As discussed further below, in order to mitigate the risk that the information on Form N-PORT could be used in ways that might ultimately result in investor harm, we are proposing to limit the public availability of Form N-PORT reports to those reports filed as of quarter end, as well as delay public availability of those reports by 60 days after quarter end.

We intend to increase transparency of fund investments through proposed Form N-PORT in several ways. First, N-PORT would improve reporting of fund derivative usage. As the Commission has previously noted, we have observed significant increases in the use of derivatives by funds, which have highlighted the need for more robust and standardized derivatives disclosures.[29] Additionally, funds that are considered "alternative" funds, which often use derivatives for implementing their investment strategy, are becoming increasingly popular among investors.[30] Although Regulation S-X establishes general disclosure requirements for financial statements in fund registration statements, based on staff review of fund filings, the lack of standardized requirements as to the terms of derivatives that must be reported has sometimes led to inconsistent approaches to reporting derivatives information and, in some cases, insufficient information concerning the terms and underlying reference assets of derivatives to allow the Commission or investors to understand the investment. This hinders both an analysis of a particular fund's investments, as well as comparability among funds.[31] The information requested in Form N-PORT would create a more detailed, uniform, and structured reporting regime. This would allow the Commission and investors to better analyze and compare funds' derivatives investments and the

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[29] *See* Derivatives Concept Release, *supra* note 7, at n.7 and accompanying text.

[30] While there is no clear definition of "alternative" in the fund industry, an alternative fund is generally understood to be a fund whose primary investment strategy falls into one or more of the three following categories: (1) non-traditional asset classes (for example, currencies); (2) non-traditional strategies (such as long/short equity positions); and/or (3) less liquid assets (such as private debt).

At the end of December 2014, alternative mutual funds had almost $200 billion in assets. Although alternative mutual funds only accounted for 1.19% of the mutual fund market as of December 2014, the almost $20.1 billion of inflows into these funds in 2014 represented 4.3% of the inflows for the entire mutual fund industry in that year. These statistics were obtained from staff analysis of Morningstar Direct data, and are based on fund categories as defined by Morningstar.

[31] *See, e.g.,* rule 12-13 of Regulation S-X [17 CFR 210.12-13] (requiring funds to generally disclose derivatives together with "other" investments); rule 6-03 of Regulation S-X [17 CFR 210.6-03] (applying articles 1-4 of Regulation S-X to investment companies, but not specifying where derivative disclosures should be made for funds); ASC 815, Disclosures about Derivative Instruments and Hedging Activities (discussing general derivative disclosure) ("ASC 815"); ASC 820, Fair Value Measurements (requiring disclosure of valuation information for major categories of investments) ("ASC 820"). *See also* Part II.C.

exposures they create, which can be important to understanding funds' investment strategies, use of leverage, and potential for risk of loss.

Furthermore, as discussed further below, proposed Form N-PORT would require funds to report certain risk metrics that would provide measurements of a fund's exposure to changes in interest rates, credit spreads and asset prices, whether through investments in debt securities or in derivatives. Financial statement information provides historical information over a particular time period (*e.g.*, a statement of operations), or information about values of assets at a particular point in time (*e.g.*, a balance sheet including, for funds, a schedule of investments). Risk metrics, on the other hand, measure the change in value of an investment in response to small changes in the underlying reference asset of an investment, whether the underlying reference asset is a security (or index of securities), commodity, interest rate, or credit spread over an interest rate. Based on staff experience, as well as staff outreach to asset managers and entities that provide risk management services to asset managers, discussed further below, we believe that fund portfolio managers and risk managers commonly calculate these risk metrics to analyze the exposures in their portfolios.[32] The Commission believes that staff can use these risk measures to better understand the exposures in the fund industry, thereby facilitating better monitoring of risks and trends in the fund industry as a whole.

Form N-PORT would also require information about certain fund activities such as securities lending, repurchase agreements, and reverse repurchase agreements,

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32 *See generally* John C. Hull, OPTIONS, FUTURES, AND OTHER DERIVATIVES, SEVENTH EDITION (2009) (discussing, for example, the function of duration, convexity, delta, and other calculations used for measuring changes in the value of bonds or derivatives as a result in changes in underlying asset prices or interest rates); Sheldon Natenberg, OPTION VOLATILITY AND PRICING (1994) (same).

including information regarding the counterparties to which the fund is exposed in those transactions, as well as in over-the-counter derivatives transactions. Such information would increase transparency concerning these activities and would provide better information regarding counterparty information, which would be useful in assessing both individual and multiple fund exposures to a single counterparty.[33]

Proposed Form N-PORT also requires information that would assist the Commission in assessing fund liquidity risk by, for example, requiring funds to provide information about the market liquidity and pricing of portfolio investments, as well as information regarding fund flows, which is helpful to understanding the liquidity pressures a fund might experience due to investor redemption activity.

Finally, as discussed further below, Form N-PORT would be filed electronically in a structured, XML format. This format would enhance the ability of the Commission, as well as investors and other potential users, to analyze portfolio data both on a fund-by-fund basis and also across funds. As a result, although we are proposing to collect certain information on Form N-PORT that may be similarly disclosed or reported elsewhere (*e.g.,* portfolio investments would continue to be included as part of the schedules of investments contained in shareholder reports, and filed on a semi-annual basis with the Commission on Form N-CSR), we believe that it is appropriate to also collect this

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[33] *See, e.g.,* Report by Task Force on Tri-Party Repo Infrastructure, May 17, 2010 (concluding that insufficient transparency of the tri-party repurchase agreement market contributed to the build-up of exposures and the lack of prior concerted action to address the issues that led to financial turmoil during 2007-2009). The Task Force on Tri-Party Repo Infrastructure was formed in September 2009 under the purview of the Payments Risk Committee, a private sector body sponsored by the Federal Reserve Bank of New York. The Task Force membership includes representatives from multiple types of market participants that participate in the tri-party repo market, as well as relevant industry associations. Federal Reserve and Commission staff participated in meetings of the Task Force as observers and technical advisors.

information in a structured format for analysis by our staff as well as investors and other potential users.

1. Who Must File Reports on Form N-PORT

Our proposal would require a report on Form N-PORT to be filed by each registered management investment company and each ETF organized as a UIT.[34] Registrants offering multiple series would be required to file a report for each series separately, even if some information is the same for two or more series. Money market funds and SBICs would not be required to file reports on Form N-PORT.[35]

As indicated above, our proposal would require all ETFs to file reports on Form N-PORT, regardless of their form of organization. Although most ETFs today are structured as open-end management investment companies, there are several ETFs that are organized as UITs.[36] ETFs organized as UITs have significant numbers of investors who we believe could benefit from the disclosures required in Form N-PORT.[37]

We request comment on the entities that would be required to file reports on Form N-PORT.

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[34] *See* proposed rule 30b1-9.

[35] Money market funds already file their monthly portfolio investments with the Commission. *See* Form N-MFP. SBICs are unique investment companies that operate differently than other management investment companies. They are "privately owned and managed investment funds, licensed and regulated by [the Small Business Administration ("SBA")], that use their own capital plus funds borrowed with an SBA guarantee to make equity and debt investments in qualifying small businesses." *See* SBIC Program Overview *available at* https://www.sba.gov/content/sbic-program-overview. As of December 31, 2014, only one SBIC had publicly offered securities outstanding.

[36] There are currently eight ETFs organized as UITs that have registered with the Commission.

[37] Commission staff estimates that as of December 2014, ETFs organized as UITs represented 14% of all assets invested in ETFs. This analysis is based on data from Morningstar Direct.

- Should any funds that we are proposing to require to file reports on Form N-PORT not be required to do so? If so, what types of funds?
- Should we require SBICs to file reports on Form N-PORT? How useful would the information reported on Form N-PORT be for investors?
- Our proposal would allow investors in different types of ETFs to compare their portfolio investments by means of identical disclosures on reports on Form N-PORT, regardless of whether an ETF was organized as an open-end management investment company or as a UIT. Should ETFs organized as UITs not be required to file reports on Form N-PORT? If so, why?

2. Information Required on Form N-PORT

Form N-PORT would require a fund to report certain information about the fund and the fund's portfolio investments as of the close of the preceding month, including: (a) general information about the fund; (b) assets and liabilities; (c) certain portfolio-level metrics, including certain risk metrics; (d) information regarding securities lending counterparties; (e) information regarding monthly returns; (f) flow information; (g) certain information regarding each investment in the portfolio; (h) miscellaneous securities (if any); (i) explanatory notes (if any), and (j) exhibits. Each of these is discussed in more detail below.

a. General Information and Instructions

Part A of Form N-PORT would require general identifying information about the fund, including the name of the registrant, name of the series, and relevant file numbers.[38]

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[38] *See* Form N-PORT, Items A.1 and A.2. Funds would provide the name of the registrant, the Investment Company Act and CIK file numbers for the registrant, and the address and

Funds would also report the date of their fiscal year end, the date as of which information is reported on the form, and indicate if they anticipated that this would be their final filing on Form N-PORT.[39] This information would be used to identify the registrant and series filing the report, track the reporting period, and identify final filings.

Additionally, we are proposing that funds provide the Legal Entity Identifier ("LEI") number of the registrant and series.[40] The LEI is a unique identifier associated with a single corporate entity and is intended to provide a uniform international standard for identifying counterparties to a transaction.[41] Fees are not imposed for the usage of or access to LEIs, and all of the associated reference data needed to understand, process, and utilize the LEIs are widely and freely available and not subject to any usage restrictions. Funds or registrants that have not yet obtained an LEI would be required to obtain one, which would entail a modest fee.[42] The inclusion of LEI information on Form N-PORT, however, would facilitate the ability of investors and the Commission to link the data

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telephone number of the registrant. Funds would also provide the name of and EDGAR identifier for the series.

39 *See* Form N-PORT, Items A.3 and A.4.

40 *See* Form N-PORT, Items A.1.d and A.2.c. The Commission has begun to require disclosure of the LEI in other contexts. *See, e.g.,* Form PF Adopting Release, *supra* note 14; Regulation SBSR-Reporting and Dissemination of Security-Based Swap Information, Securities Exchange Act Release No. 74244 (Feb. 11, 2015) [80 FR 14438 (Mar. 19, 2015)] ("Regulation SBSR Adopting Release").

41 The global LEI system operates under an LEI Regulatory Oversight Committee ("ROC") that currently includes members that are official bodies from over 40 jurisdictions. The Commission is a member of the ROC and currently serves on its Executive Committee. The Commission notes that it would expect to revisit the proposed requirement to report LEIs if the operation of the LEI system were to change significantly.

42 As of December 26, 2014, the cost of obtaining an LEI from the Global Markets Entity Identifier ("GMEI") Utility in the United States was $200, plus a $20 surcharge for the LEI Central Operating Unit. The annual cost of maintaining an LEI from the GMEI Utility was $100, plus a $20 surcharge for the LEI Central Operating Unit. *See* https://www.gmeiutility.org/frequentlyAskedQuestions.jsp.

reported on Form N-PORT with data from other filings or sources that is or will be reported elsewhere as LEIs become more widely used by regulators and the financial industry.[43]

Form N-PORT would also include general filing and reporting instructions, as well as definitions of specific terms referenced in the form.[44] These instructions and definitions are intended to provide clarity to funds and to assist them in filing reports on Form N-PORT.[45]

We seek comment on these proposed disclosures and instructions.

- Is there any additional or alternative information that should be required to facilitate identification of funds and analysis of the reported information with information from other filings or otherwise available elsewhere?

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43 *See, e.g.,* Press Release: Commodities Futures Trading Commission ("CFTC") Announces Mutual Acceptance of Approved Legal Entity Identifiers, CFTC (Oct. 30, 2013), *available at* http://www.cftc.gov/PressRoom/PressReleases/pr6758-13; Letter from Kenneth Bentsen, President & CEO of SIFMA to Jacob Lew, Chairman of FSOC re: Adoption of the Legal Entity Identifier, SIFMA (Apr. 11, 2014), *available at* http://www.sifma.org/issues/item.aspx?id=8589948488; Regulation SBSR Adopting Release, *supra* note 40.

Commenters to the FSOC Notice expressed support for regulatory acceptance of LEI identifiers. *See, e.g.,* Joint Comment Letter of SIFMA/Investment Adviser Association (Mar. 25, 2015) ("SIFMA/IAA FSOC Notice Comment Letter") (expressing support for the LEI initiative, and noting that the use of LEIs has already enhanced the industry's ability to identify and monitor global market participants); Comment Letter of Fidelity to FSOC Notice (Mar. 25, 2015) (expressing the need to develop analytics to make data intelligible, such as the ability to map exposures across the financial system, such as through the use of LEIs).

44 *See* Form N-PORT, General Instructions A (Rule as to Use of Form N-PORT), B (Application of General Rules and Regulations), C (Filing of Reports), D (Paperwork Reduction Act Information), E (Definitions), F (Public Availability), G (Responses to Questions), and H (Signature and Filing of Report).

45 *See id.* For example, General Instructions A, B, C, G, and H provide specific filing and reporting instructions (including how to report entity names, percentages, monetary values, numerical values, and dates), General Instructions D and F provide information about the Paperwork Reduction Act and the public availability of information reported on Form N-PORT, and General Instruction E provides definitions for specific terms referenced in Form N-PORT.

- Should the Commission require funds to obtain LEIs? Is it appropriate for the Commission to require LEIs, which are only available through the global LEI system? Why or why not? In the case of funds that have not obtained an LEI, will those funds seek to obtain an LEI in the future absent any regulatory requirement to do so? In addition to the fees for obtaining and maintaining an LEI, would there be other costs associated with funds obtaining LEIs?[46]
- Are there any instructions or definitions that should be revised? If so, how? Should any instructions or definitions be added to provide additional clarity, or deleted to avoid confusion with conflicting instructions, definitions, or industry practices?

b. Information Regarding Assets and Liabilities.

Part B of proposed Form N-PORT would seek certain portfolio level information about the fund. Part B would include questions requiring funds to report their total assets, total liabilities, and net assets.[47] Funds would separately report certain assets and liabilities, as follows. First, funds would report the aggregate value of any "miscellaneous securities" held in their portfolios.[48] Currently, Regulation S-X permits

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[46] *See supra* note 42 (discussing the costs of obtaining and maintaining an LEI identifier in the United States). The Commission has further estimated the one-time burden associated with obtaining an LEI is one hour, with ongoing administration of an LEI corresponding to one hour per year. *See* SBSR Adopting Release, *supra* note 40, at nn. 1109-1111 and accompanying text.

[47] *See* Form N-PORT, Item B.1.

[48] *See* Form N-PORT, Items B.1.a and B.2.a. As discussed further below, we are proposing that funds would also report information about miscellaneous securities on an investment-by-investment basis, although such information would be nonpublic and would be used for Commission use only. We also request comment below on whether funds should continue to be permitted to categorize investments as "miscellaneous securities." *See infra* note 151 and accompanying text.

funds to report an aggregate amount not exceeding five percent of the total value of the portfolio investments in one amount as "Miscellaneous securities," provided that securities so listed are not restricted, have been held for not more than one year prior to the date of the related balance sheet, and have not previously been reported by name to the shareholders, or set forth in any registration statement, application, or annual report or otherwise made available to the public, and, as discussed further below, we are proposing the same conditions for Form N-PORT.[49]

Funds would also report any assets invested in a controlled foreign corporation for the purpose of investing in certain types of investments ("controlled foreign corporation" or "CFC").[50] Some funds use CFCs for making certain types of investments, particularly commodities and commodity-linked derivatives, often for tax purposes. Our proposal would require funds to disclose each underlying investment in a CFC, rather than just the investment in the CFC itself, which would increase transparency on fund investments through CFCs.[51] These disclosures would allow investors to look through CFCs and understand the specific underlying holdings that they are investing in, which would in turn allow investors to better analyze their fund holdings and risk associated with CFC investments, and hence enable investors to make more informed investment decisions. In addition, as discussed further below in Part II.E.4, we believe it would be beneficial for the Commission to have certain information about funds' use of CFCs. The information

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49 *See* rule 12-12 of Regulation S-X.

50 *See* Form N-PORT, Instruction E (providing that "controlled foreign corporation" has the meaning defined in section 957 of the Internal Revenue Code [26 U.S.C. 957]) and Item B.2.b (requiring funds to report assets invested in controlled foreign corporations).

51 *See* Form N-PORT, Part B Instruction ("Report the following information for the Fund and its consolidated subsidiaries.").

we are proposing to obtain in Form N-PORT, combined with additional information we are proposing to require on Form N-CEN regarding CFCs, discussed below, would help the Commission better monitor funds' compliance with the Investment Company Act and assess funds' use of CFCs, including the extent of their use by reporting of total assets in CFCs.[52]

Second, we are proposing to require that funds report the amount of certain liabilities, in particular: (1) borrowings attributable to amounts payable for notes payable, bonds, and similar debt, as reported pursuant to rule 6-04(13)(a) of Regulation S-X [17 CFR 210.6-04(13)(a)]; (2) payables for investments purchased either (i) on a delayed delivery, when-delivered, or other firm commitment basis, or (ii) on a standby commitment basis; and (3) liquidation preference of outstanding preferred stock issued by the fund.[53] This information would allow Commission staff, as well as investors and other potential users, to better understand a fund's borrowing activities and payment obligations for assets that have been already received, which would facilitate analysis of the fund's use of financial leverage, as well as the fund's liquidity and ability to meet redemptions, which are important to understanding the risks such borrowings might create.

We request comment on the reporting of assets and liabilities proposed on Form N-PORT.

- As discussed above, our proposal would require funds to disclose each underlying investment in a CFC. Should we consider modifying the information we propose

52 *See infra* note 467 and accompanying and following text.

53 *See* Form N-PORT, Items B.2.c to B.2.e.

to require, or require additional information? How commonly do funds invest in CFCs that in turn invest their assets in underlying investments? Should we provide instructions to clarify how funds should report investments in this situation? If so, should the Commission permit funds to disclose only the ultimate underlying investments, or should the Commission require disclosure of each layer of investment?

- Are there other methods of reporting the assets (including assets in CFCs) and liabilities described above that we should consider?
- Are there other assets and liabilities that funds should be required to separately report? If so, why? For example, should the Commission require funds to separately break out categories of assets and liabilities similar to what is currently required by Form N-SAR?[54] What would be the costs associated with providing such information on a monthly basis?

c. Portfolio Level Risk Metrics

One of the purposes of Form N-PORT is to provide the Commission with information regarding fund portfolios to help us better monitor trends in the fund industry, including investment strategies funds are pursuing, the investment risks that funds undertake, and how different funds might be affected by changes in market conditions. As discussed above, the Commission uses information from fund filings, including a

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[54] *See* Form N-SAR, Item 74 (requiring funds to report consolidated balance sheet data, including cash, repurchase agreements, debt-securities, preferred stock, common stock, options, other investments, receivables, other assets, total assets, payables for portfolio instruments purchased, amounts owed to affiliated persons, senior long-term debt, other liabilities, senior equity, net assets of common shareholders, number of shares outstanding, net asset value per share, total number of shareholder accounts, and total value of assets in segregated accounts).

fund's registration statement and reports on Form N-CSR (which includes the fund's shareholder report) and Form N-Q, to inform its understanding and regulation of the fund industry. Additionally our staff reviews fund disclosures—including registration statements, shareholder reports, and other documents—both on an ongoing basis as well as retroactively every three years.[55]

The disclosures in a fund's registration statement about its investment objective, investment strategies, and risks of investing in the fund, as well as the fund's financial statements, are fundamental to understanding a fund's implementation of its investment strategies and the risks in the fund. However, the financial statements and narrative disclosures in fund registration statements and shareholder reports do not always provide a complete picture of a fund's exposure to changes in asset prices, particularly as fund strategies and fund investments become more complex. The financial statements, including a fund's schedule of portfolio investments, provide data regarding investments' values as of the end of the reporting period – a "snapshot" of data at a particular point in time – or, in the case of the statement of operations, for example, historical data over a specified time period. By contrast, based on staff experience and outreach to funds, we understand that funds commonly internally use multiple risk metrics that provide calculations that measure the change in the value of fund investments assuming a specified change in the value of underlying assets or, in the case of debt instruments and derivatives that provide exposure to interest rates and debt instruments, changes in interest rates or in credit spreads above the risk-free rate.

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55 *See, e.g.,* section 408 of the Sarbanes-Oxley Act of 2002, Pub. L. 107-204, 116 Stat. 745 (2002) (requiring the Commission to engage in enhanced review of periodic disclosures by certain issuers every three years).

Accordingly, we believe it is appropriate to propose requiring funds to report quantitative measurements of certain risk metrics that would provide information beyond the narrative, often qualitative disclosures about investment strategies and risks in the fund's registration statement, as well as a fund's historical financial statement disclosures. Monthly reporting on these risk measures, in particular, would help provide the Commission with more current information on how funds are implementing their investment strategies through particular exposures. Receiving this information on a monthly basis could help the Commission, for example, more efficiently analyze the potential effects of a market event on funds.

Specifically, we are proposing to require certain funds to provide portfolio level measures on Form N-PORT that will help Commission staff better understand and monitor funds' exposures to changes in interest rates and credit spreads across the yield curve. As discussed in Part II.A.2.g below, we are also proposing to require risk measures at the investment level for options and convertible bonds. We believe that the staff can use these measures, for example, to determine whether additional guidance or policy measures are appropriate to improve disclosures in order to help investors better understand how changes in interest rate or credit spreads might affect their investment in a fund.

Additionally, as we discussed above, we believe that institutional investors, as well as entities that provide services to both institutional and individual investors, would be able to use these risk metrics to conduct their own analyses in order to help them better understand fund composition, investment strategy, and interest rate and credit spread risk the fund is undertaking. This would complement the risk disclosures that are contained in the registration statement, thereby potentially helping all investors to make more informed investment choices. We believe that our proposal to require these funds to publicly disclose these measures quarterly, like other information in the schedule of investments, will also help provide investors with more specific, quantitative information regarding the nature of a fund's exposure to particular asset classes than they do currently. Providing this more specific and current information through periodic public disclosure of such risk metrics could be especially important for investors with respect to funds that continuously offer new shares to the public, because such funds are generally required to maintain an updated or "evergreen" prospectus that must precede or accompany delivery of those securities.[56]

In particular, for funds that invest in debt instruments, or in derivatives that provide exposure to debt or debt instruments, we believe it is important for the Commission staff, investors, and other potential users to have measures that would help them analyze how portfolio values might change in response to changes in interest rates or credit spreads.[57] To improve the ability of the Commission staff, investors, and other potential users to analyze how changes in interest rates and credit spreads might affect a fund's portfolio value, we are proposing that a fund that invests in debt instruments, or derivatives that provide exposure to debt instruments or interest rates, representing at

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56 *See* section 5(b)(2) of the Securities Act.

57 As discussed further below, the Commission also believes that there would be a benefit to collecting risk measures for derivatives that provide exposure to certain assets, such as equities and commodities. Due to the nature of these instruments, however, we believe that such information should be provided on an instrument-by-instrument basis, instead of as a portfolio level calculation.

least 20% of the fund's notional exposure, provide a portfolio level calculation of duration and spread duration across the applicable maturities in the fund's portfolio.

We are proposing to limit this requirement to funds that invest in debt instruments or derivatives that provide exposure to debt instruments or interest rates that represent at least 20% of the fund's notional value as of the reporting date.[58] We are proposing the 20% threshold because we believe that at this level, the Commission would still receive measurements of duration and spread duration from funds that make investments in debt instruments as a significant part of their investment strategy, while providing an appropriate threshold so that funds that do not invest in debt to achieve their investment strategy would not have to monitor each month whether they trigger the requirement for making such calculations. Funds that primarily invest in assets other than debt instruments, such as equities, might have some level of investments in debt instruments for cash management or other purposes. We do not believe that requiring such funds to provide monthly calculations of duration or spread duration would be helpful for understanding such funds' investment strategy or risk exposures, and we believe that the 20% threshold will provide a *de minimis* level to relieve the burden of calculating these measures for such funds. We believe that information would be most useful from funds

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[58] Specifically, we are proposing to calculate notional value as the sum of the absolute values of: (i) the value of each debt security, (ii) the notional amount of each swap, including, but not limited to, total return swaps, interest rate swaps credit default swaps, for which the underlying reference asset or assets are debt securities or an interest rate; and (iii) the delta-adjusted notional amount of any option for which the underlying reference asset is an asset described in clause (i) or (ii). *See* Form N-PORT, Item B.3, Instruction.

The delta-adjusted notional value of options is needed to have an accurate measurement of the exposure that the option creates to the underlying reference asset. *See, e.g.,* Comment Letter of Morningstar (Nov. 7, 2011) ("Morningstar Derivatives Concept Release Comment Letter") (submitted in response to the Derivatives Concept Release, *supra* note 7, which sought comment regarding the use of derivatives by management investment companies).

that actually use debt exposures as part of their investment strategy. Based on staff experience, we believe that such funds have a debt exposure of at least 20%, and commonly greater than that. As discussed below, we request comment on the proposed *de minimis* threshold.

For duration, we are proposing to require that a fund calculate the change in value in the fund's portfolio from a 1 basis point change in interest rates (commonly known as DV01) for each applicable key rate along the risk-free interest rate curve, *i.e.*, 1 month, 3 month, 6 month, 1 year, 2 year, 3 year, 5 year, 7 year, 10 year, 20 year, and 30 year interest rate, for each applicable currency in the fund. We realize that funds might not have exposures for every applicable key rate. For example, a short-term bond fund is unlikely to have debt exposures with longer maturities. Accordingly, a fund would only report the key rates that are applicable to the fund. Funds would report zero for maturities to which they have no exposure.[59] For exposures outside of the range of listed maturities listed on Form N-PORT (*i.e.*, maturities shorter than one month or longer than 30 years), funds would be instructed to include those exposures in the nearest maturity.

We believe that requiring funds to provide further detail about their exposures to interest rate changes along the risk-free rate curve would provide the Commission with a better understanding of the risk profiles of funds with different strategies for achieving debt exposures. For example, funds targeting an effective duration of five years could achieve that objective in different ways – one fund could invest predominantly in intermediate-term debt; another fund could create a long position in longer-term bonds,

[59] For funds with exposures that fall between any of the listed maturities in the form, funds would be instructed to use linear interpolation to approximate exposure to each maturity listed above.

matched with a short position in shorter-term bonds. While both funds would have an intermediate-term duration, the risk profiles of these two funds, that is, their exposures to changes in long-term and short-term interest rates, are different. Having the proposed DV01 calculations along the risk-free interest rate curve would clarify this difference. The Commission staff could use this information to better understand how funds are achieving their exposures to interest rates, and use this information to perform analysis across funds with similar strategies to identify outliers for potential further inquiry, as appropriate.

Additionally, we are proposing to require that the same funds provide a measure of spread duration (commonly known as SDV01) at the portfolio level for each of the same maturities listed above, aggregated by non-investment grade and investment grade exposures.[60] This would measure the fund's sensitivity to changes in credit spreads, *i.e.*, a measure of spread above the risk-free interest rate. This is helpful for analyzing shifts in credit spreads for non-investment grade and investment grade debt, respectively, over the yield curve, as credit spreads for investment grade and non-investment grade debt do not always shift in parallel or in lock step, particularly during times of market stress.[61] Because credit spreads can also vary based on the maturity of the bonds, we believe that

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60 Form N-PORT would include instructions stating that "Investment Grade" refers to an investment that is sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time and is subject to no greater than moderate credit risk, and "Non-Investment Grade" refers to an investment that is not Investment Grade. *See* Form N-PORT, General Instruction E. These instructions are consistent with the definitions of "Investment Grade" and "Non-Investment Grade" used in Form PF.

61 *See, e.g.,* Frank K. Reilly, David J. Wright, and James A. Gentry, *Historic Changes in the High Yield Bond Market*, Journal of Applied Corporate Finance, Volume 21, No. 3, 65-79 (Summer 2009) (discussing the historical performance, including the credit spreads of the high yield bond market compared to the investment grade bond market).

providing credit spread measures for the key rates along the yield curve, as with DV01, would help the Commission better analyze credit spreads of investments in funds.[62] Again, similar to the example above regarding the potential use of the DV01 metric, SDV01 can provide more precise information regarding funds' exposures to credit spreads when they engage in a strategy investing in investment-grade or non-investment grade debt.

In determining the methodology for the proposed measures of duration and spread duration, staff engaged in outreach to asset managers and risk service providers that provide risk management and other services to asset managers and institutional investors. The methodology proposed is both based on staff experience in using duration and spread duration, as well as this outreach to better understand common fund practices for calculating such measures. The Commission recognizes that particular funds might currently vary their methodology for calculating duration and spread duration by, for example, only providing a single measure of duration or spread duration or by only reporting key rate durations for particular maturities. Based on staff experience and outreach, the Commission believes that the proposed methodologies for reporting duration and spread duration will allow for better comparability across funds.

Also, based on outreach, Commission staff believes that service providers that provide risk management services to funds generally use a "bottom up" approach to calculating duration and spread duration, meaning that such measures are first calculated

[62] The delineation between non-investment grade and investment grade debt is similar to information regarding private fund exposures gathered on Form PF, which could be helpful for comparing and analyzing credit spreads between public and private funds. *See, e.g.*, Item 26 of Form PF.

at the position level and then aggregated at the portfolio level. Accordingly, we believe that providing the specific methodology for aggregation of duration and spread duration would not significantly increase the burden of calculating such metrics by funds, even if funds analyze such measures at the portfolio level using a methodology different from what we are proposing. As discussed below, however, we request comment on the proposed methodologies, including whether such methodologies should be modified.

For both duration and spread duration, we are proposing to require that funds provide the change in value in the fund's portfolio from a 1 basis point change in interest rates or credit spreads, rather than a larger change, such as 5 basis points or 25 basis points. Based on staff's outreach, we believe that a 1 basis point change is the methodology that many funds currently use to calculate these risk measures at the position level for internal risk monitoring and would provide sufficient information to assist the Commission in analyzing fund exposures to changes in interest rate or credit spreads. We believe that requiring funds to calculate such measures based on a larger basis point change could require more customized calculations, and therefore increase costs to funds, relative to the approach proposed. We request comment on this aspect of the proposed methodology.

While the Commission is proposing that funds provide a calculation of each of these measures at a portfolio level, the Commission has considered whether to propose, instead, that funds report these risk metrics for each debt instrument or derivative that has an interest rate or credit exposure. This would provide more precise data for analysis of various movements in interest rates and credit spreads. Additionally, as discussed above, the Commission believes that most funds currently calculate these risk metrics at a position level; however, we recognize that even if such calculations are available at a position level, reporting these metrics could cause funds to make additional systems changes to collect such position-level data for reporting, as well as potential burdens related to increased review time and quality control in submitting the reports. Based on staff's outreach and staff's experience, the Commission believes that requiring funds to provide this information for each maturity at the portfolio level would provide a sufficient level of granularity for purposes of Commission staff analysis. Finally, we believe that there would be certain efficiencies for the Commission, investors, and other potential users to having funds report the portfolio-level calculations relative to reporting position-level calculations, as this could allow for more timely and efficient analysis of the data by not requiring the Commission or other potential users to calculate the portfolio-level measures from the position-level measures. We request comment below on the relative burdens and benefits of providing portfolio level and position level data.

The Commission also considered whether to require funds to report a portfolio level measure (or, for the same reasons discussed immediately above in connection with how risk measures are calculated, position level measures) for convexity, which facilitates more precise measurement of the change in a bond price with larger changes in interest rates.[63] We have preliminarily determined not to require reporting of this metric, however, because we believe, based on staff outreach, that funds more commonly analyze non-linear changes to interest rates through stress testing, rather than through calculating convexity. We request comment, however, on whether requiring funds to

[63] More specifically, convexity measures the non-linearities in a bond's price with respect to changes in interest rates. *See* Frank J. Fabozzi, THE HANDBOOK OF FIXED INCOME SECURITIES 149-152 (8th ed. 2012).

report a portfolio-level measure of convexity would be useful to the Commission, investors, and other potential users, and the relative burdens and benefits of reporting convexity.

We request comment on the proposed requirements to provide risk measures at the portfolio level.

- We are proposing a 20% threshold because, based on staff experience, we believe that this would require funds that use debt and exposure to debt or interest rate changes as part of their investment strategy to provide those metrics, while providing a minimum threshold so that funds that invest in debt for cash management or other purposes unrelated to implementing their investment strategy would not be required to collect, calculate, or report such data. Given this objective, is 20% the appropriate threshold for determining which funds must provide these risk metrics? Should this threshold be lower, such as 5% or 10% or higher, such as 30% or 35%? Are there alternative methodologies that the Commission should consider for determining which funds should be required to provide this information? Should we, instead, base the threshold directly on the net asset value ("NAV") of the fund's debt securities and interest rate investments, rather than the fund's notional exposure to debt securities or interest rates as a percentage of the fund's NAV?
- We are proposing to require reporting information on DV01 and SDV01 at the portfolio level because we believe that this can provide the Commission and investors with useful information regarding funds' exposures to changes in interest rate and credit spreads, without imposing a potential burden that might be

involved in providing such risk metrics at a position level. We believe, however, based on staff outreach that funds or their service providers generally do calculate such information at a position level. We request comment on the relative burdens and benefits of requiring funds to report portfolio level calculations of duration and spread duration, as opposed to providing those for each relevant instrument in the portfolio. What, if any, would be the added costs and burdens associated with adapting systems in order to centrally collect and report such information? What would be the benefits to the Commission, investors, and other potential users to having more precise information in order to evaluate such exposures? Conversely, are there benefits to having funds report these measures at the portfolio level rather than the position level, even if reporting at the position level would not significantly increase costs?

- To what extent would the values reported for these risk metrics be affected by the inputs and assumptions underlying the methodologies by which funds would calculate these metrics, including assumptions regarding the valuation of the investments or underlying securities of investments, particularly for investments that have pre-payment options, such as mortgage-backed securities? Specifically, how would the comparability of information reported by different funds be affected if funds used different inputs and assumptions in their methodologies? Do funds have concerns regarding reporting measures that include such assumptions, such as proprietary or liability concerns? Are there ways the Commission could improve the standardization of the calculation of these risk metrics? If so, how?

- To the extent that funds are calculating such measures using a methodology other than what the Commission is proposing, what would the associated costs and other burdens be for funds to calculate and report these measures according to a different methodology than that typically used by the fund?
- Are there any alternatives or modifications to the methodologies that the Commission is proposing that the Commission should consider?[64] For example, should the Commission require, or permit, funds to report duration and spread duration only for the maturities that represent the highest exposures in the fund, such as the top three or the top five (or another quantity)? Should the Commission require, or permit, funds to report duration and spread duration based on a larger change in interest rates or credit spreads, such as 5 basis points or 25 basis points? How would these methodologies affect the burden on funds of reporting duration and credit spread duration? Are there more efficient ways for the Commission to collect information to increase the transparency of funds' duration and spread duration?
- Should we provide a *de minimis* amount for exposure to different currencies, under which level a fund would not have to report the DV01 or SDV01 for exposures in that currency? For example, should we only require funds with exposure to a currency equal to 5% or more of the fund's NAV to provide a DV01

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64 As discussed further below, we separately propose and request comment on additional and alternative risk metrics. *See, e.g., infra* note 127 and accompanying and following text (proposing that funds report delta for certain derivative contracts), text following note 142 (requesting comment on vega, gamma, and other risk metrics), and Part II.A.4.k (generally requesting comment on additional risk measures).

and SDV01 calculation for such currency? If we were to provide a *de miminis*, should the threshold be higher or lower?

d. Securities Lending

To increase the rate of return on their portfolios, some funds engage in securities lending activities whereby a fund lends certain of its portfolio securities to other financial institutions such as broker-dealers. In return for the security lent, funds receive collateral and sometimes a fee. To protect the fund from the risk of borrower default, the borrower generally posts collateral with the fund in an amount at least equal to the value of the borrowed securities, and this amount of collateral is adjusted daily as the value of the borrowed securities is marked to market.[65] Funds generally receive cash as collateral. A fund will typically invest cash collateral that it receives in short-term, highly liquid instruments, such as money market funds or similar pooled investment vehicles, or directly in money market instruments.[66]

The fund's income from these activities may come from fees paid by the borrowers to the fund and/or from the reinvestment of collateral. Many funds engage an external service provider—commonly called a "securities lending agent"—to administer the securities lending program. The securities lending agent is typically compensated by

65 *See* Securities Industry and Financial Markets Association, Master Securities Loan Agreement (2000 Version) §§4, 9, *available at* http://www.sifma.org/services/standard-forms-and-documentation/. *See also* Division of Investment Management, Securities and Exchange Commission, *Securities Lending by U.S. Open-End and Closed-End Investment Companies* ("Securities Lending Summary"), *available at* http://www.sec.gov/divisions/investment/securities-lending-open-closed-end-investment-companies.htm.

66 Lending funds and borrowers may negotiate the collateral that the borrower posts to the lender, and a cash collateral fee, commonly called a "rebate," that the lender pays to the borrower. The rebate is negotiated and can be negative (*i.e.*, a fee paid from the borrower to the lender) when demand for the loan of a particular security is especially great or its supply especially constrained. *See id.* at §5.

being paid a share of the fund's securities lending revenue after the counterparty has been paid any rebate due to it.[67]

Securities lending implicates certain provisions of the Investment Company Act, and funds that engage in securities lending do so in reliance on Commission staff no-action letters, and in some circumstances, exemptive orders.[68] These letters and orders address a number of areas, including loan collateralization and termination, fees and compensation, board approval and oversight, and voting of proxies.

Currently, the information that funds are required to report about securities lending activity, whether in a structured format or otherwise, is limited. For example, funds disclose on Form N-SAR whether they are permitted under their investment policies to, and whether they did engage during the reporting period in, securities lending activities.[69] Funds generally also disclose additional information regarding their securities lending programs in their registration statements.[70] In addition, consistent with current industry practices, many funds voluntarily identify particular securities that are on loan in their schedules of portfolio investments prepared pursuant to Regulation S-X. These requirements do not address other pertinent considerations, such as the extent to which a fund lends its portfolio securities, the counterparties to which the fund is

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[67] *See* Securities Lending Summary, *supra* note 65.

[68] For example, the transfer of a fund's portfolio securities to a borrower implicates section 17(f) of the Investment Company Act, which generally requires that a fund's portfolio securities be held by an eligible custodian. A fund's obligation to return collateral at the termination of a loan implicates section 18 of the Investment Company Act, which governs the extent to which a fund may incur indebtedness. *See id.*

[69] Item 70.N of Form N-SAR.

[70] *See, e.g.,* Form N-1A, Items 9(c) (disclosures regarding risks), 16(b) (disclosures of investment strategies and risks), 17(f) (disclosures of proxy voting policy), and 28(h) (exhibits of other material contracts).

exposed, the fees and revenues associated with those activities, and the significance of securities lending revenue to the investment performance of the fund.

To address these data gaps and provide additional information to the Commission, investors, and other potential users regarding a fund's securities lending activities, we are proposing that funds report certain counterparty information and position-level information monthly on Form N-PORT.[71] Also, as to other information for which annual reporting would be sufficient because it is unlikely to change on a frequent basis (*e.g.*, name and other identifying information for a fund's securities lending agent), we are proposing that funds report this information annually on Form N-CEN as discussed below in Part II.E. We are also proposing, as discussed below in Part II.C.5, to require that certain information about the income from and fees paid in connection with securities lending activities, and the monthly average of the value of portfolio securities on loan, be disclosed as part of the notes to funds' financial statements.[72]

Our proposals today are intended, in part, to increase the transparency of information available related to the lending and borrowing of securities with respect to

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[71] *See infra* text following note 74 (discussing the reporting of counterparty information); Part II.A.2.g (discussing the proposed requirements regarding position-level information). Commenters to the FSOC Notice also suggested that enhanced securities lending disclosures could be beneficial to investors and counterparties. *See, e.g.,* SIFMA/IAA FSOC Notice Comment Letter, *supra* note 43 ("Disclosures related to securities lending practices, if appropriately tailored, could potentially assist investors and counterparties in making informed choices about where they deploy their assets and how they engage in lending practices."); Comment Letter of the Vanguard Group, Inc. (Mar. 25, 2015) ("Vanguard FSOC Notice Comment Letter") (asserting that securities lending as a whole suffers from a lack of readily available data, and supporting further efforts to gather data and study the practice of securities lending).

[72] *See infra* text following note 276 (discussing proposed disclosures in the notes to funds' financial statements that would allow investors to better understand the income generated from, as well as the expenses associated with, securities lending activities).

funds as a subset of the universe of market participants engaged in securities lending activities.[73]

Counterparty Information. One risk that funds engaging in securities lending are exposed to is counterparty risk because borrowers could fail to return the loaned securities. In this event, the lender would keep the collateral. Collateral is generally posted in cash and, in practice, the loan is generally over-collateralized. The collateral requirements thereby mitigate the extent of a fund's counterparty risk. In some cases, this risk is further mitigated for the fund if the fund's securities lending agent indemnifies the fund against default by the borrower.

While we believe there is value to having information concerning securities lending counterparties to monitor risk, as well as to monitor compliance with conditions set forth in staff no-action letters and exemptive orders,[74] we are proposing to require that funds report, for each of their securities lending counterparties as of the reporting date, the full name and LEI of the counterparty (if any), as well as the aggregate value of all securities on loan to the counterparty, rather than at the loan level.[75] We believe that disclosure of counterparty information at an aggregate portfolio level would provide the Commission and investors with information to better understand the level of potential counterparty risk assumed as part of the fund's securities lending program, with a lower relative burden on funds than requesting such information on a per loan level.

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[73] *See, e.g.,* section 984(b) of the Dodd-Frank Act, Pub. L. No 111-203, 124 Stat. 1376 (2010) (directing the Commission to promulgate rules designed to increase the transparency of information available to brokers, dealers, and investors, with respect to the loan or borrowing of securities).

[74] *See generally* Securities Lending Summary, *supra* note 65.

[75] Form N-PORT, Item B.4.

We request comment on the portfolio level securities lending information requirements we are proposing.

- As discussed above, Form N-PORT would require funds to disclose the aggregate value of all securities on loan to each securities lending counterparty and the name and LEI (if any) of the counterparty. Should we instead require funds to report this information on a loan-by-loan or security-by-security basis? To what extent, if any, would such information be used by investors and other potential users? What, if any, additional issues would funds face in tracking and reporting such information on a loan-by-loan or security-by-security basis? Do funds currently track or have the ability to readily determine their counterparty exposure on a loan-by-loan or security-by-security basis? If securities lending counterparty information should be reported on a loan-by-loan or security-by-security basis, is there any additional or alternative information we should require funds to report, such as the rebate or compensation to the securities lending agent?
- Instead of requiring funds to report the aggregate value of all securities on loan to each securities lending counterparty, should we limit such disclosures to counterparties to which the fund has the greatest exposure, such as the top five or top ten counterparties?[76] Alternately, should we require funds to report aggregate exposure to a given counterparty only if such exposure constitutes more than a certain percentage of the NAV of the fund (*e.g.,* one percent)? Would either approach more appropriately consider the costs of tracking and reporting such

[76] *Cf.* Form PF, Section 1c, Item 22 (requiring advisers to private funds to report exposures to the five counterparties to which the reporting fund has the greatest mark-to-market net counterparty credit exposure).

information and the benefits that increased transparency would provide to the Commission and other potential users?

- Alternately, or in addition, should the Commission request information regarding other types of counterparty exposures? For example, should the Commission require funds to report counterparty exposures based on the amount of unsettled trades with each counterparty? If so, should such information be reported in terms of aggregate or net exposure, and why?

e. Return Information

We are proposing to require funds to provide monthly total returns for each of the preceding three months.[77] If the fund is a multiple class fund, it would report returns for each class.[78] Funds with multiple classes would also report their class identification numbers.[79] Funds would calculate returns using the same standardized formulas required for calculation of returns as reported in the performance table contained in the risk-return summary of the fund's prospectus and in fund sales materials.[80]

We are proposing to require this information on Form N-PORT because we believe it would be useful to have such information in a structured format to facilitate comparisons across funds. For example, analysis of return information over time among similar funds could reveal outliers that might merit further inquiry by Commission staff.

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77 *See* Form N-PORT, Item B.5.a.

78 *See id.*

79 *See* Form N-PORT, Item B.5.b.

80 *See* Form N-1A, Item 26(b)(1); Form N-2, Item 4, Instruction 13; Form N-3, Item 26(b)(i).

Additionally, performance that appears to be inconsistent with a fund's investment strategy or other benchmarks can form a basis for further inquiry and monitoring.[81]

Because only quarter-end reports on Form N-PORT would be made public, we are proposing that funds provide return information for each of the preceding three months.[82] This would provide investors and other potential users with monthly return information, so that they would have access to each month's return on a quarterly basis. Otherwise, we are concerned that investors might potentially confuse the month's disclosed return as representing the return for the full quarter.

We are also proposing that funds report, for each of the preceding three months, monthly net realized gain (or loss) and net change in unrealized appreciation (or depreciation) attributable to derivatives for each of the following categories: commodity contracts, credit contracts, equity contracts, foreign exchange contracts, interest rate contracts, and other derivatives contracts.[83] This item is modeled after disclosure requirements in Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 815, which governs the accounting disclosure for derivatives and hedging. This information would help the Commission staff, investors, and other

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81 Similar risk analytics were used in the Commission's Aberrational Performance Inquiry, an initiative by the Division of Enforcement's Asset Management Unit to identify hedge funds with suspicious returns. *See, e.g.,* Press Release, SEC Charges Hedge Fund Adviser and Two Executives with Fraud in Continuing Probe of Suspicious Fund Performance (Oct. 17, 2012), *available at* http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171485332.

82 *See* Form N-PORT, Item B.5.a. Although generally only information reported on Form N-PORT for the third month of each fund's fiscal quarter would be publicly available, the concerns associated with more frequent public disclosure are related to the disclosure of portfolio holdings information and would not apply to the disclosure of fund return information. *See generally* note 170 and accompanying and following text (discussing the risks of predatory trading practices such as front-running and the ability of outside investors to reverse engineer and copycat fund's investment strategies).

83 *See* Form N-PORT, Item B.5.c.

potential users better understand how a fund is using derivatives in accomplishing its investment strategy and the impact of derivatives on the fund's returns. In order to provide a point of comparison, we are also proposing that funds report, for each of the last three months, monthly net realized gain (or loss) and net change in unrealized appreciation (or depreciation) for investments other than derivatives.[84]

We request comment on the return information we are proposing in Form N-PORT.

- Should the Commission consider, as an alternative, requiring funds to provide monthly return information annually on Form N-CEN, rather than on Form N-PORT? Would this significantly reduce the burden of reporting such information?
- We are proposing to require that funds report three months of returns so that investors and other potential users, who would only observe reports on Form N-PORT on a quarterly basis, would still receive return data for each month of the year. Do commenters agree that such disclosure of monthly returns would be helpful to investors? Are there preferable alternatives for providing such information to investors? Are there potential negative consequences of reporting monthly returns? For example, could the availability of this information cause investors to emphasize short-term returns?

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84 *See* Form N-PORT, Item B.5.d. Our proposal would also amend Regulation S-X to require funds to report similar information in their financial statements, although Regulation S-X would require such information to be aggregated by type of derivative contract, rather than by category of exposure as required by Form N-PORT. We discuss below our reasons for proposing information to be reported based on contract type on Regulation S-X. *See infra* Part II.C.

- We request comment on alternative requirements for fund reporting of return information. For example, the Commission requests comment on whether to require reporting by funds of gross returns. Would gross information, with or without accompanying fee information for each class, be confusing for investors? If so, are there ways to mitigate the risk of investor confusion? Instead of requiring reporting of returns for all classes, should the Commission, for example, require funds to report return information for a single class, such as the class with the highest expense ratio or the largest share class in terms of assets under management? What would be the relative benefits and burdens of only requiring disclosure of a single class?
- Are there alternative methods that the Commission should consider for requiring funds to report the effect of derivatives on the return of the fund? For example, should the Commission require that funds report the monthly net realized gain or loss and net change in unrealized appreciation or depreciation attributable to derivatives by type of derivative (*i.e.,* forward, future, option, swap), rather than by category of exposure? What would be the burden and benefits of reporting such information relative to the proposed requirement?

f. Flow Information

Form N-PORT would require funds to separately report, for each of the preceding three months, the total net asset value of: (1) shares sold (including exchanges but excluding reinvestment of dividends and distributions); (2) shares sold in connection with reinvestments of dividends and distributions; and (3) shares redeemed or repurchased (including exchanges).[85] This information is similar to what is currently reported on Form N-SAR, and would be generally reported subject to the same guidelines that currently govern reporting of flow information on that form.[86] We propose to require this information on Form N-PORT because we believe that this information would be more helpful if reported on a monthly basis rather than retrospectively on an annual basis on Form N-CEN.

We believe that having flow information reported to us monthly will help us better monitor trends in the fund industry. For example, it could help us analyze types of funds that are becoming more popular among investors and areas of high growth in the industry. It could help us better examine investor behavior in response to market events. Finally, in combination with other information reported on Form N-PORT regarding liquidity of fund positions, it could also help us identify funds that might be at risk of experiencing liquidity stress due to increased redemptions.

- What would be the costs and burdens of providing flow information on a monthly basis on Form N-PORT? Should the Commission consider, as an alternative,

[85] *See* Form N-PORT, Item B.6.

[86] Similar to Form N-SAR, Form N-PORT would instruct funds to report amounts after any front-end sales loads had been deducted and before any deferred or contingent deferred sales loads or charges had been deducted. Shares sold would include shares sold by the fund to a registered UIT. Funds would also include as shares sold any transaction in which the fund acquired the assets of another investment company or of a personal holding company in exchange for its own shares. Funds would include as shares redeemed any transaction in which the fund liquidated all or part of its assets. Exchanges would be defined as the redemption or repurchase of shares of one fund or series and the investment of all or part of the proceeds in shares of another fund or series in the same family of investment companies. *Cf.* Form N-PORT, Item B.6 and Item 28 of Form N-SAR (requiring reporting of monthly sales and repurchases of the Registrant's/Series' shares for the past six months).

requiring funds to provide monthly flow information annually on Form N-CEN, rather than on Form N-PORT?

- To what extent would the usefulness of the flow information be affected by the fact that omnibus accounts, which generally have significant amounts of purchases and redemptions, typically net their transactions prior to executing with the funds' transfer agents? Should the Commission revise the proposed flow disclosures to address this issue and, if so, how?
- Form N-SAR currently also requires funds to report flow information related to "other" shares sold (*i.e.,* other than through new sales and exchanges and reinvestments of dividends and distributions).[87] Should the Commission also require funds to report this category of flow information on Form N-PORT? What would be the utility of requesting flow information to be separately reported in this additional category?
- Should we require that flow information be reported as to each class of the fund? Would such additional information be helpful to investors and other potential users? What would be the burdens to funds with multiple classes of reporting such information?

g. Schedule of Portfolio Investments

Part C of proposed Form N-PORT would require funds to report certain information on an investment-by-investment basis about each investment held by the fund and its consolidated subsidiaries as of the close of the preceding month. Funds would respond to certain questions that would apply to all investments (*i.e.,* the

[87] *See id.*

investment's identification, amount, payoff profile, asset and issuer type, country of investment or issuer, and fair value level, and whether the investment was a restricted security or illiquid asset). Funds would also respond, if relevant, to additional questions related to specific types of investments (*i.e.,* debt securities, repurchase and reverse repurchase agreements, derivatives, and securities lending).

Funds would have the option of identifying any investments that are "miscellaneous securities."[88] Unless otherwise indicated, funds would not report information related to those investments in Part C, but would instead report such information in Part D.[89]

i. Information for All Investments

Proposed Form N-PORT would require funds to report certain basic information about each investment. In particular, funds would report the name of the issuer and title of issue or description of the investment, as they are currently required to do on their reported schedules of investments.[90]

To facilitate analysis of fund portfolios, it is important for Commission staff to be able to identify individual portfolio securities, as well as the reference instruments of derivative investments through the use of an identifying code or number, which is not currently required to be reported on the schedule of investments. Fund shareholders and potential investors that are analyzing fund portfolios or investments across funds could similarly benefit from the clear identification of a fund's portfolio securities across funds.

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88 *See* Form N-PORT, Part D. *See also supra* note 49 and accompanying text.

89 *See infra* note 150 and accompanying and following text.

90 *See* Form N-PORT, Items C.1.a and C.1.c.

The staff has found that some securities reported by funds lack a securities identifier, and this absence has reduced the usefulness of other information reported.[91]

To address this issue, we propose to require that funds report additional information about the issuer and the security. Funds would report certain securities identifiers, if available.[92] For example, for swaps and security-based swaps, funds could report the product identification number used for reporting such instrument to a swap data repository or securities-based swap data repository, if available.[93] If a unique identifier is reported, funds would also indicate the type of identifier used.[94] Such an identifier may be internally generated by the fund or provided by a third party, but should be consistently used across the fund's filings for reporting that investment so that the Commission, investors, and other potential users of the information can track the investment from report to report.

We also propose to require funds to report the amount of each investment as of the end of the reporting period, as is currently required under Regulation S-X.[95] Funds would report the number of units or principal amount for each investment, as well as the value of each investment at the close of the period, and the percentage value of each

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91 Our inability to identify specific securities has limited our ability in other contexts to compare ownership of the securities across multiple funds and monitor issuer exposure. For example, during the month of February 2013, money market funds reported 6,821 securities without CUSIPs (approximately 10% of all securities reported on Form N-MFP).

92 *See* Form N-PORT, Item C.1.b and C.1.d to C.1.e (requiring reporting of identifiers such as LEI of the issuer, CUSIP, ISIN, ticker or other unique identifier).

93 *See infra* notes 138-140 (discussing product identifiers for security-based swaps and swaps, as addressed in rulemakings by the Commission and Commodity Futures Trading Commission, respectively).

94 *See* Form N-PORT, Item C.1.e.iii.

95 *See* Form N-PORT, Item C.2. *See* rule 12-12 of Regulation S-X.

investment when compared to the net assets of the fund.[96] Funds would also report the currency in which the investment was denominated, and, if not denominated in U.S. dollars, the exchange rate used to calculate value.

Our proposal would also require funds to report the payoff profile of the investment, indicating whether the investment is held long, short, or N/A, which would serve the same purpose as the current requirement in Regulation S-X to disclose investments sold short.[97] Funds would respond N/A for derivatives and would respond to relevant questions that indicated the payoff profile of each derivative in the derivatives portion of the form. These disclosures would identify short positions in investments held by funds.

Funds would also report the asset type for the investment: short-term investment vehicle (*e.g.*, money market fund, liquidity pool, or other cash management vehicle), repurchase agreement, equity-common, equity-preferred, debt, derivative-commodity, derivative-credit, derivative-equity, derivative-foreign exchange, derivative-interest rate, structured note, loan, ABS-mortgage backed security, ABS-asset backed commercial paper, ABS-collateralized bond/debt obligation, ABS-other, commodity, real estate, other) and issuer type (corporate, U.S. Treasury, U.S. government agency, U.S. government sponsored entity, municipal, non-U.S. sovereign, private fund, registered fund, other).[98] We have based these categories in part on staff review of how funds currently categorize investments on their schedule of investments, and in part on the

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96 *See* Form N-PORT, Item C.2.a to C.2.d. For derivatives, as appropriate, funds would provide the number of contracts.

97 *See* Form N-PORT, Item C.3. *See* rule 12-12A of Regulation S-X.

98 *See* Form N-PORT, Item C.4.a and C.4.b.

categories of investments required by private funds under Form PF.[99] These disclosures would allow the Commission, investors, and other potential users to assess the composition of fund portfolios in terms of asset and issuer types and also facilitate comparisons among similar types of investments.

Our proposal would also require funds to report, for each investment, whether the investment is a restricted security and whether the investment is an illiquid asset.[100] These disclosures would provide investors and the Commission staff with more information about liquidity risks associated with the fund's investments.

Each fund would also report whether the investment is categorized by the fund as a Level 1, Level 2, or Level 3 fair value measurement in the fair value hierarchy under U.S. Generally Accepted Accounting Principles ("U.S. GAAP").[101] Commission staff

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[99] *See, e.g.,* Form PF, Item 26 (requiring filers to report exposures by asset type); Form N-Q, Item 1 (requiring filers to report the schedules of investments required by sections 210.12-12 to 12-14 of Regulation S-X); Form N-CSR, Item 1 (requiring filers to attach a copy of the report transmitted to shareholders, which would include schedules of investments required by sections 210.12-12 to 12-14 of Regulation S-X).

[100] *See* Form N-PORT, Items C.6 and C.7. "Restricted security" would have the definition provided in rule 144(a)(3) under the Securities Act [17 CFR 230.144(a)(3)]. *See* Form N-PORT, General Instruction E. *See also* proposed rule 12-13, nn.6 and 8 of Regulation S-X, which would require similar disclosures in funds' schedules of investments to identify securities that are restricted or illiquid.

Form N-PORT would define "illiquid asset" as "an asset that cannot be sold or disposed of by the Fund in the ordinary course of business within seven calendar days, at approximately the value ascribed to it by the Fund." *See* Form N-PORT, General Instruction E. This definition is the same definition used in the liquidity guidance issued by the Commission for open-end funds. *See* Revisions of Guidelines to Form N-1A, Investment Company Act Release No. 18612 (Mar. 12, 1992) [57 FR 9829 (Mar. 20, 1992)] ("1992 Release"). As recently stated by Chair Mary Jo White, the Division of Investment Management is considering a recommendation that the Commission update liquidity standards for open-end funds and ETFs, which may result in updated guidance on this issue. *See* Speech by Securities and Exchange Commission Chair Mary Jo White (Dec. 11, 2014), *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370543677722.

[101] *See* ASC 820. An investment is categorized in the same level of the fair value hierarchy as the lowest level input that is significant to its fair value measurement. Level 1 inputs include

could use this information to identify and monitor investments that may be more susceptible to increased valuation risk and identify potential outliers that warrant additional monitoring or inquiry.[102] In addition, Commission staff would be better able to identify anomalies in reported data by aggregating all fund investments industry-wide into the various level categories. Currently, funds are required to evaluate the fair value level measurement of each investment as part of the fair value level hierarchy disclosure in their financial statements.[103] We believe that based on this requirement, funds should have pricing information available to determine the categorization of their portfolio investments as Level 1, Level 2, or Level 3 within the fair value hierarchy.

Form N-PORT would also require funds to report the country that corresponds to the country of investment or issuer based on the concentrations of the risk and economic exposure of the investment. Additionally, funds would be required to report the country in which the issuer is organized if that is different from the country of risk and economic exposure.[104]

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quoted prices (unadjusted) for identical investments in an active market (*e.g.*, active exchange-traded equity securities). Level 2 inputs include other observable inputs, such as: (i) quoted prices for similar securities in active markets; (ii) quoted prices for identical or similar securities in non-active markets; and (iii) pricing models whose inputs are observable or derived principally from or corroborated by observable market data through correlation or other means for substantially the full term of the security. Level 3 inputs are unobservable inputs. We are proposing amendments to Regulation S-X to require that funds identify level 3 securities in their schedules of investments. *See infra* Part II.C.3.

[102] For a discussion of some of the challenges regulators may face with respect to Level 3 accounting, *see, e.g.,* Konstantin Milbradt, *Level 3 Assets: Booking Profits and Concealing Losses*, in 25 Rev. Fin. Stud. 55-95 (2011).

[103] ASC 820-10-50-2 requires for each class of assets and liabilities measured at fair value, the level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3).

[104] *See* Form N-PORT, Item C.5. Currently, funds are required to report the related industry, country, or geographic region of the investment in their schedules of investments. As

These disclosures would provide the Commission staff and investors with more information about country-specific exposures associated with the fund's investments. Specifically, the Commission believes that providing both the country based on concentrations of risk and economic exposure and also the country in which the issuer is organized would assist the Commission, investors, and other potential users in understanding the country-specific risks associated with such investments. For example, knowing the country of risk and economic exposure is important for understanding the effect of such investments in a portfolio when that country might be going through times of economic or political stress, regardless of whether the investment is issued in a different country. Knowing the country in which the issuer is organized would be important information for analyzing the effect of any events that could affect the country in which the issuer is organized, such as sanctions or monetary controls, as this could affect the ability of the fund to liquidate the investment.

We request comment on our proposed disclosure requirements.

- Our proposal would require funds to report certain identifiers for their investments. Should the Commission include additional specific identifiers in Form N-PORT, such as the Financial Instrumental Global Identifier ("FIGI") or other similar identifier, if available?[105] If so, which identifier or identifiers would be expected to be reported? Are there any special considerations relating to the

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discussed below, we are proposing to amend Regulation S-X to require funds to report the industry and the country or geographic region of the investment. *See infra* Part II.C.3.

[105] Information about the FIGI is available on the Object Management Group's website, a not-for-profit technology standards consortium. *See generally* Object Management Group, Documents Associated With Financial Industry Global Identifier (FIGI) Version 1.0 – Beta 1, *available at* http://www.omg.org/spec/FIGI/1.0/Beta1/.

use of any identifiers (*e.g.*, licensing fees associated with certain identifiers, the prevalence of a particular identifier as adopted by the marketplace, etc.) that could be addressed through these reporting requirements? If so, how should the requirements be restructured to address those considerations while still providing the Commission and investors the necessary identifying information?

- We request comment on our proposal to require funds to provide other unique identifiers for investments that do not have ISIN or ticker identifiers. Should the Commission require, in certain circumstances, specific identifiers to be reported as other unique identifiers? For example, in the case of security-based swaps, should the Commission require funds to report unique product identifiers?[106] If so, why?
- How, if at all, should we modify our proposed disclosures for the amount of each investment at the end of the reporting period (as well as the currency in which it is denominated)? Likewise, should we modify our proposed disclosures for the payoff profile of each investment and the restricted/illiquid nature of securities? If so, why?
- Would our proposed asset and issuer categories allow funds to readily categorize the investments typically held in fund portfolios? Should we include additional or alternative categories, and if so why? For example, are there any specific asset subcategories with sufficiently unique features as to warrant their own asset category? To the extent that funds currently are not categorizing their

[106] *See infra* note 139 and accompanying and following text.

investments as proposed in Form N-PORT, what costs would be associated with providing such information?

- Should any of these disclosures be aggregated and reported on a portfolio basis, rather than at an individual investment level? Alternately, should any of the proposed portfolio level information be reported on an individual investment level?
- We request comment on the incremental burden of reporting this information for each investment held by the fund, relative to the current burden of reporting the total value of each class of investments categorized in each level of the fair value hierarchy, as currently required by U.S. GAAP. Are there other ways in which a fund could identify and disclose investments that do not have readily available market quotations or observable inputs as an alternative to disclosing each investment's categorization as a Level 1, Level 2, or Level 3 measurement?
- Are there additional items that should be included on Form N-PORT in order to improve the transparency regarding the liquidity and valuation of investments? For example, should the Commission require additional disclosure regarding the fund's valuation of its investments, such as the primary pricing source used (*e.g.*, exchange, broker quote, third-party pricing service, internal fair value), the name of any third-party pricing source, or whether an independent consultant or appraiser assisted with development of internal fair value? If so, should such information be disclosed on an individual security basis? Would such information increase the transparency of the pricing of thinly traded securities?

Would investors benefit from such information and, if so, how? What costs and burdens would be associated with providing such information?

- Should the Commission require funds to report both the country in which the issuer is organized and also the country with the greatest concentrations of risk and economic exposure of the investments? What is the burden of reporting both elements, if different? Should the Commission provide specific guidance or instructions for determining the country with the greatest concentration of risks and economic exposure? Should funds have the option of reporting more than one country of economic risk, or a geographic region of economic risk?
- Should funds not be required to report country codes for U.S. investments? Would such an exclusion result in reduced burdens for funds that held only domestic securities? On the other hand, would such an exclusion result in investor confusion or complicate data validation efforts, by, for example, rendering it unclear whether an investment with N/A reported for its country code was a U.S. investment or was instead a foreign investment for which a country code had not been properly reported?

ii. Debt Securities

In addition to the information required above, Form N-PORT would require additional information about each debt security held by the fund in order to gain transparency into the payment flows and convertibility into equity of such investments, as such information can be used to better understand the payoff profile and credit risk of these investments. First, funds would report the maturity date and coupon (reporting annualized rate and indicating whether fixed, floating, variable, or none).[107] Funds would also indicate whether the security is currently in default, whether interest payments for the security are in arrears or whether any coupon payments have been legally deferred by the issuer, as well as whether any portion of the interest is paid in kind.[108]

Finally, we are proposing to require additional information for convertible securities, to indicate whether the conversion is mandatory or contingent.[109] We are also proposing to require funds to disclose for each convertible security the conversion ratio, information about the asset into which the debt is convertible, and the delta, which is the ratio of the change in the value of the option to the change in the value of the asset into which the debt is convertible. This reflects the sensitivity of the debt's value to changes in the price of the asset into which the debt is convertible. The proposed requirement to provide the delta would also be required for options, as discussed further below, because convertible securities have optionality.[110] For similar reasons discussed below regarding options, the Commission believes that providing the delta for convertible securities is important to understand the extent of both the credit exposure of the debt portion of the convertible bond as well as the market price exposure relative to the underlying security into which it can be converted or exchanged.

We request comment on our proposed disclosure requirements for debt securities.

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[107] *See* Form N-PORT, Items C.9.a and C.9.b.

[108] *See* Form N-PORT, Items C.9.c to C.9.e.

[109] *See* Form N-PORT, Item C.9.f.

[110] *See* text accompanying and following note 127 (discussing information required for options, including delta).

- Are there additional or alternative characteristics of debt securities that we should require to be disclosed to assist the Commission, investors, or other potential users in understanding the nature and risks of a fund's debt security investments? For example, would disclosure of which debt securities are guaranteed, the nature of such guarantee (*e.g.,* guarantee insurance or letter of credit), and the identity of the guarantor, be useful to investors? Alternately, or in addition, should the Commission require disclosure regarding the frequency of coupon payments, principal payback schedule, priority in security structure (*e.g.,* senior, subordinated, etc.), embedded options (if any), insurance wrapper (if any), and whether the debt is secured?
- We request comment on our proposed disclosure requirements for convertible securities. With regard to the delta, to what extent would the inputs and assumptions underlying the methodology by which funds calculate price changes affect the values reported? Are there liability or other concerns associated with the reporting of such measures with such inputs and assumptions? How would the comparability of information reported between funds be affected if funds used different inputs and assumptions in calculating delta, such as different assumptions regarding the values of the funds' portfolios? Are there ways the Commission could improve the standardization of the calculation of delta? If so, how? What would the associated costs and other burdens be for funds to calculate and report these measures according to a different methodology than that typically used by the fund?

iii. Repurchase and Reverse Repurchase Agreements

In addition to the information required above for all investments, Form N-PORT would require each fund to report additional information for each repurchase and reverse repurchase agreement held by the fund. The fund would report the category that reflects the transaction from the perspective of the fund (repurchase, reverse repurchase), whether the transaction is cleared by a central counterparty—and if so the name of the central counterparty—or if not the name and LEI (if any) of the over-the-counter counterparty, repurchase rate, whether the repurchase agreement is tri-party (to distinguish from bilateral transactions), and the maturity date.[111] Funds would also report the principal amount and value of collateral, as well as the category of investments that most closely represents the collateral.[112]

These disclosures would enhance the information currently reported regarding funds' use of repurchase agreements and reverse repurchase agreements. Information regarding repurchase agreements would be comparable to similar disclosures currently required to be made by money market funds on Form N-MFP. The categories used for reporting collateral would track the categories currently used to report tri-party repurchase agreement information to the Federal Reserve Bank of New York. We believe that conforming the categories that would be used in Form N-PORT to categories

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[111] *See* Form N-PORT, Items C.10.a to C.10.e.

[112] *See* Form N-PORT, Item C.10.f. Funds would report the category of investments that most closely represents the collateral, selected from among the following (asset-backed securities; agency collateralized mortgage obligations; agency debentures and agency strips; agency mortgage-backed securities; private label collateralized mortgage obligations; corporate debt securities; equities; money market; U.S. Treasuries (including strips); other instrument). If "other instrument," funds would also include a brief description, including, if applicable, whether it is a collateralized debt obligation, municipal debt, whole loan, or international debt.

used in other reporting contexts would ease reporting burdens and enhance comparability.[113]

We request comment on our proposed disclosure requirements above.

- As discussed above, the reporting requirements contained in Form N-PORT would be comparable to similar disclosures currently required to be made by money market funds on Form N-MFP concerning repurchase agreements. Should we collect different or additional information? For example, should the proposed reporting requirements be revised to encompass characteristics of bilateral repurchase and reverse repurchase agreements, which are not typically held by money market funds but we understand are more commonly held by funds that would be reporting on Form N-PORT? If so, how? Should the categories used for reporting collateral, which as proposed would track the categories currently used to report tri-party repurchase agreement information to the Federal Reserve Bank of New York, be revised? If so, how and why?
- We believe that funds already track the characteristics of their repurchase and reverse repurchase agreements that we would require to be reported on Form N-PORT. To the extent this is true, what would be the incremental cost and burden of reporting such information to the Commission?

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113 *See* Money Market Fund Reform 2014 Release, *supra* note 13, at nn.1515-1518 and accompanying text (discussing comment letter stating that the categories used to report collateral for tri-party repurchase agreements to the Federal Reserve Bank of New York would allow for regular and efficient comparison of current and historical risk factors regarding repurchase agreements on a standardized basis).

- Are there additional or alternative disclosures that we should require to be reported to assist investors in understanding counterparty and other risks associated with the fund's repurchase and reverse repurchase agreements?

iv. *Derivatives*

As discussed above, the current reporting regime for derivatives has led to inconsistent approaches to reporting derivatives information and, in some cases, insufficient information concerning the terms and underlying reference assets of derivatives to allow the Commission or investors to understand the investment. Additionally, as discussed further below, for options, the Commission believes that it would be important to have a measurement of "delta," a measure not reported in the financial statements or schedule of investments, to better understand the exposure to the underlying reference asset that the options produce in the portfolio. Currently, the Commission and investors are sometimes unable to accurately assess funds' derivatives investments and the exposures they create, which can be important to understanding funds' investment strategies, use of leverage, and risk of loss. Our proposal is intended to increase transparency into funds' derivatives investments by requiring funds to disclose certain characteristics and terms of derivative contracts that are important to understand the payoff profile of a fund's investment in such contracts, as well as the exposures they create or hedge in the fund. This would include, for example, exposures to currency fluctuations, interest rate shifts, prices of the underlying reference asset, and counterparty credit risk. As discussed further below, we are also amending Regulation S-X to make similar changes to the reporting regime for derivatives disclosures in fund financial statements.

Consequently, in addition to the information required above for all investments, Form N-PORT would require additional information about each derivative contract in the fund's portfolio. Funds would report the category of derivative that most closely represents the investment (*e.g.,* forward, future, option, etc.).[114] Funds would also report the name and LEI (if any) of the counterparty (including a central counterparty).[115] This identifying information should assist the Commission, investors, and other potential users in better identifying and monitoring the categories of derivatives held by funds and the associated counterparty risks.[116]

Form N-PORT would also require funds to report terms and conditions of each derivative investment that are important to understanding the payoff profile of the derivative.[117] For options and warrants, including options on a derivative (*e.g.*,

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114 *See* Form N-PORT, Item C.11.a. Funds would report the category of derivative that most closely represents the investment, selected from among the following (forward, future, option, swaption, swap, warrant, other). If "other," funds would provide a brief description.

115 *See* Form N-PORT, Item C.11.b.

116 Commenters to the FSOC Notice indicated that counterparty data for derivative disclosures is not often available and discussed the need to have more transparency in this regard. *See, e.g.,* Comment Letter of Americans for Financial Reform (Mar. 27, 2015) ("Americans For Financial Reform FSOC Notice Comment Letter") (asserting that counterparty data in derivative disclosures is not often available); Comment Letter of the Systemic Risk Council (Mar. 25, 2015) ("Systemic Risk Council FSOC Notice Comment Letter") (discussing the need to have information about investment vehicles that hold bank liabilities).

117 We are proposing to require similar information on a fund's schedule of investments. *See* Part II.C.2. Commenters to the FSOC Notice were supportive of enhanced derivatives disclosures. *See, e.g.,* Systemic Risk Council FSOC Notice Comment Letter, *supra* note 116 ("While most managed funds do not employ leverage to the same degree that banks do, we encourage regulators to consider carefully whether there are potential improvements to the current data collection regime (*e.g.*, for registered investment advisers) that would allow regulators to track the presence and concentration of leverage in the asset management industry, particularly as it arises from use of derivatives...."); Americans for Financial Reform FSOC Notice Comment Letter, *supra* note 116 (stating that regulatory oversight should include ensuring appropriate transparency of fund positions to both investors and regulators, asserting that current derivatives disclosure requirements for registered investment companies "appear very poor," noting the deficiency of just current accounting values and

swaptions), funds would report the type (*e.g.*, put), payoff profile (*e.g.*, written), number of shares or principal amount of underlying reference instrument per contract, exercise price or rate, expiration date, and the unrealized appreciation or depreciation of the option or warrant.[118] Form N-PORT would require funds to provide a description of the reference instrument, including name of issuer, title of issue, and relevant securities identifier.[119]

We recognize that some derivatives have underlying assets that are indices of securities or other assets or a "custom basket" of assets, the components of which are not publicly available. We are proposing requirements to ensure that the Commission, investors, and other potential users are aware of the components of such indices or custom baskets. If the reference instrument is an index for which the components are publicly available on a website and are updated on that website no less frequently than quarterly, funds would identify the index and provide the index identifier, if any.[120] We

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expressing the need for risk and exposure metrics that show the potential losses or gains to the fund if market prices change, and suggesting that new disclosures should require derivatives data to be sufficiently granular such that regulators and market participants could perform their own independent calculations of risk exposure, rather than relying on aggregated metrics of total risk); Vanguard FSOC Notice Comment Letter, *supra* note 71 (asserting that regulators would benefit by better understanding how and why mutual funds use derivatives).

118 *See* Form N-PORT, Item C.11.c. The type of warrant or option would be selected from among the following (put or call). The payoff profile of the warrant or option would be selected from among the following (written or purchased). Funds would respond N/A for warrants for both type and payoff profile. As discussed above, funds would report the number of option contracts in Item C.2.a of Form N-PORT. *See supra* note 96 and accompanying text.

119 *See* Form N-PORT, Items C.11.c.iii.2 and C.11.c.iii.3. For the securities identifier, funds would report, if available, CUSIP of the reference asset, ISIN (if CUSIP is not available), ticker (if CUSIP and ISIN is not available), or other unique identifier (if CUSIP, ISIN, and ticker are not available). *See also supra* note 92 and accompanying and following text.

120 *See* Form N-PORT, Item C.11.c.iii.2.

are proposing to require at least quarterly public disclosure for the components of the index because it matches the frequency with which funds are currently required and, as proposed in this release, would continue to be required, to disclose their portfolio holdings.[121] If the index's components are not publicly available as provided above, and the notional amount of the derivative represents 1% or less of the NAV of the fund, the fund would provide a narrative description of the index.[122] If the index's components are not publicly available in that manner, and the notional amount of the derivative represents more than 1% of the NAV of the fund, the fund would provide the name, identifier, number of shares or notional amount or contract value as of the trade date (all of which would be reported as negative for short positions), value, and unrealized appreciation or depreciation of every component in the index.[123]

We are proposing this requirement because we believe that it is important for the Commission, investors, and other potential users to have transparency into all exposures to assets that the fund has, regardless of whether the fund directly holds investments in those assets or chooses to create those exposures through a derivatives contract.[124] We are proposing the 1% notional amount threshold based on our experience with the summary schedule of investments, which requires funds to disclose investments for

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[121] *See infra* Part II.A.4 (discussing proposed rules concerning the public disclosure of reports on Form N-PORT).

[122] *See supra* note 120.

[123] *See id.* Short positions in the index, if any, would be reported as negative numbers. The identifier for each index component would include CUSIP, ISIN (if CUSIP is not available), ticker (if CUSIP and ISIN are not available), or other identifier (if CUSIP, ISIN, and ticker are not available. If other identifier is provided, the fund would indicate the type of identifier used.

[124] We are also proposing to modify Regulation S-X to require similar disclosures. *See infra* Part II.C.2.a (discussing proposed rule 12-13, n.3 of Regulation S-X).

which the value exceeds 1% of the fund's NAV in that schedule.[125] We believe that, similar to this threshold in the summary schedule of investments, providing a 1% *de minimis* for disclosing the components of a derivative with nonpublic reference assets considers the need for the Commission, investors, and other potential users to have transparency into the exposures that derivative contracts create while not requiring extensive disclosure of multiple components in a non-public index for instruments that represent a small amount of the fund's overall value.

If the reference instrument is a derivative, funds would indicate the category of derivative (*e.g.*, swap) and would provide all information required to be reported on Form N-PORT for that type of derivative.[126]

We are also proposing to require funds to report the delta of the option, which is the ratio of the change in the value of the option to the change in the value of the reference instrument.[127] This measure reflects the sensitivity of the option's value to changes in the price of the reference instrument. Disclosure of delta for options and warrants would provide the Commission, investors, and other potential users a more accurate measure of a fund's full exposure to the reference instrument than the option's notional amount, which we would otherwise not be able to determine. Accordingly, having the measurement of delta for options is important for the Commission, as well as investors and other potential users, to measure the impact, on a fund or group of funds

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[125] *See* rule 12-12C, n.3 of Regulation S-X.

[126] *See* Form N-PORT, Item C.11.c.iii.1. Funds would report the category of derivative that most closely represents the investment, selected from among the following (forward, future, option, swaption, swap, warrant, other). If "other," funds would provide a brief description.

[127] *See* Form N-PORT, Item C.11.c.vii.

that holds options on an asset, of a change in such asset's price. Also, as the Commission has previously observed, funds can use options as a form of obtaining a leveraged position in an underlying reference asset.[128] Having a measurement of exposures created through this type of leverage can help the Commission, investors, and other potential users better understand the risks that the fund faces as asset prices change, since the use of this type of leverage can magnify losses or gains in assets.

For futures and forwards (other than foreign exchange forwards, which share similarities with foreign exchange swaps and should be reported accordingly as discussed below), Form N-PORT would require funds to report a description of the reference instrument, the payoff profile (*i.e.,* long or short), expiration date, aggregate notional amount or contract value as of the trade date, and unrealized appreciation or depreciation.[129] The description of the reference instrument would conform to the same requirements as the description of reference instruments for warrants and options.[130]

For foreign exchange forwards and swaps, funds would report the amount and description of currency sold, amount and description of currency purchased, settlement date, and unrealized appreciation or depreciation.[131]

For swaps (other than foreign exchange swaps), funds would report the description and terms of payments necessary for a user of financial information to understand the nature and terms of payments to be paid and received, including, as applicable: a description of the reference instrument, obligation, or index; financing rate

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128 *See* Derivatives Concept Release, *supra* note 7.

129 *See* Form N-PORT, Item C.11.d.

130 *See* Form N-PORT, Item C.11.d.ii. *See also supra* notes 119–126 and accompanying text.

131 *See* Form N-PORT, Item C.11.e.

to be paid or received; floating or fixed rates to be paid and received; and payment frequency.[132] The description of the reference instrument would conform to the same requirements as the description of reference instruments for forwards and futures.[133] Funds would also report upfront payments or receipts, unrealized appreciation or depreciation, termination or maturity date, and notional amount.[134]

Finally, for derivatives that do not fall into the categories enumerated in Form N-PORT, funds would provide a description of information sufficient for a user of financial information to understand the nature and terms of the investment. This description would include, as applicable, currency, payment terms, payment rates, call or put features, exercise price, and a description of the reference instrument, among other things.[135] The description of the reference instrument would conform to the same requirements as the description of reference instruments for swaps.[136] Funds would also report termination or maturity (if any), notional amount(s), unrealized appreciation or depreciation, and the delta (if applicable).[137] We recognize that new derivative products will continue to evolve, and thus the disclosures for this category are intended to be flexible enough to encompass the changing needs and products that may emerge.

We request comment on our proposed disclosure requirements for derivatives.

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132 *See* Form N-PORT, Item C.11.f.i. Funds would separately report the description and terms of payments to be paid and received. The description of the reference instrument, obligation, or index would include the information required to be reported for the descriptions of reference instruments for warrants, options, futures, or forwards.

133 *See id. See also supra* note 130 and accompanying text.

134 *See* Form N-PORT, Items C.11.f.ii to C.11.f.v.

135 *See* Form N-PORT, Item C.11.g.1.

136 *See* Form N-PORT, Item C.11.f.i. *See also supra* note 133 and accompanying text.

137 *See* Form N-PORT, Items C.11.g.ii to C.11.g.v.

- Is there additional or alternative information about derivative contracts that we should be requiring? Should we modify the information we are proposing to require for any derivatives contracts? Should other terms and conditions, categories of derivatives, payoff profiles, or identifiers be included in Form N-PORT so that all material elements of derivatives contracts can be reported?
- For options, should funds be required to identify the option exercise type (*e.g.*, American, European, Bermudan, Asian, other) or report any additional information for more exotic option exercise types (*e.g.*, rainbow, barrier, lookback, etc.)?
- We recently adopted Regulation SBSR, which will require one of the parties to security-based swap transactions to report certain information to registered security-based swaps data repositories or the Commission.[138] The reporting party will report certain identifying information, including unique product identifiers to identify each security-based swap, as well as certain primary and secondary trade information, including the terms of any standardized fixed or floating rate payments, the frequency of any such payments, and any additional data elements included in the agreement between the counterparties that are necessary for a person to determine the market value of the transaction.[139] The Commodities Futures Trading Commission has engaged in similar efforts with regards to

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[138] *See* Regulation SBSR Adopting Release, *supra* note 40 (requiring the reporting of certain information for each registered security-based swap transaction to registered security-based swap data repositories or to the Commission, including unique product identifiers and transaction identifiers).

[139] *See* rule 901 of Regulation SBSR [17 CFR 242.901].

unique product identifiers that would be reported with regards to swaps.[140] Are there methods the Commission should consider to harmonize the SBSR reporting requirements with the proposed reporting requirements on Form N-PORT? For example, should we consider ways to allow a fund to import the data reported to swap and security-based swap data repositories automatically into the fund's reports on Form N-PORT? How would this affect investors' ability to analyze this data for swaps and security-based swaps held by funds? Should we require funds to report the product identifiers or any other data we are not currently proposing to require on Form N-PORT that will be required to be reported for swaps or security-based swaps? If so, why?

- Proposed Form N-PORT would require funds to list all underlying reference assets unless the underlying reference asset is an index whose components are publicly available on a website and are updated on that website no less frequently than quarterly, in which case funds would identify the index and publisher of the index, or unless the notional amount of the derivative represents 1% or less of the NAV of the fund, in which case funds would provide a narrative description of the index.[141] To the extent such indices are proprietary or subject to licensing agreements, what would be the effect of this requirement? For example, would funds incur costs for amending licensing agreements? Would index providers be willing to amend existing licensing agreements? If not, how would this impact

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[140] *See generally* Q&A — Swap Data Recordkeeping and Reporting Requirements, CFTC, *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/sdrr_qa.pdf.

[141] *See, e.g., supra* notes 120–123.

funds that make such investments and the marketplace of fund options available to investors generally? Are there other concerns about disclosing the components of proprietary indices? Should we alter this requirement, and if so how? For example, should we not require funds to report underlying index components for derivatives unless the derivative's notional amount represents at least 5%, or some other percentage, of the NAV of the fund? Alternatively, should we limit the required disclosure of index components to the top 50 components and/or components that represent more than 1% of the index? If the reference asset is a modified version of an index whose components are publicly available on a website, for example a version that is customized to exclude certain issuers that the fund is restricted from owning, would requiring a narrative of those modifications be preferable to funds and investors rather than requiring each holding of the modified index to be listed? If so, should such narrative disclosure be reported in the "explanatory notes" section of Form N-PORT?[142]

- How, if at all, should we modify the proposed requirement to report delta? To what extent would the inputs and assumptions underlying the methodology by which funds calculate this measure affect the value reported? Are there potential liability or other concerns associated with the reporting of such measures according to such inputs and assumptions? For example, how would the comparability of information reported between funds be affected if funds used different inputs and assumptions in their methodologies?

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[142] *See infra* note 155 and accompanying and following text.

- Are there additional or alternative metrics that we should consider requiring to be reported? Would the disclosure of risk metrics such as vega—which measures the amount that an option contract's price changes in relation to a 1% change in the volatility of the underlying asset—or gamma—which measures the sensitivity of delta in response to price changes in the underlying instrument—enhance the utility of the derivatives information reported in Form N-PORT? What would be the costs and burdens to funds and benefits to investors and other potential users of requiring funds to report such additional or alternative metrics? How would the comparability of information reported by different funds be affected if funds used different inputs and assumptions in their methodologies, such as different assumptions regarding the values of the funds' portfolios?
- We believe that funds already track the characteristics of their derivatives that we would require to be reported on Form N-PORT. To the extent this is correct, what would be the incremental cost and burden of reporting such information to the Commission?

v. *Securities on Loan and Cash Collateral Reinvestment*

As discussed above, our proposal would require funds to report on Form N-PORT, for each of their securities lending counterparties as of the reporting date, the full name and LEI of the counterparty (if any), as well as the aggregate value of all securities on loan to the counterparty.[143] We are also proposing that funds report on Form N-PORT, on an investment-by-investment level, information about securities on loan and the reinvestment of cash collateral that secures the loans. For each investment

[143] *See supra* note 75 and preceding, accompanying, and following text.

held by the fund, a fund would report: (1) whether any portion of the investment was on loan by the fund, and, if so, the value of the securities on loan;[144] (2) whether any amount of the investment represented reinvestment of the cash collateral and, if so, the dollar amount of such reinvestment;[145] and (3) whether any portion of the investment represented non-cash collateral received to secure loaned securities and, if so, the value of the securities representing such non-cash collateral.[146]

These disclosures would provide information about how funds reinvest the cash collateral received from securities lending activity and should allow for more accurate determination of the value of collateral securing such loans. This could improve the ability of Commission staff, as well as investors, brokers, dealers, and other market participants to assess collateral reinvestment risks and associated potential liquidity and loss risks, as well as better understand leverage creation through the reinvestment of collateral.[147] These disclosures could also help identify those investments that one or more funds might have to sell or redeem in the event of widespread termination or default by borrowers. More generally, this information could help to address concerns expressed by industry participants about the lack of transparency in funds' securities lending transactions.[148]

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144 *See* Form N-PORT, Item C.12.c.

145 *See* Form N-PORT, Item C.12.a.

146 *See* Form N-PORT, Item C.12.b.

147 As discussed above, commenters to the FSOC Notice suggested that enhanced securities lending disclosures could be beneficial to investors and counterparties. *See supra* note 71.

148 *See, e.g.,* Transcript of Securities and Exchange Commission Securities Lending and Short Sale Roundtable (Sept. 29, 2009), *available at* http://www.sec.gov/news/openmeetings/2009/roundtable-transcript-092909.pdf (discussing, among other things, the lack of publicly available information to market participants about securities lending transactions).

We request comment on our proposed disclosure requirements for securities loans and cash collateral reinvestment.

- Should the Commission require funds to report information about securities on loan or reinvestment of cash collateral at the portfolio level, rather than at the individual security level? If so, what categories should be used to report such reinvestment? For example, would it be appropriate to use the same collateral categories for securities lending that we are proposing to be used for repurchase and reverse repurchase agreements?
- As discussed, Form N-PORT would require funds to indicate, for each investment, whether any portion of the investment represented non-cash collateral received to secure loaned securities. To what extent would this information be helpful to brokers, dealers, and investors? To what extent do funds receive collateral other than cash?
- Is there additional or alternative information regarding securities lending transactions that the Commission should require to be disclosed in reports on Form N-PORT?
- We believe that funds already track the characteristics of their securities lending and cash collateral reinvestment transactions that we would require to be reported on Form N-PORT. Is this belief correct? What would be the burden of reporting such information to the Commission?

h. Miscellaneous Securities

In Part D of Form N-PORT, as currently permitted by Regulation S-X, funds would have the option of identifying and reporting certain investments as "miscellaneous securities."[149] Funds electing to separately report miscellaneous securities would use the same Item numbers and report the same information that would be reported for each investment if it were not a miscellaneous security.[150] Consistent with the disclosure regime established by Regulation S-X, all such responses regarding miscellaneous securities would be nonpublic and would be used for Commission use only, notwithstanding the fact that all other information reported for the third month of each fund's fiscal quarter on Form N-PORT would otherwise be publicly available.[151] Keeping information related to these investments nonpublic may serve to guard against the premature release of those securities positions and thus deter front-running and other predatory trading practices, while still allowing the Commission to have a complete record of the portfolio for monitoring, analysis, and checking for compliance with Regulation S-X.[152] The only information publicly reported for miscellaneous securities would be their aggregate value, which would be consistent with current practice as permitted by Regulation S-X.[153]

- Should funds continue to be allowed to use the category of miscellaneous securities, either on Form N-PORT or in publicly disclosed schedules of investments pursuant to instruction 1 to rule 12-12 and instruction 5 to rule 12-12C of Regulation S-X? To what extent do funds currently use "miscellaneous

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149 *See generally supra* note 49 and accompanying text.

150 *See* Form N-PORT, Part D.

151 *See* rule 12-12 of Regulation S-X.

152 *See, e.g.,* Quarterly Portfolio Holdings Adopting Release, *supra* note 19, at n.64 and accompanying text.

153 *See supra* notes 48-49 and accompanying text.

securities" as a line item in their schedule of investments, as opposed to disclosing all investments in securities of unaffiliated issuers? For what purposes? Should we continue to allow funds to exclude the full disclosures of such securities from funds' schedules of investments? Alternatively, should we consider lowering the threshold, such as to two percent or one percent of the total value of securities of unaffiliated issuers?

i. Explanatory Notes

In Part E of Form N-PORT, funds would have the option of providing explanatory notes relating to the filing, if any.[154] Any notes provided in public reports on Form N-PORT (*i.e.,* reports on Form N-PORT for the third month of the fund's fiscal quarter) would be publicly available, whereas notes provided in nonpublic filings of Form N-PORT would remain nonpublic.[155] Funds would also report, as applicable, the Item number(s) to which the notes are related.[156]

These notes, which would be optional, could be used to explain assumptions that funds made in responding to specific items in Form N-PORT. Funds could also provide context for anomalous responses or discuss issues that could not be adequately addressed elsewhere given the constraints of the form. Similar information in other contexts has

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[154] *See* Form N-PORT, Part E. *Cf.* Form PF, Item 4 (providing advisers to private funds the option of explaining any assumptions that they made in responding to any questions in the form).

[155] *See infra* Part II.A.4 of this release.

[156] *See* Form N-PORT, Part E.

assisted Commission staff in better understanding the information provided by funds, and we expect that explanatory notes provided on Form N-PORT would do the same.[157]

We request comment on our proposed disclosure requirements.

- Would the format outlined above for the explanatory notes allow funds to adequately discuss their responses on Form N-PORT? If not, how should the format be modified?
- Should explanatory notes in publicly available filings of Form N-PORT be nonpublic? If so, why?

j. Exhibits

In Part F of Form N-PORT, for reports filed for the end of the first and third quarters of the fund's fiscal year, a fund would also attach the fund's complete portfolio holdings as of the close of the period covered by the report. These portfolio holdings would be presented in accordance with the schedules set forth in §§210.12-12 to 12-14 of Regulation S-X.

As discussed further below in Part B, we are proposing to rescind Form N-Q because reports on Form N-PORT for the first and third fiscal quarters would make similar reports on Form N-Q unnecessarily duplicative. While we recognize that the quarterly, publicly disclosed reports on Form N-PORT will provide structured data to investors and other potential users, we recognize that the amount and structured format of the data contained in those reports are not primarily designed for individual investors. We believe that such investors might prefer that portfolio holdings schedules for the first

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157 *See, e.g.*, Form N-MFP, Item 43 ("Explanatory notes. Disclose any other information that may be material to other disclosures related to the portfolio security.").

and third quarters continue to be presented using the form and content specified by Regulation S-X, which investors are accustomed to viewing in reports on Form N-Q and in shareholder reports. Therefore, we are proposing to require that, for reports on Form N-PORT for the first and third quarters of a fund's fiscal year, the fund would attach its complete portfolio holdings for that fiscal quarter, presented in accordance with the schedules set forth in §§210.12-12 to 12-14 of Regulation S-X.

Requiring funds to attach these portfolio holdings schedules to reports on Form N-PORT would provide the Commission, investors, and other potential users with access to funds' current and historical portfolio holdings for those funds' first and third fiscal quarters. Our proposal would also consolidate these disclosures in a central location, together with other fund portfolio holdings disclosures in shareholder reports and reports on Form N-CSR for funds' second and fourth fiscal quarters.

Under our proposal, and consistent with current practice, funds would have until 60 days after the end of their second and fourth fiscal quarters to transmit reports to shareholders containing portfolio holdings schedules prepared in accordance with Regulation S-X for that reporting period.[158] In contrast, under our proposal, funds would have 30 days after the end of their first and third fiscal quarters to file reports on Form N-PORT that would include portfolio holdings schedules prepared in accordance with Regulation S-X, although such reports would not be required to be made public until 60 days after the close of the reporting period. Although our proposal would require funds to prepare Regulation S-X compliant portfolio holdings schedules for their first and third

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[158] *See supra* note 27 (discussing current requirements to transmit reports to shareholders); *infra* Part II.C (discussing our proposed amendments to Regulation S-X).

fiscal quarters 30 days more rapidly than they do currently, we believe that this would be reasonable given the significant overlap with information that would be required to be reported on Form N-PORT, and the fact that funds would be required to file reports on Form N-PORT within 30 days after the end of each month. In addition, the portfolio schedules attached to Form N-PORT would be neither audited nor certified, which we believe would significantly reduce the time required for preparation and validation. We request comment below on the timing of preparing this attachment.

As discussed below, we are proposing to allow funds to transmit reports to shareholders by posting online those reports, together with the funds' complete portfolio holdings for the first and third fiscal quarters presented in accordance with the schedules set forth in §§210.12-12 to 12-14 of Regulation S-X disclosures.[159] We recognize that there would be duplication between the portfolio schedules posted online for funds relying upon proposed rule 30e-3 and the portfolio schedules for funds attached on reports on Form N-PORT. However, we believe that requiring the Regulation S-X schedules to be filed as exhibits to Form N-PORT reports would serve the purpose of making the schedules permanently available on the Commission's Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR") (even when such schedules are no longer required to be maintained online pursuant to proposed rule 30e-3).

We request comment on our proposed exhibits.

- Should funds be required to attach portfolio holdings schedules to reports on Form N-PORT? Is there an alternative that would be better for funds and

[159] *See supra* Part II.D.3.

investors in terms of informing investors' investment decisions with regards to current and historical portfolio holdings?

- As discussed above, the attached portfolio holdings schedules are intended for investors, but would not be required to be made publicly available to investors until 60 days after the close of the reporting period; however, as proposed, funds would be required to prepare and file this attachment within 30 days of the end of the reporting period. Should funds be allowed to file reports on Form N-PORT for the first and third fiscal quarters without Regulation S-X compliant schedules, but then be required to amend those reports on Form N-PORT to attach Regulation S-X compliant schedules no later than 60 days after the end of the reporting period?
- Should the portfolio schedules attached to Form N-PORT, which are similar to reports funds are providing currently on Form N-Q, be certified, as is currently required by Form N-Q?

k. General Request for Comments Regarding the Information on Form N-PORT

In addition to the requests for comment above, we request general comment on feasible alternatives to the information we would be requiring funds to report on Form N-PORT that would minimize the reporting burdens on funds while maintaining the anticipated benefits of the reporting and disclosure.[160] We also request comment on the

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[160] *See* section 30(c)(2)(A) of the Investment Company Act [15 U.S.C. 80a-29(c)(2)(A)] (requiring Commission to consider and seek public comment on feasible alternatives to the required filing of information that minimize reporting burdens on funds).

utility of the information proposed to be included in reports to the Commission, investors, and the public in relation to the costs to funds of providing the reports.[161]

- Would Form N-PORT, as proposed, appropriately consider the usefulness of the information to the Commission, investors, and other potential users of the required information and the costs that would be associated with reporting this information? If not, which data points or items should be enhanced or scaled back? Are there any proposed items in Form N-PORT that should be revised to avoid duplication of reporting requirements in different Commission rules or forms? If so, please explain. On the other hand, are there any elements in Form N-PORT that the Commission should carry over to other Commission forms or rules?
- Are there specific items that the proposed form would require that are unnecessary or otherwise should not be required in the manner that we propose? Alternately, is there different or additional information that we have not identified that could be useful to us or investors in monitoring funds? For example, to the extent there are fund-specific, sector-specific, or industry-wide risks that would not be addressed by the information we are proposing to collect today, should we require additional or alternative information that would be relevant to an evaluation of the risk characteristics of the fund and its portfolio investments? Likewise, is there any investment- or entity-specific information that should be included in Form N-PORT to facilitate analysis of the information that would be

[161] *See* section 30(c)(2)(B) of the Investment Company Act (requiring Commission to consider and seek public comment on the utility of information, documents and reports to the Commission in relation to the associated costs).

reported? Should the manner in which information would be reported in Form N-PORT be revised to improve the clarity of disclosures or reduce reporting burdens?

- We believe that the information we are proposing to require would be readily available to funds as a matter of general business practice. Do commenters agree with this assumption? For example, do fund accounting or financial reporting systems, or those of a fund's custodian, generally contain the investment information that we are requesting in our proposal? What is the feasibility and burden of requiring funds to report information that is not contained in such systems? To the extent that any items that we have requested are not contained in fund accounting or financial reporting systems, are there other types of readily available data that would provide us with similar information?

3. Reporting of Information on Form N-PORT

As discussed above, the Commission proposes that funds would report information on Form N-PORT in XML, so that Commission staff, investors, and other potential users could create databases of fund portfolio information to be used for data analysis. Forms N-CSR and N-Q are not currently filed in a structured format, which results in reports that are comprehensible to a human reader, but are not suitable for automated processing, and generally require filers to reformat the required information from the way it is stored for normal business uses.[162] By contrast, requiring that reports on Form N-PORT be structured would allow the Commission and other potential users to

[162] Forms N-CSR and N-Q are required to be filed in HTMA or ASCII/SGML. *See* rule 301 of Regulation S-T; EDGAR Filer Manual (Volume II) version 27 (June 2014) at 5-1.

combine information from more than one report in an automated way to, for example, construct a data base of fund portfolio investments without additional formatting. Based upon our experiences with Forms N-MFP and PF, both of which require filers to report information in an XML format, we believe that requiring funds to report information on Form N-PORT in an XML format would provide the information that we seek in the most timely and cost-effective manner.[163] As discussed further below in the economic analysis, the XML format may also improve the quality of the information disclosed by imposing constraints on how the information would be provided, by providing a built-in validation framework of the data in the reports.[164]

- What would be the costs to funds of providing data conforming to a Form N-PORT XML Schema? How would costs be affected, if at all, by the size of the funds and fund complexes reporting this data? How would this affect smaller fund companies?
- Should the Commission allow or require the form to be provided in an XML Schema derived from existing XML based languages, such as Financial products Markup Language ("FpML") or XBRL? FpML is an industry standard created by ISDA for exchanging and reporting the terms and conditions of derivatives contracts. XBRL is another industry standard used by the Commission for many reporting forms.

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[163] We anticipate that the XML interactive data file would be compatible with a wide range of open source and proprietary information management software applications. Continued advances in interactive data software, search engines, and other web-based tools may further enhance the accessibility and usability of the data. *See, e.g.,* Money Market Fund Reform 2010 Release, *supra* note 13, at n.341.

[164] *See infra* Part IV.B.b.

- Is there another structured format that would allow investors and analysts to easily download and analyze the data?

The Commission is considering whether reports on Form N-PORT should be submitted through EDGAR or another electronic filing system, either maintained by the Commission or by a third-party contractor. If reports on Form N-PORT were required to be submitted through EDGAR, the electronic filing requirements of Regulation S-T would apply.[165]

We request comment on this aspect of our proposal.

- Are there specific other capabilities that the Commission should consider in developing or selecting an electronic filing system? For example, should the system have the capability to cross-check information reported to other electronic filing systems, such as the Investment Adviser Registration Depository (where registration forms for investment advisers are filed)? If so, which platforms and why?
- Is EDGAR the optimal vehicle for filing reports on Form N-PORT with the Commission? If not, what vehicle would be optimal for filing reports and why? Should the Commission allow the filing of documents in electronic media other than on EDGAR? If so, please make specific recommendations.
- Are there any particular concerns with filing such reports on EDGAR as opposed to a third party system or vice versa? If so, what are those concerns and what are potential remedies for such concerns? For example, as discussed further below,

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165 *See generally* 17 CFR 232 (governing the electronic submission of documents filed with the Commission).

as proposed, reports on Form N-PORT for the first and second month of each fiscal quarter would not be made public. Accordingly, any filing would need to have confidentiality protections to keep the information on such Forms non-public. How should EDGAR or an alternative filing platform best address the confidentiality of this information?

- How important to investors and other interested parties is the fact that EDGAR currently serves as the filing system for fund filings with the Commission, and thus serves as a single repository where investors may examine historical filings by a given fund on related forms and generally compare reports made by other funds? To what extent, if at all, could investors become confused by the use of a new filing system for Form N-PORT and the use of EDGAR for other fund filings? How should any such investor confusion be mitigated by funds and the Commission?

Our proposal would require funds to report information on Form N-PORT no later than 30 days after the close of each month.[166] We request comment on this aspect of our proposal.

- Would 30 days be sufficient for funds to gather and report this information to the Commission? If not, what amount of time would be required and why? Conversely, could funds easily and reliably gather and report this information in less than 30 days, which would provide the Commission staff with more timely

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[166] In contrast, one commenter to the FSOC Notice suggested that funds should report information to the Commission on a real-time basis. *See* Comment Letter of Occupy the SEC to the FSOC Notice (Mar. 25, 2015) (suggesting that asset managers should be required to provide real-time data, and that the Commission have the capability to monitor all funds' transactions on a real-time basis).

data?[167] If so, what amount of time would be appropriate? To what extent, if at all, should this determination be affected by the fact that funds would have 60 days to report their schedule of investments in their financial statements prepared pursuant to Regulation S-X?

As an alternative to monthly reports filed on Form N-PORT, should the Commission require quarterly reports that include portfolio information for each month of that quarter? How would the viability of this alternative be affected, if at all, by the technological challenges and inadvertent disclosure risks associated with combining in a single form nonpublic portfolio information relating to the first two months of each quarter with public portfolio information relating to the third month of that quarter? We note that this alternative would eliminate many of the benefits of monthly reporting, such as the ability of monthly data to address the staleness of quarterly data and to assist in monitoring funds by decreasing the delay between reports. However, this alternative would still provide twelve data points per year, which should improve the Commission staff's ability to perform analyses of portfolios, and would discourage various forms of portfolio manipulation, as discussed above. What, if any, other factors should the Commission consider in evaluating this alternative?

[167] *See, e.g.*, Money Market Fund Reform 2014 Release, *supra* note 13 (requiring money market funds to report their holdings and other information to the Commission within five days after the end of each month).

4. Public Disclosure of Information Reported on Form N-PORT

We are proposing that funds report information on Form N-PORT on a monthly basis, no later than 30 days after the close of each month.[168] For reasons discussed below, and consistent with current disclosure practices, only information reported for the third month of each fund's fiscal quarter would be publicly available, and such information would not be made public until 60 days after the end of the third month of the fund's fiscal quarter.[169]

The quarterly portfolio reports that the Commission currently receives on Forms N-Q and N-CSR can quickly become stale due to the turnover of portfolio securities and fluctuations in the values of portfolio investments. Monthly portfolio reporting would decrease the delay between reports, which should prove useful to the Commission for fund monitoring, particularly in times of market stress. This would also triple the number of data points reported to the Commission in a given year, as well as ensure that the Commission has current information, which should in turn enhance the ability of Commission staff to perform analyses of funds in the course of monitoring for industry trends, or identifying issues for examination or inquiry.

As discussed above, the Commission generally believes that public availability of information, including the types of information that would be collected on Form N-PORT

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168 Commission staff understands that certain funds currently report their investments to shareholders as of the last business day of the reporting period, while other funds report their investments as of the last calendar day of the reporting period. In recognition of this fact, and in an effort to avoid disruptions to current fund operations, the information reported on Form N-PORT may reflect the fund's investments as of the last business day, or last calendar day, of the month for which the report is filed.

169 As discussed above, portfolio schedules are currently available to the public in reports that are mailed to shareholders or filed with the Commission either 60 or 70 days following the end of each reporting period. *See supra* note 27 and accompanying text.

that may not currently be reported or disclosed by funds, can benefit investors by assisting them in making more informed investment decisions. Although Form N-PORT is not primarily designed for disclosing information to individual investors, we believe that many investors, particularly institutional investors, as well as academic researchers, financial analysts, and economic research firms, could use the information reported on Form N-PORT to evaluate fund portfolios and assess the potential for returns and risks of a particular fund. Accordingly, whether directly or through third parties, we believe that the periodic public disclosure of the information on proposed Form N-PORT could benefit all fund investors.

The Commission, however, recognizes that more frequent portfolio disclosure could potentially harm fund shareholders by expanding the opportunities for professional traders to exploit this information by engaging in predatory trading practices, such as trading ahead of funds, often called "front-running."[170] Similarly, the Commission is sensitive to concerns that more frequent portfolio disclosure may facilitate the ability of outside investors to "free ride" on a mutual fund's investment research, by allowing those investors to reverse engineer and "copycat" the fund's investment strategies and obtain for free the benefits of fund research and investment strategies that are paid for by fund shareholders.[171] Both front-running and copycatting can reduce the returns of shareholders who invest in actively managed funds.[172]

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[170] *See, e.g.,* Quarterly Portfolio Holdings Adopting Release, *supra* note 19, at n.128 and accompanying text.

[171] *See, e.g., id.* at n.129 and accompanying text.

[172] *See The Potential Effects of More Frequent Portfolio Disclosure on Mutual Fund Performance*, 7 Investment Company Institute Perspective No. 3 (June 2001), *available at* http://www.ici.org/pdf/per07-03.pdf ("Potential Effects of More Frequent Disclosure").

We discussed these concerns when we first proposed and adopted Form N-MFP, and made the determination to make each monthly report on Form N-MFP public, with a 60 day delay.[173] In that release, however, we noted that, due to the short-term and restricted nature of money market fund securities, and because shares of money market funds are ordinarily purchased and redeemed at a stable share price, we believed opportunities for such activities were curtailed.[174] By contrast, funds other than money market funds can pursue a variety of investment strategies and invest in a variety of securities and other investments. Accordingly, we do not believe that the factors that mitigated our concerns about the potential for front running or free-riding in money market funds are as equally applicable to mutual funds.

Empirical studies indicate that the portfolio holdings information that investment companies disclose to the Commission and to shareholders contains information that can be used by other investors to front-run and copycat the positions of reporting funds.[175] Based on these studies, as well as experience and discussions with fund groups and market participants, the Commission is sensitive to the possibility that increasing the frequency of public portfolio disclosures to a monthly basis could further enable others to discern trading strategies of the funds, potentially subjecting registered investment companies to such predatory trading practices, resulting in competitive harms to the fund and its investors.

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[173] *See* Money Market Fund Reform 2010 Release, *supra* note 13 (adopting Form N-MFP with a 60 day delay for public disclosure). In 2014, the Commission eliminated the 60 day delay in the public disclosure of Form N-MFP. *See* Money Market Fund Reform 2014 Release, *supra* note 13.

[174] *See* Money Market Fund Reform 2010 Release, *supra* note 13, at text following n.573.

[175] *See infra* notes 663-667 and accompanying and following text.

We recognize that some free-riding and front running activity can occur even with quarterly disclosure, with the potential for investor harm. Conversely, however, investors previously petitioned for quarterly disclosures, noting numerous benefits that quarterly disclosure of portfolio schedules could provide, including allowing investors to better monitor the extent to which their funds' portfolios overlap, and hence enabling investors to make more informed asset allocation decisions, and providing investors with greater information about how a fund is complying with its stated investment objective.[176] The Commission cited many of these benefits when it adopted Form N-Q, and based on staff experience and outreach, believes that the current practice of quarterly portfolio disclosures provides benefits to investors, notwithstanding the opportunities for front-running and reverse engineering it might create.

Our proposal is intended to appropriately consider the benefits to the Commission, investors, and other potential users of public portfolio disclosures, including the reporting of such disclosures in a structured format and additional portfolio information that would be required on proposed Form N-PORT and the potential costs associated with making that information available to the public, which could be ultimately borne by investors. Accordingly, in an attempt to minimize these potential

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[176] *See* Quarterly Portfolio Holdings Adopting Release, *supra* note 19, at n.32 and accompanying text (discussing prior investor petitions for rulemaking). Investors that petitioned for quarterly disclosure also argued that increasing the frequency of portfolio disclosure would expose ''style drift'' (when the actual portfolio holdings of a fund deviate from its stated investment objective) and shed light on and prevent several potential forms of portfolio manipulation, such as ''window dressing'' (buying or selling portfolio securities shortly before the date as of which a fund's holdings are publicly disclosed, in order to convey an impression that the manager has been investing in companies that have had exceptional performance during the reporting period) and ''portfolio pumping'' (buying shares of stock the fund already owns on the last day of the reporting period, in order to drive up the price of the stocks and inflate the fund's performance results).

costs and harms, we propose to require public disclosure of fund reports on Form N-PORT once each quarter, rather than monthly, thereby maintaining the status quo regarding the frequency of public portfolio disclosure. As discussed above, funds are currently required to disclose their portfolio investments quarterly, via public filings with the Commission and semi-annual reports distributed to shareholders. Consequently, the Commission is not currently proposing to make public the information reported for the first and second months of each fund's fiscal quarter on Form N-PORT. Only information reported for the third month of each fund's fiscal quarter on Form N-PORT would be made publicly available, and such information would not be made public until 60 days after the end of the third month of the fund's fiscal quarter. We believe that maintaining the status quo with regard to the frequency and the time lag of portfolio reporting would allow the Commission, the fund industry, and the marketplace to assess the impact of the structured and more detailed data reported on Form N-PORT on the mix of information available to the public, and the extent to which these changes might affect the potential for predatory trading, before determining whether more frequent or more timely public disclosure would be, beneficial to investors in funds.

We are proposing to maintain the status quo of public disclosure of quarterly information based upon each fund's fiscal quarters, rather than calendar quarters, to ensure that public disclosure of information filed on Form N-PORT would be the same as the portfolio disclosures reported on a semi-annual fiscal year basis on Form N-CSR. We believe that such overlap would minimize the risks of predatory trading, because otherwise funds with fiscal year-ends that fall other than on a calendar quarter- or year-end would have their portfolios publicly available more frequently than funds with fiscal year-ends that fall on a calendar quarter- or year-end, thus increasing the risks to those funds discussed above related to potential front-running or reverse engineering.

We request comment on the proposed frequency and delay of public disclosure of information reported on Form N-PORT.

- Should we require information on Form N-PORT reported for the first and second month of each fund's fiscal quarter be made public? Are the concerns about front-running or other possible harms discussed above warranted given the 60-day delay? Would a different combination of public disclosure frequency and delay better protect funds and their investors from the risks of predatory trading, while still providing timely and regular information to investors? To what extent would investors benefit from receiving monthly data as opposed to quarterly data?
- Are there alternatives we should consider to provide investors and other potential users with the information reported on Form N-PORT for the first and second months of each quarter? For example, would the potential harms discussed above be mitigated if reports on Form N-PORT for the first and second months were made public 60 days (or a shorter or longer time period) after the end of each quarter, or 60 days (or a shorter or longer time period) after the end of each fund's fiscal year, thereby increasing the time lag of such information? If monthly information were to be provided quarterly or annually, how would that affect the benefits of such information to investors and other potential users?
- Would Form N-PORT contain the type of information that, if disclosed on a monthly basis, could reveal information that a fund would consider proprietary or

confidential or that could place the fund at a competitive disadvantage? If so, please explain and provide examples, as applicable.

- Would restricting public disclosure of the information reported on Form N-PORT to information reported for the third month of each fund's fiscal quarter alleviate concerns about front-running or other possible harms that might be caused by making the monthly information reported on Form N-PORT public? Should we instead provide that all or a portion of the requested information on Form N-PORT be submitted in nonpublic reports to the Commission? If so, please identify the specific items that should remain nonpublic and explain why.
- Do commenters believe that our proposed 60-day delay in making the information public would be helpful in protecting against possible front running or free riding? Would a shorter delay (*e.g.,* 45 or 30 days) or a longer delay (*e.g.*, 70 days) be more appropriate? If so, why? For example, should we provide for a longer delay to prevent investors other than shareholders from trading along with the fund, to the possible detriment of the fund and its shareholders? Alternately, would a shorter delay, for example 30 days, better serve the needs of shareholders and potential fund investors while still appropriately protecting the interests of funds?
- Should information be reported on Form N-PORT as of the third month of each fund's fiscal year, as proposed, or should we instead require a uniform public reporting schedule for all funds to facilitate comparison of information reported on Form N-PORT (*e.g.,* March 31, June 30, September 30, and December 31)? To what extent would a uniform public disclosure schedule increase burdens to

funds, given that one of the purposes for selecting fiscal year-ends that vary from calendar year-ends is to spread out filing burdens throughout the year for fund complexes?

B. Rescission of Form N-Q and Amendments to Certification Requirements of Form N-CSR

1. Rescission of Form N-Q

Along with our proposal to adopt new Form N-PORT, we are proposing to rescind Form N-Q. Management companies other than SBICs are currently required to report their complete portfolio holdings as of the end of their first and third fiscal quarters on Form N-Q. Because the data reported on proposed Form N-PORT would include the portfolio holdings information contained in reports on Form N-Q, we believe that Form N-PORT, if adopted, would render reports on Form N-Q unnecessarily duplicative. Therefore, we believe it is appropriate to rescind Form N-Q rather than require funds to report similar information to the Commission on two separate forms.

However, as noted earlier, we believe that individual investors and other potential users might prefer that portfolio holdings schedules for the first and third quarters continue to be presented using the form and content specified by Regulation S-X, which investors are accustomed to viewing in reports on Form N-Q and in shareholder reports. Therefore, we are proposing to require that, for reports on Form N-PORT for the first and third quarters of a fund's fiscal year, the fund would attach its complete portfolio holdings for that fiscal quarter, presented in accordance with the schedules set forth in §§210.12-12 to 12-14 of Regulation S-X [17 CFR 210.12-12 – 12-14]. Also, as discussed below, proposed new rule 30e-3 would allow funds to satisfy requirements to transmit reports to shareholders by posting on a website those shareholder reports and these same portfolio schedules for the funds' first and third quarters.[177]

2. Amendments to Certification Requirements of Form N-CSR

In connection with the Commission's implementation of the Sarbanes-Oxley Act of 2002, Form N-Q and Form N-CSR require the principal executive and financial officers of the fund to make quarterly certifications relating to (1) the accuracy of information reported to the Commission, and (2) disclosure controls and procedures and internal control over financial reporting.[178] Rescission of Form N-Q would eliminate certifications as to the accuracy of the portfolio schedules reported for the first and third fiscal quarters.

Under today's proposal, the certifications as to the accuracy of the portfolio schedules reported for the second and fourth fiscal quarters on Form N-CSR would remain. However, we are proposing to amend the form of certification in Form N-CSR to require each certifying officer to state that he or she has disclosed in the report any change in the registrant's internal control over financial reporting that occurred during the most recent fiscal half-year, rather than the registrant's most recent fiscal quarter as currently required by the form.[179] Lengthening the look-back of this certification to six months, so that the certifications on Form N-CSR for the semi-annual and annual reports

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[177] *See infra* Part II.D.

[178] *See* Item 3 of Form N-Q (certification requirement); Form N-Q Adopting Release, *supra* note 152; Item 12 of Form N-CSR (certification requirement); Certification of Management Investment Company Shareholder Reports and Designation of Certified Shareholder Reports as Exchange Act Periodic Reporting Forms; Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002, Investment Company Act Release No. 24914 (Jan. 27, 2003) [68 FR 5348 (Feb. 3, 2003)] (adopting release for Form N-CSR).

[179] Proposed Item 11(b) of Form N–CSR; proposed paragraph 5(b) of certification exhibit of Item 11(a)(2) of Form N–CSR.

would cover the first and second fiscal quarters and third and fourth fiscal quarters, respectively, would fill the gap in certification coverage that would otherwise occur once Form N-Q is rescinded. To the extent that certifications improve the accuracy of the data reported, removing such certifications could have negative effects on the quality of the data reported. Likewise, if the reduced frequency of the certifications affects the process by which controls and procedures are assessed, requiring such certifications semi-annually rather than quarterly could reduce the effectiveness of the fund's disclosure controls and procedures and internal control over financial reporting are assessed. However, we expect such effects, if any, to be minimal because certifying officers would continue to certify portfolio holdings for the fund's second and fourth fiscal quarters and would further provide semi-annual certifications concerning disclosure controls and procedures and internal control over financial reporting that would cover the entire year.

3. Request for Comment

We request comments on the proposed rescission of Form N-Q and related rule and form amendments.

- Should we rescind Form N-Q, as we have proposed? Should we instead retain Form N-Q, and not require Regulation S-X compliant schedules to be attached to reports for the first and third fiscal quarters on Form N-PORT? Why or why not?
- Would the proposed amendments to the certification requirements in Form N-CSR be an appropriate substitute for the certification requirements in Form N-Q? Would the change from quarterly to semiannual certifications have an effect on the quality of funds' internal controls or on other costs associated with certifications? If so, are those changes appropriate?

C. Amendments to Regulation S-X

1. Overview

As part of our larger effort to modernize the manner in which funds report holdings information to investors, today we are proposing amendments to Regulation S-X, which prescribes the form and content of financial statements required in registration statements and shareholder reports.[180] As discussed above, many of the proposed amendments to Regulation S-X, particularly the amendments to the disclosures concerning derivative contracts, are similar to the proposed requirements concerning disclosures of derivatives that would be required on reports on proposed Form N-PORT. The proposed amendments to Regulation S-X would, among other things, require similar disclosures in a fund's financial statements in its shareholder reports and, as applicable, website disclosures in order to provide investors, particularly individual investors, with clear and consistent disclosures across funds concerning fund investments in derivatives in a human-readable format, as opposed to the structured format of proposed Form N-PORT.

As outlined below, we are proposing amendments to Articles 6 and 12 of Regulation S-X that would: (1) require new, standardized disclosures regarding fund holdings in open futures contracts, open forward foreign currency contracts, and open

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[180] *See* rule 1-01, *et seq* of Regulation S-X [17 CFR 210.1-01, *et seq*]. While "funds" are defined in the preamble as registered investment companies other than face amount certificate companies and any separate series thereof—*i.e.,* management companies and UITs—we note that our proposed amendments to Regulation S-X apply to both registered investment companies and BDCs. *See infra* notes 264 and 265. Therefore, throughout this section, when discussing fund reporting requirements in the context of our proposed amendments to Regulation S-X, we are also including changes to the reporting requirements for BDCs.

swap contracts,[181] and additional disclosures regarding fund holdings of written and purchased option contracts; (2) update the disclosures for other investments, as well as reorganize the order in which some investments are presented; and (3) amend the rules regarding the general form and content of fund financial statements. Our amendments would also require prominent placement of disclosures regarding investments in derivatives in a fund's financial statements, rather than allowing such schedules to be placed in the notes to the financial statements. Finally, our amendments would require a new disclosure in the notes to the financial statements relating to a fund's securities lending activities.

As discussed above, the proposed rules will renumber the current schedules in Article 12 of Regulation S-X and break out the disclosure of derivatives currently reported on Schedule 12-13 into separate schedules. These changes are summarized in Figure 1, below.

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[181] We recognize that under the federal securities laws, certain derivatives fall under the definition of securities notwithstanding, for purposes of our proposals to Regulation S-X, we expect funds to adhere to the requirements of the disclosure schedules for the relevant derivative investment, regardless of how it would be defined under the federal securities laws. *See, e.g.*, proposed rule 12-13C of Regulation S-X (Open swap contracts).

PROPOSED CHANGES TO ARTICLE 12 OF REGULATION S-X

CURRENT RULES	PROPOSED RULES
12-12 (Investments in securities of unaffiliated issuers)	12-12 (Investments in securities of unaffiliated issuers)
12-12A (Investments—securities sold short)	12-12A (Investments—securities sold short)
12-12B (Open option contracts written)	12-13 (Open option contracts written)*
12-12C (Summary schedule of investments in securities of unaffiliated issuers)	12-12B (Summary schedule of investments in securities of unaffiliated issuers)*
	12-13A (Open futures contracts)*
	12-13B (Open forward foreign currency contracts)*
12-13 (Investments other than securities)	12-13C (Open swap contracts)*
	12-13D (Investments other than those presented in §§210.12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B, and 12-13C)*
12-14 (Investments in and advances to affiliates)	12-14 (Investments in and advances to affiliates)

* Denotes new or renumbered schedules.

Figure 1

We believe the proposed amendments will assist comparability among funds, and increase transparency for investors regarding a fund's use of derivatives and the liquidity of certain investments. We have endeavored to mitigate burdens on the industry by proposing to require similar disclosures both on Form N-PORT and in a fund's financial statements.[182] As a further consideration, we believe that the amendments we are proposing today are generally consistent with how many funds are currently reporting investments (including derivatives), and other information according to current industry practices.

2. Enhanced Derivatives Disclosures

In 2011, as part of a wider effort to review the use of derivatives by management investment companies, we issued a concept release and request for comment on a range

[182] *See* discussion *supra* Part II.A.2.g.iv.

of issues.[183] We received comment letters from a variety of stakeholders, including investors, fund groups, and third-party users of the information, who commented on a number of issues. Several commenters noted that holdings of derivative investments are not currently reported by funds in a consistent manner.[184] Commenters also suggested that more disclosure on underlying risks was necessary, including more information on counterparty exposure and reporting relating to the notional amount of certain derivatives.[185] Another commenter specifically requested that we revise Regulation S-X

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[183] Derivatives Concept Release, *supra* note 7.

[184] Comments submitted in response to the Derivatives Concept Release are available at http://www.sec.gov/comments/s7-33-11/s73311.shtml. *See* Morningstar Derivatives Concept Release Comment Letter, *supra* note 58 ("This is because fund companies are not reporting derivative holdings in a consistent manner and are not reporting derivative holdings in a manner that identifies the underlying risk exposure."); Comment Letter of Rydex|SGI (Nov. 7, 2011) ("Rydex|SGI Derivatives Concept Release Comment Letter") ("However, the quality and extent of such derivatives disclosure still varies greatly from registrant to registrant."). Commenters to the FSOC Notice made similar observations. *See, e.g.*, Americans for Financial Reform FSOC Notice Comment Letter, *supra* note 116 ("While full position-level data on securities portfolios is available periodically for registered funds, current derivatives disclosure requirements appear very poor."); Systematic Risk Council FSOC Notice Comment Letter, *supra* note 116 ("While most managed funds do not employ leverage to the same degree that banks do, we encourage regulators to consider carefully whether there are potential improvements to the current data collection regime [] that would allow regulators to track the presence and concentrations of leverage in the asset management industry, particularly as it arises from the use of derivatives . . . .").

[185] *See* Morningstar Derivatives Concept Release Comment Letter, *supra* note 58 ("Notional exposure ... is a better measure of risk"); Comment Letter of Oppenheimer Funds to Derivatives Concept Release (Nov. 7, 2011) ("Instead, counterparty risks incurred through the investments in derivatives ... should be considered in a new SEC rulemaking that is primarily disclosure based."); Rydex|SGI Derivatives Concept Release Comment Letter, *supra* note 184 (recommending that funds that invest in derivatives should disclose notional exposure for non-exchanged traded derivatives and a fund's exposure to counterparties). Commenters to the FSOC Notice made similar observations relating to counterparty disclosures. *See, e.g.*, Americans for Financial Reform FSOC Notice Comment Letter, *supra* note 116 ("Counterparty data is also often not available."); Systematic Risk Council Comment Letter, *supra* note 116 (discussing the need to have information about investment vehicles that hold bank liabilities).

in order to keep "financial reporting current with developments in the financial markets."[186]

While the rules under Regulation S-X establish general requirements for portfolio holdings disclosures in fund financial statements, they do not prescribe standardized information to be included for derivative instruments other than options. Currently, rule 12-13 of Regulation S-X (Investments other than securities) requires limited information on the fund's investments other than securities – that is, the investments not disclosed under rules 12-12, 12-12A, 12-12B, and 12-14.[187] Thus, under Regulation S-X, a fund's disclosures of open futures contracts, open forward foreign currency contracts, and open swap contracts are generally reported in accordance with rule 12-13.

To address issues of inconsistent disclosures and lack of transparency as to derivative instruments, we are proposing to amend Regulation S-X by proposing new schedules for open futures contracts, open forward foreign currency contracts, and open swap contracts. We are also proposing to modify the current disclosure requirements for purchased and written option contracts. Finally, we are proposing to include certain instructions regarding the presentation of derivatives contracts that are generally consistent with instructions that are currently included, or that we are proposing to add, in either rule 12-12 (Investments in securities of unaffiliated issuers) or rule 12-13 (Investments other than securities).[188]

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[186] Comment Letter of Stephen A. Keen to Derivatives Concept Release (Nov. 8, 2011).

[187] The schedule to rule 12-13 requires disclosure of: (1) description; (2) balance held at close of period – quantity; and (3) value of each item at close of period. *See* rule 12-13 of Regulation S-X.

[188] *See, e.g.*, proposed rule 12-12, n.2 of Regulation S-X (instructions for categorizing investments); n.10 (disclosure of illiquid securities); n.12 (disclosure of costs basis for

a. Open Option Contracts Written — Rule 12-13 (Current Rule 12-12B) and Options Purchased

Our proposed rule would modify the current disclosure of written option contracts.[189] First, we are adding new columns to the schedule for written option contracts that would require a description of the contract (replacing the current column for name of the issuer), the counterparty to the transaction,[190] and the contract's notional amount.[191] Thus, under the new rule 12-13, for each open written options contract, funds would be required to disclose: (1) description; (2) counterparty; (3) number of contracts; (4) notional amount; (5) exercise price; (6) expiration date; and (7) value.[192] Second, we are proposing to add an instruction to current rule 12-12, which is the schedule on which purchased options are required to be disclosed, that would require funds to provide all information required by proposed rule 12-13 for written option contracts.[193]

We are also proposing for options where the underlying investment would otherwise be presented in accordance with another provision of rule 12-12 or proposed rules 12-13 through 12-13D that the presentation of that investment must include a

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Federal income tax purposes); *see also* rule 12-13, n.7 of Regulation S-X (current requirement for disclosure of costs basis for Federal income tax purposes).

189 Under current rule 12-12B, funds are required to report, for open option contracts, the name of the issuer, number of contracts, exercise price, expiration date, and value. *See* rule 12-12B of Regulation S-X [17 CFR 210.12-12B].

190 *See supra* note 116. This information should assist investors in identifying and monitoring the counterparty risks associated with a fund's investments in over-the-counter derivatives.

191 While rule 12-13 is specific to open option contracts written, the same disclosures also apply for purchased options as required by proposed instruction 3 to rule 12-12. *See also* proposed rule 12-12B, n.5 of Regulation S-X.

192 *See* proposed rule 12-13 of Regulation S-X.

193 *See* proposed rule 12-12, n.3 of Regulation S-X.

description, as required by those provisions.[194] Thus, if another investment contains some sort of optionality (*e.g.*, put or call features), the investment's disclosure must include both a description of the optionality (as required by proposed rule 12-13), and a description of the underlying investments, as required by the applicable provisions of proposed rules 12-12, 12-12A, and 12-13 through 12-13D. For example, reporting for a swaption would include the disclosures required under both the swaps rule (proposed rule 12-13C) and the options rule (proposed rule 12-13).

As required in proposed Form N-PORT,[195] in the case of an option contract with an underlying investment that is an index or basket of investments whose components are publicly available on a website as of the fund's balance sheet date,[196] or if the notional amount of the holding does not exceed one percent of the fund's NAV as of the close of the period, we are proposing that the fund provide information sufficient to identify the underlying investment, such as a description.[197] If the underlying investment is an index whose components are not publicly available on a website as of the fund's balance sheet date, or is based upon a custom basket of investments, and the notional amount of the option contract exceeds one percent of the fund's NAV as of the close of the period, the

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[194] *See* proposed rules 12-12, n.3; 12-12B, n.5; and 12-13, n.3 of Regulation S-X.

[195] *See* Item C.11.c.iii of proposed Form N-PORT.

[196] Under the proposal, the components would be required to be publicly available on a website as of the fund's balance sheet date at the time of transmission to stockholders for any report required to be transmitted to stockholders under rule 30e-1. The components would be required to remain publicly available on a website as of the fund's balance sheet date until 70 days after the fund's next fiscal year-end. For example, components of an index underlying an option contract for a fund's 12/31/14 annual report must be made publicly available on a website as of 12/31/14 by the time that the 12/31/14 annual report is transmitted to stockholders. The components must remain publicly available until 3/10/16.

[197] *See* proposed rule 12-13, n.3 of Regulation S-X. *See supra* note 120 and accompanying text (discussing the rationale for similar proposed requirements in Form N-PORT).

fund would list separately each of the investments comprising the index or basket of investments.[198] We believe that disclosure of the underlying investments of an option contract is an important element to assist investors in understanding and evaluating the full risks of the investment. We are also proposing to include a similar instruction for swap contracts.[199] The disclosures in proposed instruction 3 would provide investors with more transparency into both the terms of the underlying investment and the terms of the option.

We are also proposing several instructions to rule 12-13 and the other rules we are proposing concerning derivatives holdings (*e.g.*, open futures contracts, open swap contracts) in order to maintain consistency with the disclosures required by current rule 12-13. Current rule 12-13 contains an instruction requiring identification of "each investment not readily marketable."[200] We are proposing to modify this requirement in proposed rule 12-13 and the other rules concerning derivatives holdings in order to increase transparency into the marketability of, and observability of valuation inputs for, a fund's investments by requiring separate identification of investments that are restricted securities, as well as those investments that were fair valued using significant unobservable inputs. Thus, we are proposing to require funds to indicate if an investment

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198 *See id.*

199 *See* proposed rule 12-13C, n.3 of Regulation S-X.

200 *See* rule 12-13, n.4 of Regulation S-X ("The term 'investment not readily marketable' shall include investments for which there is no independent publicly quoted market and investments which cannot be sold because of restrictions or conditions applicable to the investment or the company.").

cannot be sold because of restrictions or conditions applicable to the investment.[201] We are also proposing to require funds to indicate if a security's fair value was determined using significant unobservable inputs.[202]

Current rule 12-13 likewise contains an instruction to include tax basis disclosures for investments other than securities.[203] We are extending this requirement to proposed rule 12-13, as well as the other rules concerning derivatives holdings.[204] We believe that this type of tax basis information is important to investors in investment companies, which are generally pass-through entities pursuant to Subchapter M of the Internal Revenue Code.[205]

In order to provide greater transparency to investors into which investments are deemed illiquid, we are also proposing to require funds to identify illiquid investments.[206]

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201 *See* proposed rule 12-13, n.6 of Regulation S-X; *see also* proposed rules 12-13A, n.4; 12-13B, n.2; 12-13C, n.5; and 12-13D, n.6 of Regulation S-X.

202 *See* proposed rule 12-13, n.7 of Regulation S-X; *see also* proposed rules 12-13A, n.5; 12-13B, n.3; 12-13C, n.6; and 12-13D, n.7 of Regulation S-X. These instructions would require funds to identify each investment categorized in Level 3 of the fair value hierarchy in accordance with ASC Topic 820. *See* ASC 820-10-20 (defining "level 3 inputs" as "unobservable inputs for the asset or liability"); *see also* ASC 820-10-35-37A ("In some cases, the inputs used to measure the fair value of an asset or a liability might be categorized within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is *significant* to the entire measurement.") (emphasis added); *see also* discussion *supra* note 101.

203 *See* rule 12-13, n.7 of Regulation S-X.

204 *See* proposed rule 12-13, n.10 of Regulation S-X; *see also* proposed rules 12-13A, n.8; 12-13B, n.6; 12-13C, n.9; and 12-13D, n.11 of Regulation S-X.

205 *See* 26 U.S.C. 851, *et seq.*

206 *See* proposed rule 12-13, n.8 of Regulation S-X; *see also* proposed rules 12-13A, n.6; 12-13B, n.4; 12-13C, n.7; and 12-13D, n.8 of Regulation S-X. *See generally* 1992 Release, *supra* note 100. As previously stated, the staff is reviewing possible recommendations to the Commission for rulemaking to update liquidity standards for mutual funds and ETFs, which may result in changes to the Commission's current guidance on this issue. *See supra* note 100.

Liquidity is an important consideration for a fund's investors in understanding the risk exposure of a fund. For example, in times of market stress, illiquid investments may not be readily sold at their approximate value. Indicating which investments are illiquid would allow an investor to understand which holdings in a fund are likely to be sold at a discount if a portion of the fund's investments must be sold to meet cash needs, such as redemptions or distributions.

Proposed rule 12-13 would also include other new instructions.[207]

b. Open Futures Contracts — New Rule 12-13A

We are proposing new rule 12-13A, which would require standardized reporting of open futures contracts.[208] For open futures contracts, funds are currently required to report under rule 12-13 a description of the futures contract (including its expiration date), the number of contracts held (under the balance held—quantity column), and any unrealized appreciation and depreciation (under the value column).[209] In order to allow investors to better understand the economics of a fund's investment in futures contracts, our proposal would also require funds to report notional amount and value.[210] Therefore, under the proposal, funds with open futures contracts would report: (1) description; (2) number of contracts; (3) expiration date; (4) notional amount; (5) value; and (6)

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[207] Instruction 2 would add "description" and "counterparty" to the organizational categories of options contracts that must be listed separately. *See* proposed rule 12-13, n.2 of Regulation S-X. Instruction 4 would clarify that the fund need not include counterparty information for exchange-traded options. *See* proposed rule 12-13, n.4 of Regulation S-X.

[208] *See* proposed rule 12-13A of Regulation S-X.

[209] *See* rule 12-13 of Regulation S-X.

[210] *See* proposed rule 12-13A, columns D and E of Regulation S-X.

unrealized appreciation and depreciation.[211] In addition, instruction 7 would include the new requirement that funds should reconcile the total of Column F (unrealized appreciation/depreciation) to the total variation margin receivable or payable on the related balance sheet.[212] We believe that proposed instruction 7 would improve transparency by linking the information in the schedule of open futures contracts with the related balance sheet.

As discussed above, our proposal also contains certain new instructions for rule 12-13A that are generally the same across all of the schedules for derivatives contracts.[213] Based on staff review of disclosures of open futures contracts of funds, we believe that these proposed disclosures are generally consistent with current industry practice.[214]

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211 *See* proposed rule 12-13A of Regulation S-X.

212 *See* proposed rule 12-13A, n.7 of Regulation S-X.

213 Instruction 1 would require funds to organize long purchases of futures contracts and futures contracts sold short separately. *See* proposed rule 12-13A, n.1 of Regulation S-X. Instruction 2 would require funds to list separately futures contracts where the descriptions or expiration dates differ. *See* proposed rule 12-13A, n.2 of Regulation S-X. Instruction 3 would clarify that the description should include the name of the reference asset or index. *See* proposed rule 12-13A, n.3 of Regulation S-X. Instruction 4 would require the fund to indicate each investment which cannot be sold because of restrictions or conditions applicable to the investment. *See* proposed rule 12-13A, n.4 of Regulation S-X. Instruction 5 would require the fund to indicate each investment whose fair value was determined using significant unobservable inputs. *See* proposed rule 12-13A, n.5 of Regulation S-X. Instruction 6 would require the fund to identify each illiquid investment. *See* proposed rule 12-13A, n.6 of Regulation S-X. Instruction 8 would extend current rule 12-13's tax basis disclosure to disclosures of open futures contracts. *See* proposed rule 12-13A, n.8 of Regulation S-X.

214 We understand that many funds disclose either value or notional amount for open futures contracts, but may not disclose both. Our proposal would require disclosure of both value and notional amount.

c. Open Forward Foreign Currency Contracts — New Rule 12-13B

We are also proposing new rule 12-13B, which would require standardized disclosures for open forward foreign currency contracts.[215] Currently, under rule 12-13, funds are required to report a description of the contract (including a description of what is to be purchased and sold under the contract and the settlement date), the amount to be purchased and sold on settlement date (under the balance held—quantity column), and any unrealized appreciation or depreciation (under the value column).[216] In order to allow investors to better understand counterparty risk for forward foreign currency contracts, our proposal would additionally require funds to disclose the counterparty to each transaction.[217] As proposed, funds holding open forward foreign currency contracts would therefore report the: (1) amount and description of currency to be purchased; (2) amount and description of currency to be sold; (3) counterparty; (4) settlement date; and (5) unrealized appreciation/depreciation.[218] Based on staff review of disclosures of open forward foreign currency contracts of funds, we believe that these proposed disclosures are generally consistent with current industry practice. Our proposal would also include certain new instructions to the schedule that are similar to the other derivatives disclosure requirements we are proposing today.[219]

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[215] *See* proposed rule 12-13B of Regulation S-X.

[216] *See* rule 12-13 of Regulation S-X.

[217] *See* proposed rule 12-13B, column C of Regulation S-X.

[218] *See* proposed rule 12-13B of Regulation S-X.

[219] Instruction 1 would require the fund to separately organize forward foreign currency contracts where the description of currency purchased, currency sold, counterparties, or settlement dates differ. *See* proposed rule 12-13B n.1 of Regulation S-X. Instruction 2 would require the fund to indicate each investment which cannot be sold because of restrictions or conditions applicable to the investment. *See* proposed rule 12-13B n.2 of

d. Open Swap Contracts — New Rule 12-13C

We are also proposing new rule 12-13C, which would require standardized reporting of fund positions in open swap contracts.[220] Under rule 12-13, funds currently report description (including a description of what is to be paid and received by the fund and the contract's maturity date), notional amount (under balance held—quantity column), and any unrealized appreciation or depreciation (under the value column).[221] Our proposal would additionally require funds to report the counterparty to each transaction (except for exchange-traded swaps), the contract's value, and any upfront payments or receipts.[222] This additional information would allow investors to both better understand the economics of the transaction, as well as its associated risks.[223] Thus, as proposed, funds would report for each swap the: (1) description and terms of payments to be received from another party; (2) description and terms of payments to be paid to another party; (3) counterparty; (4) maturity date; (5) notional amount; (6) value; (7)

Regulation S-X. Instruction 3 would require the fund to indicate each investment whose fair value was determined using significant unobservable inputs. *See* proposed rule 12-13B n.3 of Regulation S-X. Instruction 4 would require the fund to identify each illiquid investment. *See* proposed rule 12-13B n.4 of Regulation S-X. Instruction 5 would clarify that Column E (unrealized appreciation/depreciation) should be totaled and agree with the total of correlative amounts shown on the related balance sheet. *See* proposed rule 12-13B n.5 of Regulation S-X. Instruction 6 would extend current rule 12-13's tax basis disclosure to disclosures of open forward foreign currency contracts. *See* proposed rule 12-13B n.6 of Regulation S-X.

[220] *See* proposed rule 12-13C of Regulation S-X.

[221] *See* rule 12-13 of Regulation S-X.

[222] *See* proposed rule 12-13C, columns C, F, and G of Regulation S-X.

[223] For example, upfront payments disclose whether cash was paid or received when entering into a swap contract, allowing investors to better understand the initial cost of the investment, if any.

upfront payments/receipts; and (8) unrealized appreciation/depreciation.[224] We are proposing these categories of information in an effort to increase transparency of swap contracts, while maintaining enough flexibility for the variety of swap products that currently exist and future products that might come to market.[225]

While instruction 3 of proposed rule 12-13C provides specific examples for the more common types of swap contracts (*e.g.*, credit default swaps, interest rate swaps, and total return swaps), we recognize that other types of swaps exist (*e.g.*, currency swaps, commodity swaps, variance swaps, and subordinated risk swaps).[226] For example, a cross-currency swap has two notional amounts, one for the currency to be received and one for the currency to be paid. For a cross-currency swap, funds would report for purposes of Column A of proposed rule 12-13C, a description of the interest rate to be received and the notional amount that the calculation of interest to be received is based upon. Column B of proposed rule 12-13C would include a description of the interest rate to be paid and the notional amount that the calculation of interest to be paid is based upon. Column E would include both notional amounts and the currency in which each is denominated, or the same information could be presented in two separate columns.

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[224] *See* proposed rule 12-13C of Regulation S-X. The description and terms of payments to be paid and received (and other information) to and from another party should reflect the investment owned by the fund and allow an investor to understand the full nature of the transaction.

[225] *See id.* at n.1 (requiring the fund to list each major category of swaps by descriptive title); n.2 (requiring the fund to list separately each swap where description, counterparty, or maturity dates differ within each major category).

[226] *See* proposed rule 12-13C, n.3 of Regulation S-X.

As required in our proposed disclosures for open option contracts[227] and in proposed Form N-PORT,[228] in the case of a swap with a referenced asset that is an index whose components are publicly available on a website as of the fund's balance sheet date, or if the notional amount of the holding does not exceed one percent of the fund's NAV as of the close of the period, we are proposing that the fund provide information sufficient to identify the referenced asset, such as a description.[229] If the referenced asset is an index whose components are not publicly available on a website as of the fund's balance sheet date, or is based upon a custom basket of investments, and the notional amount of the holding exceeds one percent of the fund's NAV as of the close of the period, the fund would list separately each of the investments comprising the referenced assets.[230] As with underlying investments for option contracts, we believe that disclosure of the underlying referenced assets of a swap would assist investors in better understanding and evaluating the full risks of investments in swaps.

For swaps which pay or receive financing payments, funds would disclose variable financing rates in a manner similar to disclosure of variable interest rates on securities in accordance with instruction 4 to proposed rule 12-12.[231] Our proposal would also include other instructions to this rule that are similar across all of our proposed rules for derivatives contracts.[232]

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227 *See* proposed rule 12-13, n.3 of Regulation S-X.

228 *See* Item C.11.f.i of proposed Form N-PORT.

229 *See* proposed rule 12-13C, n.3 of Regulation S-X.

230 *See id.*

231 *See* proposed rule 12-13C, n.3; and 12-12, n.4 of Regulation S-X.

232 Instruction 4 would clarify that the fund need not list counterparty for exchange traded swaps. *See* proposed rule 12-13C n.4 of Regulation S-X. Instruction 5 would require the fund to

e. Other Investments — Rule 12-13D (Current Rule 12-13)

We are also proposing to amend current rule 12-13 and, for organization and consistency, renumber it as proposed rule 12-13D. Proposed rule 12-13D is intended to continue, as is currently required by rule 12-13, to be the schedule by which funds report investments not otherwise required to be reported pursuant to Article 12.[233] As proposed, rule 12-13D would require reporting of: (1) description; (2) balance held at close of period-quantity; and (3) value of each item at close of period.[234] We expect that funds would report, among other holdings, investments in physical holdings, such as real estate or commodities, pursuant to proposed rule 12-13D. As discussed above, our proposal would also modify current rule 12-13's requirement that funds disclose "each investment not readily marketable"[235] in favor of disclosures concerning whether an investment is restricted and if an investment's fair value was determined using significant unobservable inputs.[236] Our proposal would also include certain new instructions to the schedule that are generally the same across all the schedules for derivatives contracts.[237]

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indicate each investment which cannot be sold because of restrictions or conditions applicable to the investment. *See* proposed rule 12-13C n.5 of Regulation S-X. Instruction 6 would require the fund to indicate each investment whose fair value was determined using significant unobservable inputs. *See* proposed rule 12-13C n.6 of Regulation S-X. Instruction 7 would require funds to identify each illiquid investment. *See* proposed rule 12-13C n.7 of Regulation S-X. Instruction 8 would require that columns F (value), G (upfront payments/receipts), and H (unrealized appreciation/depreciation) be totaled and agree with the totals of their respective amounts shown on the related balance sheet. *See* proposed rule 12-13C n.8 of Regulation S-X. Instruction 9 would extend current rule 12-13's tax basis disclosure to disclosures of swap contracts. *See* proposed rule 12-13C n.9 of Regulation S-X.

[233] *See* proposed rule 12-13D of Regulation S-X.

[234] *Id.*

[235] *See* rule 12-13, n.4 of Regulation S-X.

[236] *See* proposed rule 12-13D, n.6 of Regulation S-X (requiring the fund to indicate each investment which cannot be sold because of restrictions or conditions applicable to the

We request comment on our proposed amendments to rules 12-13 through 12-13D of Regulation S-X:

- Many of our proposed portfolio holdings disclosure requirements in Article 12 conform with similar requirements on proposed Form N-PORT. Are our proposed amendments to Article 12 appropriate for fund financial statements? Is there information that is currently proposed in Form N-PORT, but not in Article 12, that would benefit investors? For example, to the extent that proposed Form N-PORT instructs filers to report the country code that corresponds to the country of investment or issuer based on the concentrations of the risk and economic exposure of the investments, or, if different, the country where the issuer is organized, should those same instructions be integrated into Regulation S-X to standardize how funds report that information in their financial statements and in Form N-PORT?[238]
- Are there other categories of investments not specifically covered in Article 12 that should be specifically addressed in a new rule or directly addressed in rule 12-13D?

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investment); n.7 (requiring the fund to indicate each issue of securities whose fair value was determined using significant unobservable inputs).

237 Instruction 1 would require the fund to organize each investment separately where any portion of the description differs. *See* proposed rule 12-13D n.1 of Regulation S-X. Instruction 2 would require the fund to categorize the schedule by the type of investment, and related industry, country, or geographic region, as applicable. *See* proposed rule 12-13D n.2 of Regulation S-X. Instruction 3 would require that the description of the asset include information sufficient for a user to understand the nature and terms of the investment. *See* proposed rule 12-13D n.3 of Regulation S-X. Instruction 8 would require the fund to identify each illiquid investment. *See* proposed rule 12-13D n.8 of Regulation S-X.

238 *See supra* note 104 and accompanying and following text (discussing how funds would report country codes for portfolio investments on Form N-PORT).

- To what extent are proposed rules 12-13 through 12-13D consistent with industry practices? How are our proposed amendments different? Are there other industry practices that we should include in our proposal with respect to the disclosure of derivative investments?
- The schedules to rules 12-13 through 12-13D use the term "description" to require funds to disclose the information sufficient for a user of financial information to identify the investment. Should the instructions to any of those rules be enhanced or modified to clarify what is meant by the term "description?" If so, how should these be enhanced or modified?
- The schedules to rules 12-13 (Open option contracts written), 12-13B (Open forward foreign currency contracts), 12-13C (Open swap contracts), and 12-13D (Other investments) would require disclosure of the counterparty to the transaction for non-exchange traded instruments. Should we, as proposed, require disclosure of the counterparty to certain transactions? Should the exchange or clearing member be disclosed for exchange-traded derivatives? Are there any additional counterparty or exchange risks that should be disclosed? If so, why? Are there any confidentiality or other concerns with requiring the disclosure of counterparties?
- We request comment on our proposed amendments to rule 12-13 (Open option contracts written). Should we require different or additional information about these contracts? Should any of the proposed information requirements be excluded? Is it appropriate to require disclosure of "notional amount" for option contracts? Is this metric useful to investors? Should we require the disclosures of

open option contracts written to be grouped or subtotaled? For example, should we require over-the-counter option contracts to be grouped by counterparty?

- As proposed, rule 12-13 would require disclosure of each option contract with an underlying investment that is an index or basket of investments whose components are not publicly available on a website and the notional amount of the holding exceeds one percent of the NAV of the fund. Are there better alternatives to disclose the underlying investments for an options contract if it consists of a custom basket of securities? If so, what alternatives and why? To the extent such indices are proprietary or subject to licensing agreements, what would be the effect of this requirement? For example, would funds incur costs for amending licensing agreements? Would index providers be unwilling to amend existing licensing agreements? If so, how would this impact funds that make such investments and the marketplace generally? Are there other concerns about disclosing the components of proprietary indices? Should we alter this requirement, and if so how? Is our exceeding one percent of the NAV disclosure threshold appropriate? Should there be a different disclosure threshold applied to an option contract's underlying investments? If so, what threshold and why? For example, should there be a disclosure threshold applied to individual holdings (*e.g.*, if the notional amount of a single underlying investment in a custom basket is less than a certain percentage of a fund's net assets)? Should we use a different percentage for the disclosure threshold, such as exceeding five percent of the NAV? Alternatively, would summary disclosure be adequate to inform investors, similar to instruction 3 of rule 12-12C, which requires disclosure of the 50 largest issues and any other issue the value of which exceeded one percent of net asset value of the fund as of the close of the period? If so, how should such a disclosure be handled? If the reference asset is a modified version of an index whose components are publicly available on a website as of the fund's balance sheet date, for example a version that is customized to exclude certain issuers that the fund is restricted from owning, would requiring a narrative of those modifications be preferable to funds and investors rather than requiring each holding of the modified index to be listed?

- We request comment on proposed rule 12-13A (Open futures contracts). Should we require different or additional information about these contracts? Should any of the proposed information requirements be excluded? Our proposed rule would require disclosure of notional amount and value on open futures contracts. Should we require disclosure of notional amount for futures contracts? Should we require disclosure of value for futures contracts? Should we require the disclosures of open futures contracts to be grouped or subtotaled? If so, how? For example, should we require open futures contracts to be organized by country of issuance?
- We request comment on proposed rule 12-13B (Open forward foreign currency contracts). Should we require different or additional information about these contracts? Should any of the proposed information requirements be excluded? Rule 12-13B, as proposed, is limited to forward foreign currency contracts. Are there other types of forwards that should be addressed in this section that would not otherwise be presented as other derivative investments, such as swaps?

Should we require the disclosures of open forward foreign currency contracts to be grouped or subtotaled? If so, how? For example, should we require open forward foreign currency contracts to be organized by currency or type of transaction (*e.g.*, purchased or sold U.S. dollars)?

- We request comment on proposed rule 12-13C (Open swap contracts). Should we require different or additional information about these contracts? Should any of the proposed information requirements be excluded? Instruction 1 to proposed rule 12-13C requires the schedule to be organized by descriptive title (*e.g.*, credit default swaps, interest rate swaps). Should we require additional subgrouping of the schedules beyond what is already required? For example, should we require over-the-counter swaps to be grouped by counterparty?
- Instruction 3 of proposed rule 12-13C contains examples of information that could be included for credit default swaps, interest rate swaps, and total return swaps. Is the example contained in proposed rule 12-13C adequate? Is there any other information that should be disclosed as part of the description for credit default swaps, interest rate swaps, and total return swaps? Are there other types of swaps that should be included as examples within proposed rule 12-13C? If so, what information should be included in the example?
- As proposed, rule 12-13C would require disclosure of each investment with a referenced asset that is an index whose components are not periodically publicly available on a website and the notional amount of the holding exceeds one percent of the NAV of the fund. Are there better alternatives to disclose the underlying assets of a swap if it consists of a custom basket of securities? If so, what

alternative and why? To the extent such indices are proprietary or subject to licensing agreements, what would be the effect of this requirement? For example, would funds incur costs for amending licensing agreements? Would index providers be unwilling to amend existing licensing agreements? If so, how would this impact funds that make such investments and the marketplace generally? Are there other concerns about disclosing the components of proprietary indices? Should we alter this requirement, and if so how? Is our exceeding one percent of the NAV disclosure threshold appropriate? Should there be a different disclosure threshold applied to a swap's referenced assets? If so, what threshold and why? For example, should there be a disclosure threshold applied to individual holdings (*e.g.*, if the notional amount of a single underlying investment in a custom basket is less than a certain percentage of a fund's net assets)? Should we use a different percentage for the disclosure threshold, such as exceeding five percent of the NAV? Alternatively, would summary disclosure be adequate to inform investors, similar to instruction 3 of rule 12-12C, which requires disclosure of the 50 largest issues and any other issue the value of which exceeded one percent of net asset value of the fund as of the close of the period? If so, how should such a disclosure be handled? Should we include this disclosure requirement for other investments? For example, should we require funds to disclose the referenced asset for futures contracts or forward foreign currency contracts if their underlying investments are composed of an index or custom basket of securities?

- We request comment on our proposed amendments in rule 12-13D (Investments other than those presented in rules 12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B, and 12-13C). Should we require different or additional information about these contracts? Should any of the proposed information requirements be excluded?

- We request comment on our proposed requirements in rules 12-13 through 12-13D that the fund identify investments which cannot be sold because of restrictions or conditions applicable to the investment. Is this requirement appropriate? Why or why not? Would this requirement assist investors and other interested parties with understanding the marketability of an investment? Why or why not?
- We request comment on our proposed requirements in rules 12-13 through 12-13D that the fund identify investments whose fair value was determined using significant unobservable inputs. Is this requirement appropriate? Why or why not? Would this requirement assist investors and other interested parties with understanding risks associated with valuation?
- Should we propose a disclosure relating to "investments not readily marketable" as is currently required by rule 12-13? Why or why not?
- We request comment on our proposed requirements in rules 12-13 through 12-13D that the fund identify investments that are considered to be illiquid. Is this requirement appropriate? Why or why not? What are the costs and benefits associated with this requirement? Will independent accountants be able to audit this disclosure?
- We request comment on our proposed disclosures based on cost for Federal income tax purposes under proposed rule 12-12A and rules 12-13 through 12-

13D. Do these disclosures provide meaningful information for investors in addition to tax basis disclosures required under U.S. GAAP? What are the costs and benefits associated with providing this disclosure? Should our proposed disclosures be reported in a separate stand-alone disclosure or, as proposed, as a note to each separate schedule? Should we eliminate the current disclosure requirement to present tax-basis cost and unrealized appreciation and depreciation in both semi-annual and annual shareholder reports? Why or why not? As an alternative, should we make the tax-basis disclosure an annual requirement?

3. Amendments to Rules 12-12 through 12-12C

While we are not proposing changes to the schedules for rules 12-12, 12-12A, and 12-12C, we are proposing certain additional rule instructions that would include new disclosures, as well as certain clarifying changes, including renumbering several of the schedules.

We are proposing several modifications to the instructions to rule 12-12, the rule concerning disclosure of investments in securities of unaffiliated issuers. We are proposing to modify instruction 2 to rule 12-12 (and the corresponding instructions to proposed rules 12-12A, 12-12B, 12-13D, and 12-14) which would require funds to categorize the schedule by type of investment, the related industry, and the related country, or geographic region.[239] U.S. GAAP requires investment companies that are nonregistered investment partnerships to categorize investments in securities by type,

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[239] *See* proposed rule 12-12, n.2 of Regulation S-X; *see also* proposed rules 12-12A, n.2; 12-12B, n.2; 12-13D, n.2; and 12-14, n.2 of Regulation S-X.

country or geographic region, and industry.[240] In order to provide more transparency into the industry and the country or geographic region of a fund's investments in securities, we believe that the disclosures provided by funds should provide investors with the same categorization as nonregistered investment partnerships. We also believe that disclosure of both the industry and the country or geographic region would be particularly beneficial for investors in global and international funds, where currently funds are only required to categorize their schedule by industry, country, *or* geographic region, as it would provide additional transparency into the investments owned by the fund.

In order to provide more transparency to a fund's investments in debt securities, we are proposing an instruction to rule 12-12 requiring the fund to indicate the interest rate or preferential dividend rate and maturity rate for certain enumerated debt instruments.[241] When disclosing the interest rate for variable rate securities, we are proposing that the fund describe the referenced rate and spread.[242] In proposing disclosures for variable rate securities, we considered other alternatives, such as period-end interest rate (*e.g.* the investment's interest rate in effect at the end of the period). However, we believe that disclosure of both the referenced rate and spread allow investors to better understand the economics of the fund's investments in variable rate debt securities, such as the effect of a change in the reference rate on the security's income. This proposal is intended to result in more consistency across funds in

[240] *See* ASC 946-210-50-6, Financial Services – Investment Companies ("ASC 946").

[241] *See* proposed rule 12-12, n.4 of Regulation S-X.

[242] *See id.*

disclosures of the interest rate for variable rate securities. For securities with payments-in-kind, we are proposing that the fund provide the rate paid in-kind in order to provide more transparency to investors when the fund is generating income that is not paid in cash.[243]

Our proposal would modify the current instruction to rule 12-12[244] that requires a fund to identify each issue of securities held in connection with open put or call option contracts and loans for short sales, by adding the requirement to also indicate where any portion of the issue is on loan.[245] We believe that this disclosure would increase the transparency of the fund's securities lending activities. We are also proposing to modify current instruction 3 of rule 12-12 concerning the organization of subtotals for each category of investments, making the instructions consistent with those in proposed rule 12-12B (current rule 12-12C), Summary schedule of investments in securities of unaffiliated issuers.[246]

As in our proposed derivatives disclosures,[247] in order to increase transparency into the observability of inputs used in determining the value of individual investments, we are adding the requirement for funds to disclose those investments whose fair value was determined using significant unobservable inputs.[248] Here, as in our proposed

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[243] *Id.*

[244] *See* rule 12-12, n.7 of Regulation S-X.

[245] *See* proposed rule 12-12, n.11 of Regulation S-X; *see also* proposed rule 12-12B, n.14 of Regulation S-X.

[246] *See* rule 12-12, n.3 of Regulations S-X; *see also* proposed rule 12-12B, n.2 of Regulation S-X.

[247] *See* proposed rules 12-13, n.7; 12-13A, n.5; 12-13B, n.3; 12-13C, n.6; and 12-13D, n.7 of Regulation S-X.

[248] *See* proposed rule 12-12, n.9 of Regulation S-X.

derivatives disclosures, we would expect funds to identify each investment categorized in Level 3 of the fair value hierarchy in accordance with ASC Topic 820. We are also extending this requirement to proposed rules 12-12A and 12-12B.[249]

As in proposed rules 12-13 through 12-13D,[250] proposed instruction 10 to rule 12-12 would contain a requirement to identify each issue of illiquid securities.[251] Like other proposed rules, we believe that this requirement would provide investors with greater transparency and understanding of the liquidity of a fund's investments.[252]

Likewise, we are proposing several modifications to rule 12-12A regarding the presentation of securities sold short, in order to conform the instructions to proposed rule 12-12.[253]

Funds are permitted to include in their reports to shareholders a summary portfolio schedule, in lieu of a complete portfolio schedule, so long as it conforms with

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[249] *See* proposed rules 12-12A, n.6 and 12-12B, n.12 of Regulation S-X.

[250] *See* proposed rules 12-13, n.8; 12-13A, n.6; 12-13B, n.4; 12-13C, n.7; and 12-13D, n.8 of Regulation S-X.

[251] *See* proposed rule 12-12, n.10 of Regulation S-X.

[252] *See supra* note 206 and accompanying text.

[253] Instruction 2 would require the fund to organize the schedule in rule 12-12A in the same manner as is required by instruction 2 of rule 12-12. *See* proposed rule 12-12A, n.2. Instruction 3 would require the fund to identify the interest rate or preferential dividend rate and maturity rate as required by instruction 4 of proposed rule 12-12. *See* proposed rule 12-12A, n.3 of Regulation S-X. Instruction 4 would require the subtotals for each category of investments be subdivided both by investment type and business grouping or instrument type, and be shown together with their percentage value compared to net assets, in the same manner as is required by proposed instruction 5 of rule 12-12. *See* proposed rule 12-12A, n.4 of Regulation S-X. Instruction 6 would require the fund to identify each issue of securities whose fair value was determined using significant unobservable inputs. *See* proposed rule 12-12A, n.6 of Regulation S-X. Instruction 7 would require the fund to identify each issue of securities held in connection with open put or call option contracts in the same manner as required by proposed instruction 11 of rule 12-12. *See* proposed rule 12-12A, n.7 of Regulation S-X. Instruction 8 would extend rule 12-12's tax basis disclosure to securities sold short. *See* proposed rule 12-12A, n.8 of Regulation S-X.

current rule 12-12C (Summary schedule of investments in securities of unaffiliated issuers).[254] In order to maintain numbering consistency and organization throughout the regulation, we are proposing to rename current rule 12-12C (Summary schedule of investments in securities of unaffiliated issuers) as rule 12-12B. As in rule 12-12 and 12-12A, we are not proposing to modify the schedule of proposed rule 12-12B (current rule 12-12C), but again added similar changes to its instructions.[255]

We request comment on our amendments to proposed rules 12-12 through 12-12B of Regulation S-X:

- Are our proposed amendments to rule 12-12 through 12-12B appropriate? Are there other amendments to rules 12-12 through 12-12B that should be made to improve disclosures regarding the investments that would be reported under the rules? If so, what amendments and why?
- We request comment on proposed amendments to rule 12-12 (Investments in securities of unaffiliated issuers). For variable rate securities, we propose to require disclosure of a description of the reference rate and spread (*e.g.*, USD

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[254] *See* rule 6-10(c)(2) of Regulation S-X [17 CFR 210.6-10(c)(2)]; *see also* Quarterly Portfolio Holdings Adopting Release, *supra* note 19.

[255] Instruction 2 would add "type of investment" to the current subtotal requirements for the summary schedule. *See* proposed rule 12-12B, n.2 of Regulation S-X. Instruction 3 would extend rule 12-12's proposed requirement that funds indicate the interest rate or preferential dividend rate and maturity rate for certain enumerated securities. *See* proposed rule 12-12B, n.3 of Regulation S-X. Instruction 5 would require for options purchased all information that would be required by rule 12-13 for written option contracts. *See* proposed rule 12-12B, n.5 of Regulation S-X. Instruction 12 would require the fund to indicate each issue of securities whose fair value was determined using significant unobservable inputs. *See* proposed rule 12-12B, n.12 of Regulation S-X. Instruction 13 would require the fund to identify illiquid securities. *See* proposed rule 12-12B, n.13 of Regulation S-X. Instruction 14 would extend rule 12-12's requirement that the fund indicate where any portion of the issue is on loan. *See* proposed rule 12-12B, n.14 of Regulation S-X.

LIBOR 3-month + 2%). Is this requirement appropriate? Should we alternatively require disclosure of the period end interest rate?

- We request comment on instruction 2 to proposed rule 12-12 (and the corresponding instructions to rules 12-12A, 12-12B, and 12-14) which would require funds to categorize the schedule by type of investment, the related industry, and the related country, or geographic region. Should we include this instruction in our proposed rules? What are the costs or benefits associated with such a requirement?
- We request comment our proposed modifications in rules 12-12 and 12-12B that would require a fund to indicate where any portion of the issue is on loan. Should we include this requirement in our proposed rules? Why or why not?
- We request comment on instruction 4 to proposed rule 12-12. Should we require funds to disclose the interest rate or preferential dividend rate and maturity rate for certain debt instruments? Are there any types of securities that should (or should not) be included in instruction 4's list of applicable debt instruments?
- We request comment on our proposal to require a fund to disclose each issue of illiquid securities. Should we include this requirement in our proposed rules? Why or why not? Would the fund's independent accountants be able to audit this disclosure?
- We request comment on our proposed requirements in rules 12-12, 12-12A, and 12-12B that the fund identify investments whose fair value was determined using significant unobservable inputs. Is this requirement appropriate? Why or why

not? Would this requirement assist investors and other interested parties with understanding risks associated with valuation?

- Are our amendments to proposed rules 12-12 through 12-12B consistent with industry practices? If not, how are our amendments different and what would be the costs and benefits associated with such differences? Are there other industry practices that we should include in our proposal?

4. Investments In and Advances to Affiliates

We are proposing amendments to rule 12-14 (Investments in and advances to affiliates).[256] Rule 12-14 requires a fund to make certain disclosures about its investments in and advances to any "affiliates" or companies in which the investment company owns 5% or more of the outstanding voting securities.[257] The rule currently requires that a fund disclose the "amount of equity in net profit and loss for the period" for each controlled company, but does not require disclosure of realized or unrealized gains or losses. Based upon staff experience, we believe that the presentation of realized gains or losses and changes in unrealized appreciation or depreciation would assist investors with better understanding the impact of each affiliated investment on the fund's statement of operations. As a result, we are proposing to modify column C of the schedule to rule 12-14 to require "net realized gain or loss for the period,"[258] and column

[256] *See* proposed rule 12-14 of Regulation S-X.

[257] *See* rule 12-14 of Regulation S-X.

[258] *See* proposed rule 12-14, column C of Regulation S-X. Column C of current rule 12-14 requires disclosure of the "amount of equity in net profit and loss for the period," which is derived from the controlled company's income statement and does not directly translate to the impact to a fund's statement of operations. We are proposing to replace this requirement with "net realized gain or loss for the period."

D to require "net increase or decrease in unrealized appreciation or depreciation for the period" for each affiliated investment.[259]

Likewise, in instruction 6(e) and (f), we are proposing to require disclosure of total realized gain or loss and total net increase or decrease in unrealized appreciation or depreciation for affiliated investments in order to correlate these totals to the statement of operations.[260] Disclosure of realized gains or losses and changes in unrealized appreciation or depreciation, in addition to the current requirement to disclose the amount of income, would allow investors to understand the full impact of an affiliated investment on a fund's statement of operations.

Additionally, we are proposing a new instruction 7 in order to make the categorization of investments in and advances to affiliates consistent with the method of categorization used in proposed rules 12-12, 12-12A, and 12-12B.[261] We are also proposing several other modifications to the instructions to rule 12-14 in order to, in part, conform the rule to our proposed disclosure requirements in rules 12-12 and 12-13.[262]

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[259] *See id.* at column D.

[260] *See* proposed rule 12-14, nn.6(e) and (f) of Regulation S-X.

[261] *See id.* at n.7; *see also* proposed rule 12-12, n.5, 12-12A. n.4, 12-12B, n.2 of Regulation S-X.

[262] Instruction 1 would delete the instruction to segregate subsidiaries consolidated in order to make the disclosures under rule 12-14 consistent with the fund's balance sheet. *See* proposed rule 12-14, at n.1 of Regulation S-X. Instruction 2 would require the fund to organize the schedule to rule 12-14 in the same manner as is required by instruction 2 of rule 12-12. *See* proposed rule 12-14, at n.2 of Regulation S-X. Instruction 3 would require the fund to identify the interest rate or preferential dividend rated and maturity rate, as applicable. *See* proposed rule 12-14, at n.3 of Regulation S-X. Instruction 4 would add column F to the columns to be totaled and update the instruction to state that Column F should agree with the correlative amount shown on the related balance sheet. *See* proposed rule 12-14, at n.4 of Regulation S-X. Instruction 5 would update the reference to instruction 8 of rule 12-12 and reference to rule 12-13 to reflect the changes in the numbering of the instructions for those rules. *See* proposed rule 12-14, at n.5 of Regulation S-X. Instruction 6(a) and (b) would update references to column D to reference Column E in order to reflect our proposed

We request comment on our proposed amendments to rule 12-14 of Regulation S-X:

- Are our proposed amendments to rule 12-14 appropriate? Are there other amendments to rule 12-14 that should be made to improve disclosures regarding the investments that would be reported under the rule? If so, what amendments and why?
- In proposed rule 12-14, we are no longer requiring information about the fund's equity in the profit or loss of each controlled portfolio company. Instead, we are proposing to require the realized gain or loss and change in unrealized appreciation or depreciation for all affiliated investments. Is this change appropriate? Is it still important to understand the equity in the profit or loss of each controlled company in addition to the controlled portfolio company's effect on the fund's statement of operations? Would the presentation of realized gains or losses and changes in unrealized appreciation or depreciation assist investors with better understanding the impact of each affiliated investment on the fund's statement of operations? Why or why not? Are there other changes to the

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changes to rule 12-14's schedule. *See* proposed rule 12-14, at nn.6(a) and (b) of Regulation S-X. Instruction 6(d), which proposes to add clarifying language from instruction 7 of rule 12-12, would provide the fund with more detail on the definition of non-income producing securities. *See* proposed rule 12-14, at n.6(d) of Regulation S-X. Instruction 8 would require the fund to identify each issue of securities whose fair value was determined using significant unobservable inputs. *See* proposed rule 12-14, at n.8 of Regulation S-X. Instruction 9 would require the fund to identify illiquid securities. *See* proposed rule 12-14, at n.9 of Regulation S-X. Instruction 10 would require the fund to indicate each issue of securities held in connection with open put or call option contracts, loans for short sales, or where any portion of the issue is on loan, as required by note 11 to rule 12-12. *See* proposed rule 12-14, at n.10 of Regulation S-X. Instruction 11 would extend rule 12-12's tax basis disclosure to investments in and advances to affiliates. *See* proposed rule 12-14, at n.11 of Regulation S-X.

disclosure of affiliated transactions that would better assist investors with understanding the impact of affiliated investments on the fund's statement of operations?

- In addition to those discussed above, what are the costs and benefits associated with the proposed changes? Would the proposed changes under rule 12-14 reduce any burdens on filers? If so, how?
- Are our amendments to proposed rule 12-14 consistent with industry practices? If not, how are our amendments different? Are there other industry practices that we should include in our proposal with respect to the disclosure of affiliated investments?

5. Form and Content of Financial Statements

Finally, we are proposing revisions to Article 6 of Regulation S-X, which prescribes the form and content of financial statements filed for funds. Many of the revisions we are proposing today are intended to conform Article 6 with our proposed changes to Article 12 and update other financial statement requirements.[263] As part of these changes, we are proposing to modify the title and description of Article 6 from "Registered Investment Companies" to "Registered Investment Companies and Business Development Companies" to clarify that BDCs are subject to Article 6 of Regulation S-X.[264] This does not change existing requirements for BDCs.[265]

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[263] We are also proposing to amend the reference in rule 6-03(c) to §210.3A-05, as that section of Regulation S-X was rescinded in 2011. *See* Rescission of Outdated Rules and Forms, and Amendments to Correct References, Securities Act Release No. 33-9273 (Nov. 4, 2011) [76 FR 71872 (Nov. 21, 2011)].

[264] *See* proposed rules 6-01; 6-03; 6-03(c)(1); 6-03(d); 6-03(i); 6-04; and 6-07 of Regulation S-X.

In order to allow a more uniform presentation of investment schedules in a fund's financial statements, we are proposing to rescind subparagraph (a) of rule 6-10 under Regulation S-X, regarding which schedules are to be filed.[266] We believe that a fund and its consolidated subsidiaries should present their consolidated investments for each applicable schedule, without indicating which are owned directly by the fund or which are owned by the consolidated subsidiaries.

Moreover, current rule 6-10(a) provides that if the information required by any schedule (including the notes thereto) is shown in the related financial statement or in a note thereto without making such statement unclear or confusing, that procedure may be followed and the schedule omitted.[267] We believe that some funds may have interpreted this guidance as allowing presentation of some Article 12 schedules (*e.g.*, rules 12-13 and 12-14) in the notes to the financial statements, as opposed to immediately following the schedules required by rules 12-12, 12-12A, and 12-12C, and are therefore proposing to eliminate rule 6-10(a). In light of the increased use of derivatives by funds, we believe that all schedules required by rule 6-10 should be presented together within a fund's financial statements, and not in the notes to the financial statements. We recognize that

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A BDC is a closed-end fund that is operated for the purpose of making investments in small and developing businesses and financially troubled businesses and that elects to be regulated as a BDC. *See* section 2(a)(48) of the Investment Company Act (defining BDCs). BDCs are not subject to periodic reporting requirements under the Investment Company Act, although they must comply with periodic reporting requirements under the Exchange Act.

265 *See* Instruction 1.a to Item 6.c of Form N-2 ("A business development company should comply with the provisions of Regulation S-X generally applicable to registered management investment companies. (*See* section 210.3-18 [17 CFR 210.3-18] and sections 210.6-01 through 210.6-10 of Regulation S-X [17 CFR 210.6-01 through 210.6-10]).").

266 *See* proposed rule 6-10 of Regulation S-X.

267 *See* rule 6-10 of Regulation S-X.

our proposal would change current practice for some funds but believe that, coupled with more detailed disclosure rules for derivatives, this amendment would provide more consistent disclosure and improve the usability of financial statements for investors.[268]

We are also proposing changes to rules 6-03 and 6-04 to specifically reference the investments required to be reported on separate schedules in amended Article 12.[269] Additionally, we are proposing to eliminate current rule 6-04.4, which requires disclosure of "Total investments" on the balance sheet under "Assets," recognizing that investments reported under proposed rules 12-13A through 12-13D could potentially be presented under both assets and liabilities on the balance sheet.[270] For example, a fund may hold a forward foreign currency contract with unrealized appreciation and a different forward foreign currency contract with unrealized depreciation. The fund presents on its balance sheet an asset balance for the contract with unrealized appreciation and a liability balance for the contract with unrealized depreciation. Totaling the amounts of investments reported under assets could be misleading to investors in this example, or in other examples where a fund holds derivatives in a liability position (*e.g.*, unrealized depreciation on an interest rate swap contract). A "Total investments" amount in the Assets section of the fund's balance sheet would include the fund's investments in securities and derivatives that are in an appreciated position, but it would not include the unrealized depreciation on the interest rate swap contract, which would be classified

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[268] Additionally, in order to conform proposed rule 6-10(b) with the new requirements under Article 12, we added schedules corresponding to our proposed new schedules of derivatives investments.

[269] *See* proposed rules 6-03(d), 6-04.3 and 6-04.9 of Regulation S-X.

[270] *See* rule 6-04.4 of Regulation S-X [17 CFR 210.6-04.4].

under the Liabilities section of the fund's balance sheet. Given the increasing use of derivatives by funds, we believe eliminating current rule 6-04.4 would provide more complete information to investors. We are also proposing a corresponding change in rule 6-03(d) to remove the reference to "total investments reported under [rule 6-04.4]."[271]

We are also proposing to amend rule 6-04 to refer individually to our derivatives disclosures in proposed rules 12-13A through 12-13C.[272] As is currently the case, these proposed amendments are not meant to require gross presentation where netting is allowed under U.S. GAAP.[273] For example, if a fund held a forward foreign currency contract which had unrealized appreciation and another forward foreign currency contract which had unrealized depreciation, the fact that forward foreign currency contracts are mentioned in proposed rules 6-04.3(b) and 6-04.9(d) is not meant to require both contracts to be presented gross on the balance sheet if netting were allowed under U.S. GAAP.

Proposed rule 6-05.3 would also specifically require presentation of items relating to investments other than securities in the notes to financial statements.[274] Current rule 6-05.3 only requires presentation in the notes to financial statements of disclosure required by rules 6-04.10 through 6-04.13, which include information relating to securities sold short and open option contracts written.[275] Our proposal would also amend rule 6-05.3 to

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[271] *See* proposed rule 6-03(d) of Regulation S-X.

[272] *See* proposed rules 6-04.3; 6-04.6; and 6-04.9 of Regulation S-X.

[273] *See* ASC 210, Balance Sheet ("ASC 210") and ASC 815.

[274] *See* proposed rule 6-05.3 of Regulation S-X.

[275] *See* rule 6-05.3 of Regulation S-X [17 CFR 210.6-05.3].

require fund financial statements to reflect all unaffiliated investments other than securities presented on separate schedules under Article 12.[276]

We are also proposing to add new disclosure requirements that are designed to increase transparency to investors about certain investments and activities. First, we are proposing to add new subsection (m) to rule 6-03 that would require funds to make certain disclosures in connection with a fund's securities lending activities and cash collateral management.[277] Specifically, we are proposing to require disclosure of (1) the gross income from securities lending, including income from cash collateral reinvestment; (2) the dollar amount of all fees and/or compensation paid by the registrant for securities lending activities and related services, including borrower rebates and cash collateral management services; (3) the net income from securities lending activities; (4) the terms governing the compensation of the securities lending agent, including any revenue sharing split, with the related percentage split between the registrant and the securities lending agent, and/or any fee-for-service, and a description of services included; (5) the details of any other fees paid directly or indirectly, including any fees paid directly by the registrant for cash collateral management and any management fee deducted from a pooled investment vehicle in which cash collateral is invested; and (6) the monthly average of the value of portfolio securities on loan.[278] We believe that these proposed disclosures would allow investors to better understand the income generated from, as well as the expenses associated with, securities lending activities. Second, our

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[276] *See* proposed rule 6-05.3 of Regulation S-X.

[277] *See supra* note 71 and accompanying text.

[278] *See* proposed rule 6-03(m) of Regulation S-X.

proposal would also amend rule 6-07 to require funds to make a separate disclosure for income from non-cash dividends and payment-in-kind interest on the statement of operations.[279] Our proposed amendment to rule 6-07 is intended to increase transparency for investors in order to allow them to better understand when fund income is earned, but not received, in the form of cash.

We are proposing to amend rule 6-07.7(a) in order to conform statement of operations disclosures of the net realized gains or losses from investments to include our additional derivatives disclosures in proposed rules 12-13A through 12-13C.[280] Likewise, we are proposing similar changes to proposed 6-07.7(c) (current rule 6-07.7(d)) in order to conform statement of operations disclosures of the net increase or decrease in the unrealized appreciation or depreciation of investments to include our new derivatives disclosures.[281] We recognize that Regulation S-X, which organizes net realized gains and losses (and net increases or decreases in the unrealized appreciation or depreciation) by investment type, diverges from our approach in proposed Form N-PORT, which organizes net realized gain or loss and net change in unrealized appreciation or depreciation attributable to derivatives by each instrument's primary underlying risk exposure.[282] While we believe that organizing these disclosures by exposure type, which are derived from ASC Topic 815, are appropriate for Form N-PORT; we also believe that it is more appropriate for statement of operations disclosures to be organized by major types of investment transactions, as doing so would be consistent with the types of

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[279] *See* proposed rule 6-07.1 of Regulation S-X.

[280] *See* proposed rule 6-07.7(a) of Regulation S-X.

[281] *See* proposed rule 6-07.7(c) of Regulation S-X.

[282] *See* Item B.5.c of proposed Form N-PORT.

investments requiring separate schedules in Article 12 and allow investors to relate the disclosures in the schedule of investments with the statement of operations.[283]

We are also proposing to eliminate Regulation S-X's requirement for specific disclosure of written options activity under current rule 6-07.7(c).[284] This provision was adopted prior to FASB adopting disclosures generally applicable to derivatives, including written options, now required by ASC Topic 815.[285] We are proposing that the requirement for specific disclosures for written options activity be removed because they are generally duplicative of the requirements of ASC Topic 815, which include disclosure of the fair value amounts of derivative instruments, gains and losses on derivative instruments, and information that would enable users to understand the volume of derivative activity.[286]

We are also proposing to eliminate the exception in Schedule II of current rule 6-10 which does not require reporting under current rule 12-13 if the investments, at both the beginning and end of the period, amount to one percent or less of the value of total

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[283] *See* ASC 815.

[284] *See* rule 6-07.7(c) of Regulation S-X [17 CFR 210.6-07.7(c)].

[285] *See* ASC 815.

[286] *Id.* Rule 6-07.7(c) requires disclosure in a note to the financial statements of the number and associated dollar amounts as to option contracts written: (i) At the beginning of the period; (ii) during the period; (iii) expired during the period; (iv) closed during the period; (v) exercised during the period; (vi) balance at end of the period. The balances at the beginning of the period and end of the period are available in the prior period-end and current period-end schedules of open option contracts written, respectively. By eliminating the written options roll-forward, investors would no longer have information regarding the number of contracts expired, closed, or exercised during the period. However, disclosures required by ASC 815 provide gains and losses on derivative instruments, including written options, along with information that would enable users to understand the volume of derivative activity during the period.

investments.[287] We believe that it is appropriate to propose eliminating this exception, because a fund may have significant notional amount in its portfolio that could be valued at one percent or less of the value of total investments. Accordingly, removing this exception would provide more transparency to investors regarding a fund's derivatives activity.

We request comment on our proposed changes to Article 6 of Regulation S-X.

- Are our proposed amendments to Article 6 of Regulation S-X appropriate? If not, which amendments are not appropriate and why? Are there other amendments to Article 6 of Regulation S-X that we should propose? If so, what amendments and why?
- Are there alternative methods of presentation of derivatives that we should consider, rather than the proposed requirement that all schedules be presented in the same location? If so, what method and why is it preferable?
- As we discussed above, among others, our basis for proposing to eliminate rule 6-10(a) was our belief that a fund and its consolidated subsidiaries should present their consolidated investments for each applicable schedule, without indicating which are owned directly by the fund and which are owned by the consolidated subsidiaries. Is this proposed change appropriate? Why or why not? Should we require different or additional information about consolidated investments?
- We request comment on our proposal to eliminate rule 6-04.4, which requires disclosure of "Total investments" on the balance sheet under "Assets," and the

[287] *See* rule 6-10(c)(1) Schedule II of Regulation S-X; *see also* proposed rule 6-10(b)(1) Schedule II of Regulation S-X.

corresponding reference to rule 6-04.4 in rule 6-03(d). Are these proposed changes appropriate? Why or why not? Would eliminating current rule 6-04.4 provide more complete information to investors?

- We request comment on our proposal to amend rule 6-05.3 to specifically require presentation of items relating to investments other than securities in the notes to the financial statements, as well as require fund financial statements to reflect all unaffiliated investments presented on separate schedules under Article 12. Are our proposed changes appropriate? Why or why not?
- Would the disclosure required under proposed rule 6.03(m) concerning income and expenses in connection with securities lending activities provide meaningful information to investors or other potential users? For example, would the disclosures regarding compensation and other fee and expense information relating to the securities lending agent and cash collateral manager be useful to fund boards in evaluating their securities lending arrangements? Would these disclosures be sufficient for this purpose, or would additional information be necessary, for example, to put the fee and expense information in context (*e.g.*, the nature of the services provided by the securities lending agent and cash collateral manager)? Should the Commission instead require that these or other similar disclosures, be provided elsewhere in the fund's financial statements (*e.g.*, the Statement of Operations), or provided as part of other disclosure documents (*e.g.*, the Statement of Additional Information) or reporting forms (*e.g.*, proposed Form N-CEN)? Why or why not?

- Is the proposed disclosure under rule 6-07.1 for non-cash dividends and payment-in-kind interest on the statement of operations meaningful to investors or other potential users of the fund's financial statements? Should all non-cash interest be disclosed, including amortization and accretion, or should just payment-in-kind interest be disclosed?
- Do our proposed amendments to rules 6-07.7(a) and 6-07.7(c) omit any classifications of gains or loss or changes in unrealized appreciation or depreciation that should be disclosed? If so, which categories and why?
- We request comment on our proposal to eliminate Regulation S-X's requirements for specific disclosure of written options activity under rule 6-07.7(c). Does the current requirement for specific disclosure of written options activity under rule 6-07.7(c) provide a user of financial statements with sufficient incremental benefit to merit retaining this disclosure in addition to the disclosures required by ASC Topic 815? Why or why not?
- Proposed rule 6-10(b) would no longer allow funds to omit the schedule of investments other than securities if the investments, other than securities, at both the beginning and end of the period amount to one percent or less of the value of total investments. Is this change appropriate? Are there any costs associated with this change? If so, what are they?
- Are our amendments to Article 6 of Regulation S-X generally consistent with industry practices, except where specifically noted in the discussion above? If not, how are our amendments different? Are there other industry practices that

we should include in our proposal with respect to the form and content of financial statements?

D. Option for Website Transmission of Shareholder Reports

1. Overview

The Commission is proposing new rule 30e-3 under the Investment Company Act, which would, if adopted, permit, but not require, a fund to satisfy requirements under the Act and rules thereunder to transmit reports to shareholders if the fund makes the reports and certain other materials accessible on its website. Reliance on the rule would be subject to certain conditions, including conditions relating to (1) the availability of the shareholder report and other required information, (2) prior shareholder consent, (3) notice to shareholders of the availability of shareholder reports, and (4) shareholder ability to request paper copies of the shareholder report or other required information.

This new option is intended to modernize the manner in which periodic information is transmitted to shareholders. We believe it would improve the information's overall accessibility while reducing burdens such as printing and mailing costs borne by funds, and ultimately, by fund shareholders. As described below, today's proposal draws on the Commission's experience with use of the Internet as a medium to provide documents and other information to investors. The proposal is supported by recent Commission investor testing efforts and other empirical research concerning investors' preferences about report transmission methods and use of the Internet for financial and other purposes generally. At the same time, the Commission recognizes that empirical research, discussed below, demonstrates that some investors continue to prefer to receive paper reports. The proposal therefore incorporates a set of protections intended to avoid investor confusion and protect the ability of investors to choose their preferred means of communication.

Reliance on the rule would be optional. Funds that do not maintain websites or that otherwise wish to transmit shareholder reports in paper or pursuant to the Commission's existing electronic delivery guidance would continue to be able to satisfy transmission requirements by those transmission methods. Furthermore, under the rule as proposed, a fund relying on the rule to satisfy shareholder report transmission obligations with respect to certain shareholders would not be precluded from transmitting shareholder reports to other shareholders pursuant to the Commission's electronic delivery guidance. We expect that funds would continue to rely on the Commission's guidance to electronically transmit reports to shareholders who have elected to receive reports electronically, and rely on the rule with respect to shareholders who have not so elected (*i.e.*, those who currently receive printed shareholder reports by mail).

2. Discussion

Funds are generally required to transmit reports to shareholders on a semiannual basis.[288] Historically, these reports have been printed and mailed to shareholders. With advances in technology and, in particular, the increasing use of the Internet as a medium through which information, financial or otherwise, is made accessible, we have previously issued guidance describing the circumstances under which transmission of

[288] *See* section 30(e) of the Investment Company Act [15 U.S.C. 80a-29(e)]; rule 30e-1 (reports to stockholders of management companies); rule 30e-2 (reports to shareholders of unit investment trusts substantially all the assets of which consist of securities issued by a management company).

disclosure documents may be effected through electronic means.[289] Under that guidance, funds may transmit documents electronically provided that a number of conditions related to shareholder notice, access, and evidence of delivery are met.[290]

Recent investor testing and Internet usage trends have highlighted that preferences about electronic delivery of information have evolved, and that many investors would prefer enhanced availability of fund information on the Internet. For example, investor testing sponsored by the Commission and conducted in 2011[291] suggested that an investor

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289 *See generally* Use of Electronic Media for Delivery Purposes, Investment Company Act Release No. 21399 (Oct. 6, 1995) [60 FR 53458 (Oct. 13, 1995)] ("1995 Release") (providing Commission views on the use of electronic media to deliver information to investors, with a focus on electronic delivery of prospectuses, annual reports to security holders and proxy solicitation materials under the federal securities laws); Use of Electronic Media by Broker-Dealers, Transfer Agents, and Investment Advisers for Delivery of Information, Investment Company Act Release No. 21945 (May 9, 1996) [61 FR 24644 (May 15, 1996)] ("1996 Release") (providing Commission views on electronic delivery of required information by broker-dealers, transfer agents and investment advisers); Use of Electronic Media, Investment Company Act Release No. 24426 (Apr. 28, 2000) [65 FR 25843 (May 4, 2000)] ("2000 Release") (providing updated interpretive guidance on the use of electronic media to deliver documents on matters such as telephonic and global consent; issuer liability for website content; and legal principles that should be considered in conducting online offerings).

More recently, the Division of Investment Management published guidance stating the staff's position that electronic delivery of a notice pursuant to rule 19a-1 under the Investment Company Act, consistent with the Commission's electronic delivery guidance, would satisfy the purposes and policies underlying the rule. *See* Division of Investment Management, Securities and Exchange Commission, *Shareholder Notices of the Sources of Fund Distributions – Electronic Delivery*, IM Guidance Update No. 2013-11 (Nov. 2013), *available at* http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-11.pdf ("2013-11 IM Guidance Update").

290 *See id.*

291 In 2011, the Commission engaged a consultant to conduct investor testing regarding shareholder reports. We have placed the consultant's report concerning that testing ("Investor Testing of Mutual Fund Shareholder Reports") in the comment file for the proposed rule (available at www.sec.gov/comments/s7-08-15/s70815.shtml). Separately, Commission staff prepared a study of investor financial literacy pursuant to section 917 of the Dodd-Frank Act. Materials relating to this study, including the staff's report, are available at http://www.investor.gov/publications-research-studies/sec-research.

Also, in 2007, the Commission engaged a consultant to conduct focus group interviews and a telephone survey concerning investors' views and opinions about various disclosure looking for a fund's annual report is most likely to seek it out on the fund's website, rather than request it by mail or phone or by retrieving it from the Commission's EDGAR system.[292] Many investors indicated that they would prefer that fund information be made available in both electronic and print versions, with a plurality of respondents preferring electronic transmission by email with the option to easily request a print copy of a particular report, though a significant minority indicated that they would still prefer to receive a print copy through the mail.[293]

In the time since this investor testing was conducted, access to and use of the Internet has continued to increase significantly, including among demographic groups that have previously been less apt to use the Internet. For example, a study conducted by

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documents filed by companies, including mutual funds. We have placed the consultant's report concerning the focus group testing and related transcripts in the comment file for the proposed rule (available at www.sec.gov/comments/s7-08-15/s70815.shtml). The consultant's report concerning the telephone survey ("Telephone Survey Report") is available at http://www.sec.gov/pdf/disclosuredocs.pdf. Respondents to the telephone survey who had received a mutual fund shareholder report, for example, were asked about their preferences for a mode of delivery of the information contained in a shareholder report, and "an Internet website" received the highest ratings (with 49% rating it 7 or above on a 10 point scale), compared with 42% of respondents who rated "a paper copy" 7 or above. *See* Telephone Survey Report at 96.

292 *See* Investor Testing of Mutual Fund Shareholder Reports, *supra* note 291, at 72. When asked "If you wanted to see a mutual fund annual report, how would you access/obtain the report? Please check all that apply.," 59.5% of respondents selected "look on the mutual fund company's website," compared with 33.3% who selected "ask my financial advisor," 24.5% who selected "request by mail," 21.0% who selected "do a web search (Google, etc.)," 18.8% who selected "request by phone," 12.3% who selected "check with my employer's HR or employee benefits representative," 11.3% who selected "look on the SEC's website or on EDGAR," and 2.3% who selected "other." *Id.*

293 *See id.* at 185. When asked "How would you prefer to receive information about your mutual fund investments?," 25.8% of respondents selected "online through a link provided in an e-mail, with the option to request a print version," compared with 19.5% of respondents who selected "in print through the mail, with a web address provided for an online version," 18.5% who selected "online through a link provided in an e-mail," 16.5% who selected "a print summary of the key information through the mail, with a web address provided for a complete online version," 13.8% who selected "in print through the mail," and 6.0% who selected "I don't have a preference." *Id.*

the Pew Research Center's Internet & American Life Project in 2013 found that only 15% of American adults ages 18 and older do not use the Internet or email—falling from 26% in 2011, when our investor testing was conducted, and from 39% a decade before in 2001.[294] These researchers also found that for the first time in 2012, more than half of adults over the age of 64 used the Internet, a figure that climbed to 59% in 2013.[295]

These trends have also extended to use of the Internet for financial purposes. For example, a recent survey by the Investment Company Institute found that in 2014, 94% of U.S. households owning mutual funds had Internet access (up from 68% in 2000), with widespread use among various age groups, education levels and income levels.[296] The year before, the Investment Company Institute found that 82% of U.S. households owning mutual funds used the Internet for financial purposes.[297]

Given the evolving preferences and trends in Internet usage, in particular with regard to the delivery of financial information, we believe that it is appropriate to propose a rule that would permit the website transmission of fund shareholder reports, while maintaining the ability of shareholders who prefer to receive reports in paper to receive reports in that form. Funds and their shareholders would benefit from the reductions in related printing and mailing costs. Also, the rule, as proposed, would consolidate current

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294 *See* Pew Research Center, *Who's Not Online and Why*, at 2 (Sept. 25, 2013), *available at* http://pewinternet.org/Reports/2013/Non-internet-users.aspx.

295 *See* Pew Research Center, *Older Adults and Technology Use*, at 1 (Apr. 3, 2014), *available at* http://www.pewinternet.org/2014/04/03/older-adults-and-technology-use/.

296 *See* 2015 ICI Fact Book, at 129, *supra* note 4. For example, the study found the following with respect to Internet access in mutual fund owning households: (1) head of household age 65 or older, 86% have access, (2) education level of high school diploma or less, 84% have access, and (3) household income of less than $50,000, 84% have access.

297 *See* 2014 Investment Company Fact Book, Investment Company Institute, at 115–17, *available at* http://www.ici.org/pdf/2014_factbook.pdf.

and historical portfolio holdings information in one location (*i.e.*, a particular website, as opposed to having some information on one website and other information on EDGAR), whereas currently, funds are not required to transmit or otherwise make accessible to investors holdings information as to the first and third fiscal quarters.[298]

Although we believe the proposed rule would benefit many investors, we recognize that there are concerns associated with how some investors may be affected. For example, as discussed above, investor testing suggests that a significant minority of investors prefer to receive paper reports and that some demographic groups of investors may be less likely to use the Internet. Some of these investors might not fully understand the actions they would need to take under the proposed rule to continue to receive their reports in paper. We believe that it is critical that these investors continue to receive disclosure in a means that is convenient and accessible for them. In addition, there is a risk that even some investors that prefer to use the Internet might be less likely to review reports electronically than they would in paper. We also believe it is critical that the proposed rule communicate the importance of the information that would be made available on the website.

Accordingly, as discussed below, the proposed rule would include certain safeguards for investors who wish to continue to receive shareholder reports in paper, by requiring prior consent of investors, and continuing to make shareholder reports and other required information available in paper upon request. The proposed rule would also

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[298] Currently, funds report their complete portfolio holdings as of the first and third fiscal quarters on Form N-Q, which is accessible only through EDGAR. There is no separate requirement for funds to transmit or otherwise make this information available to shareholders.

include requirements intended to emphasize the importance of the information available on the website. These protections are intended to maintain the ability of investors who prefer to receive reports in paper to continue to do so without confusion, as well as to provide to investors clear and prominent printed notifications each time a new shareholder report is made available online. We request comment below on the potential concerns articulated above, as well as the steps we are proposing to address them while capturing the potential benefits for investors and funds of electronic communication.

3. Rule 30e-3

As proposed, new rule 30e-3 would provide that a fund's annual or semiannual report to shareholders would be considered transmitted to a shareholder of record if certain conditions set forth in the rule are satisfied as to (a) availability of the report and other materials, (b) shareholder consent, (c) notice to shareholders, and (d) delivery of materials upon request of the shareholder.[299] As discussed below, these conditions are generally consistent with similar conditions in other rules adopted by the Commission, including its rules regarding the use of a summary prospectus, internet delivery of proxy materials, and "householding" of certain disclosure documents.

a. Availability of Report and Other Materials

Under the rule as proposed, the fund's report to shareholders under rule 30e-1 or 30e-2 would be required to be publicly accessible, free of charge, at a specified website address.[300] The report would need to be accessible beginning no later than the date of the transmission in reliance on this option, and ending no earlier than the date when the fund

[299] Proposed rule 30e-3(a).

[300] Proposed rule 30e-3(b)(1).

next "transmits" a report required by rule 30e-1 or 30e-2.[301] This requirement is intended to provide shareholders with the opportunity for ongoing access from the date of intended transmission until the date that the fund transmits its next shareholder report.[302]

In addition to the most current shareholder report, the rule as proposed would require that the fund post on its website (1) any previous shareholder report transmitted to shareholders of record within the last 244 days,[303] and (2) in the case of a fund that is not a money market fund or an SBIC, the fund's complete portfolio holdings as of the close of its most recent first and third fiscal quarters, if any, after the date on which its registration statement became effective.[304] In addition, a fund that is not a money market fund or an SBIC would be required to make its portfolio holdings as of the end of the next fiscal quarter accessible in the same manner within 60 days after the close of that period.[305] We are proposing exceptions to the posting requirement of first and third fiscal quarter portfolio holdings schedules for money market funds and SBICs because money

301 *Id.*

302 *See* 1995 Release, *supra* note 289 (noting that to satisfy access requirements under the Commission's electronic delivery guidance, "as is the case with a paper document, a recipient should have the opportunity to retain the information or have ongoing access equivalent to personal retention).

303 Proposed rule 30e-3(b)(1)(ii). Thus, for example, a fund with a December 31 fiscal year end wishing to rely on rule 30e-3 to transmit its annual report to shareholders would also be required to ensure that its semiannual report as of June 30 is similarly accessible. Only those annual and semiannual reports that are required under rule 30e-1 or rule 30e-2 are required to be accessible in order to rely on rule 30e-3. Thus, for example, if a fund is transmitting a report for its first operational semiannual period, the fund could rely on rule 30e-3 to transmit that report, despite not having made a previous report publicly accessible provided that it meets the other required conditions.

304 *See* proposed rule 30e-3(b)(1)(iii).

305 *See* proposed rule 30e-3(b)(2). For example, a fund with a December 31 fiscal year end wishing to rely on rule 30e-3 to transmit its annual report to shareholders would also be required to ensure that its complete portfolio holdings for the first quarter of the next year is similarly available.

market funds are currently required to post certain portfolio holdings and other information on their websites pursuant to rule 2a-7,[306] and because SBICs are neither currently required to file reports on Form N-Q,[307] nor would SBICs be required to file reports on proposed Form N-PORT.[308]

These materials would also be required to be publicly accessible in the same manner and for the same time period as the current shareholder report.[309] We are proposing this requirement so that shareholders have access to a complete year of portfolio holdings information in one location (*i.e.*, the website on which the report transmitted under the proposed rule is made accessible), rather than have to separately access portfolio holdings information for the first and third quarters by accessing the fund's reports on Form N-PORT for those periods.

To conform the form and content of the portfolio holdings schedules for the first and third quarters to those schedules presented in the fund's shareholder reports for the second and fourth quarters, the proposed rule would require the schedules for the first and third quarters to be presented in accordance with the schedules set forth in §§210.12-12 – 12-14 of Regulation S-X [17 CFR 210.12-12 – 12-14], which need not be audited.[310] As discussed above, we have also proposed to require that these materials be filed as exhibits

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306 *See* rule 2a-7(h)(10). In 2014, we adopted certain amendments to the website disclosure requirements for money market funds under rule 2a-7. The compliance date for these amendments is April 14, 2016. *See* Money Market Fund Reform 2014 Release, *supra* note 13, at sections III.E.9 and III.N.4.

307 *See* rule 30b1-5.

308 *See* proposed rule 30b1-9.

309 Proposed rules 30e-3(b)(1) and (b)(2).

310 *Id.*

to Form N-PORT, regardless of whether the fund intends to rely on the rule to satisfy its shareholder report transmission obligations.[311]

These website portfolio disclosure requirements would be generally consistent with funds' current disclosure obligations under Regulation S-X for reports filed on Forms N-Q and N-CSR.[312] Accordingly, we anticipate that most funds would have established procedures in place to report and validate such disclosures, and that funds would be familiar with these disclosure requirements. These website portfolio disclosure requirements are also intended to provide disclosures that would be easily understood and familiar to investors, because these disclosures would contain similar information and would be presented in a similar manner as those currently included in shareholder reports.

Proposed rule 30e-3 would require compliance with certain conditions designed to ensure the accessibility of shareholder reports and other required materials.[313] First, the website address on which the shareholder reports and other required portfolio information are made accessible could not be the Commission's website address for electronic filing.[314] Second, the materials required to be posted on the website would have to be presented in a format that is convenient for both reading online and printing on paper, and persons accessing the materials would have to be able to permanently retain (free of

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311 *See supra* Part II.A.2.j.

312 *See generally supra* note 27.

313 These requirements are largely similar to the accessibility requirements of rule 498 under the Securities Act, which allows funds to use a summary prospectus, and rule 14a-16 under the Securities Exchange Act, which requires issuers and other soliciting persons to furnish proxy materials by posting these materials on a public website and notifying shareholders of the availability of these materials and how to access them.

314 *See* proposed rule 30e-3(b)(3). Currently, the Commission's electronic filing system for fund documents is EDGAR.

charge) an electronic copy of the materials in this format.[315] These conditions are designed to ensure that shareholder reports and other information posted on a fund's website pursuant to the proposed rule are user-friendly and allow shareholders the same ease of reference and retention abilities they would have with paper copies of the information.

Third, the rule as proposed would include a safe harbor provision that would allow a fund to continue relying on the rule even if it did not meet the posting requirements of the rule for a temporary period of time.[316] In order to rely on this safe harbor, a fund would be required to have reasonable procedures in place to ensure that the required materials are posted on its website in the manner required by the rule and take prompt action to correct noncompliance with these posting requirements.[317] We are proposing this safe harbor because we recognize that there may be times when, due to events beyond a fund's control, such as system outages or other technological issues, natural disasters, acts of terrorism, pandemic illnesses, or other circumstances, a fund is temporarily not in compliance with the Internet posting requirements of the rule.[318]

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[315] *See* proposed rules 30e-3(b)(4) and (5).

[316] *See* proposed rule 30e-3(b)(6). The rule provides that the conditions in paragraphs (b)(1) through (b)(5) of the rule (*i.e.*, the posting requirements) shall be deemed to be met, notwithstanding the fact that the materials required by paragraph (b)(1) of the rule are not available for a period of time in the manner required by the posting requirements, so long as certain conditions are met. *See id.*

[317] *See* proposed rules 30e-3(b)(6)(i) and (ii). The rule would require prompt action "as soon as practicable following the earlier of the time at which it knows or reasonably should have known" that the required documents are not available in the manner prescribed by the posting requirements of the rule.

[318] *Compare* rule 498(e)(4) of the Securities Act (providing a similar safe harbor under the summary prospectus rule for the same reasons).

b. Shareholder Consent

While we believe that many investors would prefer electronic transmission of shareholder reports based on investor testing and Internet usage trends, we also acknowledge that there likely will be investors that may continue to prefer receiving shareholder reports in paper.[319] To maintain the ability of those shareholders to receive paper copies of their shareholder reports, the rule as proposed would require that a fund obtain shareholder consent prior to relying on the rule to satisfy transmission obligations with respect to a particular shareholder.[320] Specifically, rule 30e-3 as proposed would permit electronic transmission of shareholder report to a particular shareholder only if the shareholder has either previously consented to this method of transmission,[321] or has been determined to have provided implied consent under certain conditions specified in the

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[319] *See supra* notes 291–296 and accompanying text.

[320] These conditions are substantially similar to certain of the conditions relating to the Commission's rules on "householding" prospectuses, shareholder reports, and proxy statements and information statements to investors who share an address. *See, e.g.,* rule 154 under the Securities Act [17 CFR 230.154] (permitting householding of prospectuses); rules 30e-1 and 30e-2 under the Investment Company Act (permitting householding of fund shareholder reports); rules 14a-3 and 14c-3 under the Exchange Act (permitting householding of proxy statements and information statements). *See generally* Delivery of Disclosure Documents to Households, Investment Company Act Release No. 24123 (Nov. 4, 1999) [64 FR 62540 (Nov. 16, 1999)] (adopting householding rules with respect to prospectuses and shareholder reports); Delivery of Proxy Statements and Information Statements to Households, Investment Company Release No. 24715 (Oct. 27, 2000) [65 FR 65736 (Nov. 2, 2000) (adopting householding rules with respect to proxy statements and information statements). For purposes of the householding rules, consent may be written or implied.

[321] While the householding rules require that consent be "in writing," we are not proposing a similar "in writing" requirement as, consistent with the Commission's guidance on electronic delivery, consent may be provided in a number of ways, including in writing, electronically, or telephonically. *See* 1995 Release, *supra* note 289 (noting that one method for satisfying evidence of delivery is to obtain informed consent from an investor to receive information through a particular medium); 1996 Release, *supra* note 289 (stating that informed consent should be made by written or electronic means); 2000 Release, *supra* note 289 (stating Commission's view that an issuer or market intermediary may obtain an informed consent telephonically, as long as a record of that consent is retained).

rule.[322] Under the proposed rule, each series of a registrant offering multiple series would need to obtain separate consent as to a shareholder, regardless of whether consent was obtained from that shareholder by other series offered by that registrant.[323]

To obtain implied consent as to a shareholder, the fund would be required to transmit to the shareholder a separate written statement ("Initial Statement"), at least 60 days before it begins to rely on the rule, notifying the shareholder of the fund's intent to make future shareholder reports available on the fund's website until the shareholder revokes consent.[324] As proposed, the Initial Statement must be written using plain English principles so that it will be easily understood by most investors[325] and:

- state that future shareholder reports will be accessible, free of charge, at a website;[326]
- explain that the fund will no longer mail printed copies of shareholder reports to the shareholder unless the shareholder notifies the fund that he or she wishes to receive printed reports in the future;[327]
- include a toll-free telephone number and be accompanied by a reply form that is pre-addressed with postage-paid and that includes the information that the fund would need to identify the shareholder, and explain that the shareholder can use

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322 Proposed rule 30e-3(c).

323 *See id.*

324 *See* proposed rule 30e-3(c)(1). For purposes of the rule, "Initial Statement" would be defined as the notice described in paragraph (c)(1) of the rule. *See* proposed rule 30e-3(h)(2).

325 *See* proposed rules 30e-3(c)(1) and (e). *See also* A Plain English Handbook, Securities and Exchange Commission, *available at* https://www.sec.gov/pdf/handbook.pdf.

326 Proposed rule 30e-3(c)(1)(i).

327 Proposed rule 30e-3(c)(1)(ii).

either of those two methods at any time to notify the fund that he or she wishes to receive printed reports in the future;[328]

- state that the fund will mail printed copies of future shareholder reports within 30 days after the fund receives notice of the shareholder's preference;[329] and
- contain a prominent legend in bold-face type that states: "How to Continue Receiving Printed Copies of Shareholder Reports."[330]

The Initial Statement is designed to permit funds to infer that a shareholder has consented to electronic transmission of future shareholder reports by alerting the shareholder to the fact that the shareholder will no longer receive printed copies in the future unless the shareholder notifies the fund that he or she wishes to receive print copies of such reports in the future. Because of the importance of this information, in addition to the required prominent legend on the envelope in which the Initial Statement is delivered or on the Initial Statement itself, the proposed rule would require certain conditions intended to ensure that the Initial Statement is not obscured by other materials. Specifically, the proposed rule would require that the Initial Statement could not be incorporated into or combined with another document,[331] nor could it be sent along with other shareholder communications (with the exception of the fund's current summary

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328 Proposed rule 30e-3(c)(1)(iii).

329 Proposed rule 30e-3(c)(1)(iv).

330 Proposed rule 30e-3(c)(1)(v). This legend would be required to appear on the envelope on which the Initial Statement is delivered, or alternatively, if the Initial Statement is delivered separately from other communications to investors, the legend may appear either on the Initial Statement or on the envelope in which the Initial Statement is delivered.

331 *See* proposed rule 30e-3(c)(2).

prospectus, statutory prospectus, statement of additional information, or Notice of Internet Availability of Proxy Materials under rule 14a-16 under the Exchange Act).[332]

If the fund does not receive the reply form or other notification indicating that a particular shareholder wishes to continue to receive paper reports by mail within 60 days after the fund sends the Initial Statement, then the fund may begin to transmit shareholder reports to that shareholder electronically, provided that it meets the other conditions of the rule.[333]

c. Notice

Proposed rule 30e-3 would require funds relying on the rule with respect to a shareholder who has consented to electronic transmission pursuant to the conditions of paragraph (c)(1) of the rule to send a notice ("Notice") within 60 days of the close of the fiscal period to which the report relates.[334] The proposed requirements for a Notice largely mirror the notice requirements under the Commission's rules mandating the posting of proxy materials online.[335]

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[332] *See* proposed rule 30e-3(c)(3). For purposes of the proposed rule, (1) "summary prospectus" would mean the summary prospectus described in paragraph (b) of rule 498, (2) "statutory prospectus" would mean a prospectus that satisfies the requirements of section 10(a) of the Securities Act, and (3) "statement of additional information" means the statement of additional information required by Part B of the registration form applicable to the fund. *See* proposed rule 30e-3(h).

[333] Proposed rule 30e-3(c)(4).

[334] *See* proposed rule 30e-3(d). For purposes of the rule, "Notice" would be defined as the notice described in paragraph (d) of the rule. *See* proposed rule 30e-3(h)(3).

[335] *See* rule 14a-16 under the Exchange Act [17 CFR 240.14a-16].

As proposed, the Notice, like the Initial Statement, would be required to be written using plain English principles so that it will be easily understood by most investors.[336] and:

- contain a prominent legend in bold-face type stating that an important report to shareholders is available online and in print by request;[337]
- state that each shareholder report contains important information about the fund, including its portfolio holdings, and is available on the Internet or, upon request, by mail, and encouraging shareholders to access and review the report;[338]
- include a website address that leads directly to each report the fund is transmitting to the recipient shareholder in reliance on rule 30e-3;[339]
- include the website address where the shareholder report and other required portfolio information is posted;[340]
- provide instructions on how a shareholder may request, at no charge, a paper copy of the shareholder report or other materials required to be made accessible online,

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336 *See* proposed rules 30e-3(d)(1) and (e).

337 Proposed rule 30e-3(d)(1)(i). The rule as proposed would also require that the legend include the specific fund name to which the Notice relates, or the fund complex name.

338 Proposed rule 30e-3(d)(1)(ii).

339 Proposed rule 30e-3(d)(1)(iii). A fund could send a joint Notice with other funds held by the same shareholder in a fund complex; however, the Notice would have to include a link to each of those funds' shareholder reports. A fund may also send a separate Notice if it so wishes.

340 Proposed rule 30e-3(d)(1)(iv). The website address would have to be specific enough to lead investors directly to the documents that are required to be posted online under the rule. The website address could be a central site with prominent links to each document, but could not be a home page or section of the website other than where the documents are posted. *See id.*

and an indication that the shareholder will not receive a paper copy of the report unless requested;[341] and

- include a toll-free telephone number and must be accompanied by a reply form that is pre-addressed with postage-paid and that includes the information that the fund would need to identify the shareholder, and explain that the shareholder can use either of those two methods at any time to notify the fund that he or she wishes to receive printed reports in the future.[342]

The proposed Notice is designed to alert shareholders to the availability of a shareholder report online and to provide shareholders with information on how to obtain a paper copy of the report if they should want one. We believe it is important to limit the information in the Notice and the other materials sent along with the Notice in order to ensure that shareholders are made aware of the availability of a shareholder report and so that the availability of the report does not become obscured. Therefore, the rule as proposed would limit the information contained in the Notice to the information required by the rule.[343] The Notice also could not be incorporated into or combined with another document,[344] nor could it be sent along with other shareholder communications (with the exception of the fund's current summary prospectus, prospectus, statement of additional information, or Notice of Internet Availability of Proxy Materials under rule 14a-16 under the Exchange Act).[345]

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[341] Proposed rule 30e-3(d)(1)(v).

[342] Proposed rule 30e-3(d)(1)(vi).

[343] *See* proposed rule 30e-3(d)(3).

[344] *See* proposed rule 30e-3(d)(2).

[345] *See* proposed rule 30e-3(d)(4).

Similar to the Commission's rules on householding prospectuses, shareholder reports, and proxy statements and information statements,[346] proposed rule 30e-3 also would allow funds to send one Notice to shareholders who share an address so long as the fund addresses the Notice to the shareholders individually or as a group.[347] In addition, the proposed rule would require funds to file a form of the Notice with the Commission not later than 10 days after the Notice is sent to shareholders.[348] This filing would occur on a new EDGAR submission type which would be created by the Commission. We believe the Notice filing requirement would assist us in overseeing compliance with the rule.

d. Delivery Upon Request

Proposed rule 30e-3 would also require, as a condition to reliance on the rule to transmit shareholder reports electronically, that the fund (or a financial intermediary through which shares of the fund may be purchased or sold) must send, at no cost to the requestor and by U.S. first class mail or other reasonably prompt means, a paper copy of any of the materials discussed above—*viz.*, the fund's most recent annual and semiannual reports, and the fund's portfolio holdings as of its most recent first and third fiscal quarters—to any person requesting such a copy within three business days after receiving a request for a paper copy.[349] This requirement is intended to allow for investors to

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[346] *See, e.g.*, rule 154 under the Securities Act (permitting householding of prospectuses); rules 30e-1 and 30e-2 under the Investment Company Act (permitting householding of fund shareholder reports); rules 14a-3 and 14c-3 under the Exchange Act (permitting householding of proxy statements and information statements).

[347] *See* proposed rule 30e-3(d)(5).

[348] *See* proposed rule 30e-3(d)(6).

[349] Proposed rule 30e-3(f).

receive shareholder reports and portfolio information in print format, if they so prefer, even if they have consented to electronic transmission without revoking the consent.[350]

e. **Prospectuses and Statements of Additional Information Transmitted Under Rule 30e-1(d)**

Rule 30e-1(d) under the Investment Company Act permits an open-end management investment company to transmit a copy of its prospectus or statement of additional information in place of its shareholder report, if it includes all of the information that would otherwise be required to be contained in the shareholder report.[351] We recognize that the nature and purpose of the fund prospectus is different from that of fund shareholder reports. Accordingly, at this time, we are not proposing to permit a similar regime for fund prospectus delivery obligations under the Securities Act. As a result, we do not believe that it would be appropriate to permit the transmission of statutory prospectuses in the manner provided under the proposed rule. Therefore, the proposed rule would not be available to a fund seeking to transmit a copy of its currently effective statutory prospectus or statement of additional, or both, as permitted by paragraph (d) of rule 30e-1.[352]

4. Use of Summary Schedule of Investments

Under the current rules, in lieu of providing a complete schedule of portfolio investments as part of the financial statements included in its shareholder report, a fund

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350 *See, e.g.*, 1995 Release, *supra* note 289 (stating the Commission's belief that "as a matter of policy, where a person has a right to receive a document under the federal securities laws and chooses to receive it electronically, that person should be provided with a paper version of the document if any consent to receive documents electronically were revoked or the person specifically requests a paper copy (regardless of whether any previously provided consent was revoked.").

351 *See* rule 30e-1(d).

352 Proposed rule 30e-3(g).

may provide a summary schedule of portfolio investments ("Summary Schedule").[353] Pursuant to Rule 12-12C of Regulation S-X, the Summary Schedule generally must list separately the 50 largest issues and any other issue the value of which exceeded one percent of the net asset value of the fund at the close of the period.[354]

We believe that use of the summary schedule may be unnecessary,[355] and in particular, may be potentially confusing or cumbersome to investors seeking to access the fund's complete portfolio holdings.[356] For these reasons, we are proposing amendments to our registration forms that would restrict funds relying on proposed rule 30e-3 from providing a Summary Schedule in their shareholder reports in lieu of a complete schedule.[357]

5. Related Disclosure Amendments

We are also proposing some related amendments to certain of our rules and forms. First, we are proposing to amend rule 498 under the Securities Act, which concerns the use of a summary prospectus,[358] to require funds relying on proposed rule 30e-3 to

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[353] *See, e.g.*, Instruction 1 to Item 27(b)(1) of Form N-1A (permitting the inclusion of Schedule VI – Summary schedule of investments in securities of unaffiliated issuers under Rule 12-12C of Regulation S-X in lieu of Schedule 1 — Investments of securities of unaffiliated issuers under Rule 12-12 of Regulation S-X.

[354] *See* rule 12-12C, n.3 Regulation S-X [17 CFR 210.12-12C].

[355] For example, a fund using the summary schedule for considerations relating to printing and mailing costs would likely have fewer such concerns if the report is posted on its website in reliance on the proposed rule.

[356] For example, a shareholder consenting to electronic transmission that wishes to view the complete portfolio holdings would, pursuant to the rule as proposed, first receive a notice of the availability of the report, then take the step to access the report on the fund's website, only to have to take a subsequent step to request or otherwise access the full schedule.

[357] *See* proposed amendments to Item 27(b) of Form N-1A; Item 24, Instruction 7 of Form N-2; and Item 28(a), Instruction 7(i) of Form N-3.

[358] *See* rule 498 under the Securities Act [17 CFR 230.498].

include as part of the legend on the cover page of the fund's summary prospectus the website address required to be included in the Notice.[359] As proposed, the website address that leads to shareholder report information could be the same as the website address that leads to prospectus information, provided that the other conditions of each rule are met, but funds would also be permitted to use different website addresses for each type of material and provide both addresses in the legend.[360] This requirement is intended to provide investors an additional reminder of the availability of shareholder report and related portfolio holdings information on the fund's website.

Second, we are proposing to amend rule 498 under the Securities Act and rule 14a-16 under the Exchange Act to include an Initial Statement or Notice that would be required by proposed rule 30e-3 among the materials that are permitted to accompany and have equal or greater prominence than the summary prospectus prepared in reliance on rule 498 and a notice of Internet availability of proxy materials.[361] These amendments are intended to permit a fund's Initial Statement and Notice to be sent with its summary prospectus or notice of Internet availability of proxy materials if the fund wishes to send them in that manner.[362]

6. Requests for Comment

We request comments on our proposal that would permit electronic transmission of shareholder reports.

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[359] *See* rule 498(b)(1)(v)(A) under the Securities Act.

[360] *See id.*

[361] *See* proposed rules 498(f)(2) under the Securities Act and 14a-16(f)(2)(iii) under the Exchange Act.

[362] *See* proposed rule 30e-3(d)(4).

- To what extent are funds currently relying on the Commission's guidance on the use of electronic media to deliver or transmit disclosure documents and other information to shareholders? To what extent have shareholders elected to receive disclosure documents and other information in general, and shareholder reports in particular, through electronic means? In the case of shareholders who have elected electronic delivery of disclosure documents in general, and delivery of shareholder reports in particular, to what extent are those shareholders accessing those materials online? Please provide supportive data to the extent available.
- If proposed rule 30e-3 is adopted, to what extent would funds (i) choose to rely on the rule, and (ii) continue to rely on guidance concerning electronic transmission that we have already issued?
- Would availability of the rule change in any way current industry practices on transmitting shareholder reports electronically? For example, we expect that funds would continue to rely on the Commission's guidance to electronically transmit reports to shareholders who have elected to receive reports electronically, and rely on the rule with respect to shareholders who have not so elected. For administrative or other purposes, would funds discontinue their reliance on the Commission's guidance and instead rely on the rule to transmit reports electronically with respect to their entire shareholder base? If so, why? What impact, if any, would the proposed rule have on the transmission of reports to shareholders of UITs required to transmit reports pursuant to rule 30e-2 under the Investment Company Act? What impact, if any, would the proposed rule have on the transmission of reports to shareholders holding fund shares through financial

intermediaries or other omnibus type arrangements? Should we permit funds that rely on rule 30e-3 to continue to rely on prior electronic transmission guidance for certain of their shareholders? Why or why not?

- If rule 30e-3 is adopted as proposed, in the case of funds relying on the rule to transmit reports electronically to one or more shareholders, would funds nonetheless seek shareholder consent to transmit reports to those shareholders pursuant to the Commission's electronic guidance in lieu of the rule? Why or why not?
- Should we, as we have proposed, allow funds to transmit reports to shareholders electronically by making them accessible on a website? Would investors prefer that these materials be transmitted in this manner? What would be the effect of proposed rule 30e-3 on the ability of investors to access shareholder reports? Would the shareholder report information be more useful or less useful if transmitted in the manner proposed? Would investors be more aware or less aware of the availability of the information if transmitted in reliance on the proposed rule?
- Would any positive or negative effect of the proposed rule on investors be disproportionately greater for certain investors than for others? If so, which investors would be disproportionately affected, to what extent, and how would such effects manifest? What, if any, additional measures could help mitigate any such disproportionate effects? Please provide supportive data to the extent available.

- Rule 30e-3 as proposed contains a number of conditions to be satisfied for reliance on the rule. Are the proposed conditions appropriate? Are there conditions that should be added or are any of the proposed conditions inappropriate? If so, state the conditions and the reasons why.
- The rule as proposed would require that the materials required to be accessible online be publicly accessible, free of charge, at the website specified in the Notice, and does not expressly require that the website be the fund's website. Should the rule require that the materials be accessible at the fund's website? Why or why not?
- What materials should be required to be accessible in order for a fund to rely on the rule? For example, we have proposed that a fund relying on the rule would be required to make accessible the shareholder report, the shareholder report for the prior period, and in the case of a fund that is a management company other than a money market fund or an SBIC, the complete portfolio holdings for the most recent first and third fiscal quarters. Is it appropriate to require funds to post holdings information covering a full year? Should we require information be posted covering a longer period or a shorter period? If so, why? Should money market funds and SBICs relying on the rule be required to post complete portfolio holdings for the first and third quarters? Why or why not?
- The rule as proposed would require that the materials made accessible on the website be presented in a format or formats that are convenient for both reading online and printing on paper. Is the proposed format requirement appropriate? Are there liability or other concerns that would arise in connection with meeting a

fund's obligation to transmit shareholder reports under Section 30(e) and the rules thereunder? Should we instead require that the materials be presented in a format or formats that are human-readable and capable of being printed on paper in human-readable format? Why or why not?

- How soon should each of the materials be required to be accessible, and how long should each be required to remain accessible?
- The proposed rule would contain a safe harbor for instances in which the materials required to be made accessible are not available for a temporary period of time. Is the safe harbor as proposed appropriate, or should it be modified? For example, should the rule be more proscriptive as to the period of time in which action must be taken to resolve any issues?
- Should we require the website on which the proposed rule's required materials are made accessible to incorporate safeguards to protect the anonymity of its visitors? For example, should we require similar conditions to those provided in rule 14a-16 under the Exchange Act relating to Internet availability of proxy materials? Why or why not? If so, what specific requirements should we consider?
- Should the proposed rule require that a shareholder consent to electronic transmission of shareholder reports before a fund begins to rely on the rule? Should we permit funds to obtain implied consent, as proposed, or should we require funds to receive express consent? Are there certain circumstances in which funds should not be permitted to obtain implied consent? For example, if an investor upon opening a new account does not opt-in to electronic delivery of

documents, should the fund be permitted nonetheless to seek to rely on the proposed rule as to that shareholder? Why or why not?

- Under the proposed rule, each series of a registrant offering multiple series would need to obtain separate consent as to a shareholder, regardless of whether consent was obtained from that shareholder by other series offered by that registrant. If a fund has obtained implied consent from a shareholder as to a particular series, and subsequently the shareholder invests in one or more other series offered by the fund, should the fund be required to obtain consent as to those other series, or should the fund be permitted to infer consent as to all series offered by the fund? Why or why not? Should the fund be permitted to infer consent as to only other series offered by the registered investment company, or should the fund be permitted to infer consent as to other funds within the fund complex? What, if any, are the special considerations relating to investors who invest through intermediaries?
- Under the proposed rule, to obtain implied consent as to a shareholder, the fund would be required to transmit to the shareholder an Initial Statement, at least 60 days before it begins to rely on the rule. Are the proposed disclosures for the Initial Statement appropriate? Should a fund be required to provide to a shareholder other disclosures before inferring consent to electronic transmission?
- Should the rule require funds to provide multiple written statements (*i.e.*, in addition to the Initial Statement) prior to inferring consent to electronic transmission? If so, how many additional statements and how long after the Initial Statement should they be provided? What period of time after a fund

transmits the Initial Statement should we permit the fund to infer consent? Is 60 days an appropriate time? Why or why not?

- What methods should shareholders be permitted to use to deny or revoke consent to electronic transmission?
- Should we permit the Initial Statement to be incorporated into, or combined with, one or more other documents? If so, which documents should we permit the Initial Statement to be incorporated into or combined with?
- The rule as proposed would require that the Initial Statement must be sent separately from other types of communications and may not accompany any other document or materials except the fund's current summary prospectus, statutory prospectus, statement of additional information, or Notice of Internet Availability of Proxy Materials. Is this requirement appropriate? Should we permit the Initial Statement to accompany one or more other documents? If so, which documents?
- Should we, as we have proposed for the Notice, permit the Initial Statement to be sent in a "householded" manner?
- Should we require that the Initial Statement not contain any additional information other than that specified in the rule? Why or why not? Absent any requirement specified by rule, what other information would funds generally include in the Initial Statement? For example, would funds provide information on how shareholders could elect to receive the shareholder report and other documents and information electronically by satisfying the conditions contained in the Commission's guidance on use of electronic media relating to notice, access, and evidence of delivery?

- Should the rule permit funds to obtain implied consent from shareholders who have previously revoked consent? If so, should the rule prescribe a minimum period of time after consent was revoked before re-attempting to obtain implied consent from a shareholder? What period should that be and why?
- Should each fund be required to send a shareholder a Notice each time it transmits a shareholder report electronically under the proposed rule? Why or why not?
- We anticipate that the Notice would be sent in paper and mailed to shareholders. Should we permit the Notice to be sent by email if the shareholder has provided an email address? Why or why not? For example, are there any concerns that under such an approach, while a shareholder may have provided an email address (*e.g.*, as part of opening an account), the shareholder may nonetheless neither prefer nor expect to receive documents or other information through that medium? To what extent are funds and intermediaries, pursuant to regulatory requirements or otherwise, maintaining up-to-date e-mail addresses for investors? Would an investor be more likely to view a Notice delivered by one method versus another (*i.e.*, print versus electronically)? Would an investor be more likely to access the related shareholder report and other required materials when notified by one method or the other?
- Are the proposed disclosures for the Notice appropriate? Should we require that the disclosure in the Notice concerning a shareholder's ability to indicate a preference for paper transmission in the future be preceded by an additional bold-face legend or otherwise made more prominent?

- Should we permit the Notice to be incorporated into, or combined with, one or more other documents? If so, which documents should we permit the Notice to be incorporated into or combined with?
- The rule as proposed would require that the Notice must be sent separately from other types of communications and may not accompany any other document or materials except the fund's current summary prospectus, statutory prospectus, statement of additional information, or Notice of Internet Availability of Proxy Materials. Is this requirement appropriate? Should we permit the Notice to accompany one or more other documents? If so, which documents? For example, in the case of a Notice sent to a shareholder for the first time, should we permit or require the Notice to be accompanied with materials explaining the new transmission regime? Why or why not?
- Should we, as proposed, permit funds to either send separate Notices for each fund or send combined Notices for more than one fund held by a particular shareholder, or should the rule require one or the other of those approaches?
- Should we require that the Notice not contain any additional information other than that specified in the rule? Why or why not? Absent any restriction by rule, what other information would funds generally include in the Notice? For example, would funds provide information on how shareholders could elect to receive the shareholder report and other documents and information electronically by satisfying the conditions contained in the Commission's guidance on use of electronic media relating to notice, access, and evidence of delivery?

- In the case of management companies that are not SBICs, should we require such funds to send a notice each time the fund makes accessible its complete portfolio holdings for the first or third fiscal quarters? Why or why not?
- Should we, as proposed, permit the Notice to be sent in a "householded" manner?
- We are proposing that funds would file a form of the Notice with the Commission not later than 10 days after it is sent to shareholders. Is 10 days sufficient to meet this proposed filing requirement, or should some other filing period be required? If so, what time period and why?
- We anticipate that the form of Notice would be filed with the Commission on EDGAR pursuant to a separate EDGAR submission type. Should we instead require that the form of Notice be filed as an exhibit to a report filed with the Commission? For example, should we require that the form of Notice be filed as part of the fund's report on Form N-CSR or Form N-CEN? Why or why not?
- Should we require, as proposed, that funds send a paper copy of a shareholder report upon request? If so, how soon should a fund be required to send the report after receiving a request?
- Should we restrict funds relying on the proposed rule from using the summary schedule of investments? Why or why not? Are there considerations relating to the use of the summary schedule of investments other than those relating to printing and mailing costs that would make the summary schedule an important option for funds to provide portfolio holdings disclosures? Should we restrict funds from using the summary schedule only in reports transmitted pursuant to the rule, and permit funds to use the summary schedule in printed reports that are

mailed to shareholders? Would funds prefer this additional flexibility? Why or why not?

- Are the proposed amendments to rule 498 and the registration forms regarding website availability of documents appropriate? Should we also, for example, specifically require funds relying on the rule to disclose on the cover page or elsewhere in the summary prospectus or statutory prospectus its reliance on the rule and what specific documents are made available on the website?
- To what extent would the proposed rule reduce burdens such as printing and mailing costs borne by funds? Would these burden reductions ultimately accrue to fund shareholders in the form of lower total fund operating expenses? For example, would these reductions ultimately accrue to shareholders in funds with arrangements that permit or limit payments to service providers or intermediaries such as broker-dealers in connection with the printing and mailing of shareholder reports? Please provide supportive data to the extent available.
- In addition to allowing funds to electronically transmit reports to shareholders, should we also consider options for permitting similar delivery of summary or statutory prospectuses? Why or why not?

E. Form N-CEN and Rescission of Form N-SAR

1. Overview

We are proposing to amend the framework by which registered investment companies report census-type information to the Commission by rescinding Form N-SAR and replacing it with a new form—Form N-CEN.[363] Form N-SAR was adopted by the Commission in 1985 and requires that funds report a wide variety of census information to the Commission, including information relating to a fund's organization, service providers, fees and expenses, portfolio strategies and investments, portfolio transactions, and share transactions. Funds generally must file reports on Form N-SAR semi-annually, except for UITs, which file annually.[364] By contrast, as discussed further below, we are proposing to have all funds file reports on Form N-CEN annually.[365]

In recent years, Commission staff has found that the utility of the information reported on Form N-SAR has become increasingly limited. We believe there are two primary reasons for this limited utility. First, in the past two decades, we have not substantively updated the information reported on the form to reflect new market developments, products, investment practices, or risks. Second, the technology by which funds file reports on Form N-SAR has not been updated and limits the Commission staff's ability to extract and analyze the data reported. Accordingly, we believe that by updating the content and format requirements for census reporting, as discussed below, the Commission will be better able to carry out its regulatory functions, while at the same time reducing burdens on filers.

Proposed Form N-CEN would gather similar census information about the fund industry that funds currently report on Form N-SAR, which could be aggregated and

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363 We are proposing to rescind Form N-SAR and replace it with a new census reporting form, Form N-CEN, rather than to amend Form N-SAR in order to avoid technical difficulties that could arise with filing reports on an amended Form N-SAR (*e.g.*, difficulties related to changes to filing format and form specifications).

364 *See* rules 30b1-1 and 30a-1.

365 *See* proposed amendments to rule 30a-1.

analyzed by Commission staff to better understand industry trends, inform policy, and assist with the Commission's examination program. However, in order to improve the quality and utility of information reported, proposed Form N-CEN would streamline and update information reported to the Commission to reflect current Commission staff information needs and developments in the industry.[366] Additionally, where possible, we have endeavored to exclude items from proposed Form N-CEN that are disclosed or reported pursuant to other Commission forms, or are otherwise available; however, in some limited cases, we are proposing to collect information that may be similarly disclosed or reported elsewhere, but that the staff would benefit from collecting in a structured format.

In order to improve the utility of the information reported to the Commission, we are also proposing that reports on Form N-CEN be structured in an XML format.[367] By requiring reports on Form N-CEN to be filed in XML format, filers will no longer be required to use outdated technology for census reporting. Additionally, requiring reports on Form N-CEN to be filed in an updated structured format will allow reported information to be more efficiently and effectively validated, retrieved, searched, and analyzed through automated means and, therefore, more useful to end users.[368]

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[366] We are proposing to streamline our data collection, in part, through the use of yes/no questions in order to flag certain information for follow-up, if necessary, by Commission staff. *See, e.g.*, Item 11 and Item 30.a of proposed form N-CEN. For example, staff of our Office of Compliance Inspections and Examinations may rely on responses to flag questions in Form N-CEN to indicate areas for follow-up discussion or to request additional information.

[367] The Commission has adopted a number of other forms that are structured in an XML format, including Form N-MFP. Reports on Form N-SAR, by contrast, are filed with an outdated filing application.

[368] *See supra* Part II.A.3 (discussing benefits to the use of XML for reports on Form N-PORT).

2. Who Must File Reports on Form N-CEN

We are proposing to require that all registered investment companies, except face amount certificate companies,[369] file reports on Form N-CEN.[370] Funds offering multiple series would be required to report information in Part C of the form as to each series separately, even if some information is the same for two or more series.[371]

Like Form N-SAR, the sections of Form N-CEN that a fund is required to complete would depend on the type of registrant in order to better tailor the disclosure requirements.[372] All funds would be required to complete Parts A and B, and file any

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369 Face-amount certificate companies are investment companies which are engaged or propose to engage in the business of issuing face-amount certificates of the installment type, or which have been engaged in in such businesses and have any such certificates outstanding. *See* section 4(1) of the Investment Company Act [15 U.S.C. 80a-4(1)]. Face amount certificate companies are not currently required to file reports on Form N-SAR. *See* General Instruction A to Form N-SAR. Face amount certificate companies would continue to file periodic reports pursuant to section 13 or section 15(d) of the Exchange Act.

370 *See* proposed amendments to rule 30a-1. Consistent with Form N-SAR, BDCs, which are not registered investment companies, would not be required to file reports on Form N-CEN.

371 Proposed General Instruction A. Unlike Form N-PORT where separate reports would be filed for each series, registrants would file one report on Form N-CEN covering all series (as is currently done with reports on Form N-SAR). We are proposing this framework for Form N-CEN to help minimize reporting burdens, as much of the information that would be required by Form N-CEN (for example, the information reported pursuant to Parts A and B) would be the same across a fund's various series. We note that Form N-SAR's approach to series information is slightly different than that of proposed Form N-CEN, in that Form N-SAR allows registrants to indicate instances where the information is the same across all series, rather than requiring repetitive information. *See* General Instruction D(8) of Form N-SAR. Unlike Form N-SAR, however, we have sought to organize the information requested in proposed Form N-CEN so that information that is the same for all series is reported in Parts A and B of the form, with Part C, the part of the form that requires each series to respond separately, requesting information that is more likely to differ between series. Accordingly, we anticipate the need to report repetitive information should be limited.

372 *See* General Instruction A (Rule as to Use of Form N-CEN) to proposed Form N-CEN. As reflected in General Instruction A, registrants would be required to respond to each item in their required sections. To the extent an item in a required section is inapplicable to a registrant, the registrant would respond "N/A" to that item. Registrants would not, however, have to provide responses to items in sections they are not required to fill out.

attachments required under Part G. In addition, funds would complete the following Parts as applicable:

- All management companies, other than SBICs, would complete Part C;
- closed-end funds and SBICs would complete Part D;
- ETFs (including those that are UITs) would complete Part E;[373] and
- UITs would complete Part F.[374]

We request comment on who must file Form N-CEN.

- Should we require any other types of investment companies to file reports on Form N-CEN? For example, should face-amount certificate companies be required to file reports on Form N-CEN?
- Should funds offering multiple series be required to file a report for each series separately, rather than one report covering multiple series, as proposed?

3. Frequency of Reporting and Filing Deadline

Management investment companies currently file reports on Form N-SAR semi-annually,[375] and UITs file such reports annually.[376] To reduce reporting burdens, we are proposing that reports on Form N-CEN be filed annually, regardless of type of filer.[377] Form N-CEN would require census-type information, which in our experience does not

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[373] Certain investment products known as "exchange-traded managed funds" would also be required to complete Part E: of proposed Form N-CEN.

[374] Management companies that are registered on Form N-3 would also complete certain items in Part F as directed by Item 7.c.i of proposed Form N-CEN. *See* General A to proposed Form N-CEN.

[375] *See* rule 30b1-1.

[376] *See* rule 30a-1.

[377] *See* proposed amendments to rule 30a-1.

change as frequently as, for example, portfolio holdings information. Accordingly, we believe that an annual filing requirement would be sufficient for purposes of review by Commission staff, as well as investors and other market participants that might use this information.[378]

We are proposing a filing period of 60 days after the end of the fiscal year for funds to file reports on Form N-CEN.[379] This is the same filing period that management companies currently have to file reports on Form N-SAR.[380] As with Form N-SAR, and having considered the amount and nature of the information that would be requested in proposed Form N-CEN, we continue to believe that a sixty-day filing period would appropriately balance the staff's need for timely information against the time necessary for a fund to collect, verify, and report the required information to the Commission.

Rule 30b1-3 under the Investment Company Act currently requires a fund to file a transition report on Form N-SAR when a fund's fiscal year changes.[381] Because reports

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378 As discussed above, certain items that are currently reported on Form N-SAR that would be helpful to have updated on a more frequent basis would be moved to proposed Form N-PORT. For example, item 28 of Form N-SAR requires the fund to provide its monthly sales and repurchases of the Registrant's/Series' shares. In order to increase the timeliness of the information reported to the staff for funds flows, certain information relating to monthly flows would be reported on item B.6 of proposed Form N-PORT, if adopted.

379 Management companies are currently required to file Form N-SAR reports no more than 60 days after the close of their fiscal year and fiscal second quarter. *See* rule 30b1-1 under the Investment Company Act [17 CFR 270.30b1-1]. Accordingly, we anticipate that management companies, which would constitute the largest number of funds filing reports on proposed Form N-CEN, generally will already have processes in place for reporting census-type information at the end of their fiscal years. Thus, we believe requiring reports on proposed Form N-CEN after the close of a fund's fiscal year, rather than calendar year, would be the least burdensome approach for most funds.

380 *See* rule 30b1-1 under the Investment Company Act [17 CFR 270.30b1-1]; *but see* rule 30a-1 under the Investment Company Act [17 CFR 270.30a-1] (requiring UITs to file annual reports on Form N-SAR no more 60 days after the close of the calendar year).

381 *See* rule 30b1-3.

on Form N-CEN would be filed annually rather semi-annually, we believe that a rule outlining the requirements for a transition report would no longer be necessary as transition report filing requirements for fiscal year changes involve less complexity in the case of reports required to be filed once a year rather than twice a year. Consequently, we are proposing to rescind rule 30b1-3. We are, however, proposing to require that reports on Form N-CEN not cover a period of more than 12 months.[382] Thus, if a fund changes its fiscal year, a report filed on Form N-CEN may cover a period shorter than 12 months, but would not be permitted to cover a period longer than 12 months or a period that overlaps with a period covered by a previously filed report.[383]

In addition, a fund would be able to file an amendment to a previously filed report on proposed Form N-CEN at any time, including an amendment to correct a mistake or error in a previously filed report.[384] A fund that files an amendment to a previously filed report on the form would provide information in response to all items of Form N-CEN, regardless of why the amendment is filed.[385]

We request comment on the proposed frequency of reporting and proposed reporting deadline:

- Should reports on Form N-CEN be filed more frequently than annually, as proposed? Should we require management companies to file reports on Form N-CEN semi-annually and UITs to file reports annually, as is currently required by

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[382] *See* General Instruction C of proposed Form N-CEN.

[383] *Id.*

[384] *See* General Instruction E of proposed Form N-CEN. Pursuant to section 34(b) of the Investment Company Act, we expect that funds would correct a material mistake in a Form N-CEN report by filing an amendment to that report.

[385] *Id.*

Form N-SAR? Are certain information items on Form N-CEN of a nature that they may change frequently or such that more frequent information about them should be reported to the Commission? If so, should any information items in proposed Form N-CEN be reported on proposed Form N-PORT or another form instead? If so, what items and on which forms?

- Consistent with the treatment of Form N-SAR filings for management companies, we are proposing that reports be filed 60 days after the end of the fund's fiscal year. Should we require a different filing period? If so, what period should we require and why? How long would it take funds to collect, verify, and file reports covering the information required by proposed Form N-CEN? Would the burdens associated with reports on proposed Form N-CEN be greater or less than those associated with reports on Form N-SAR?
- We have proposed that reports on Form N-CEN be filed as of the end of the fund's fiscal year. We understand that funds have other filing requirements that are tied to their fiscal-year end. Should we require some other period end date, such as end of calendar year? Should UITs be required to file reports as of the end of their fiscal year, as proposed, or should they file reports as of the end of their calendar year as they currently do with reports on Form N-SAR?
- We are proposing to eliminate rule 30b1-3 under the Investment Company Act. Should we instead retain the rule? Are the general instructions to Form N-CEN, as proposed, sufficiently clear as to the filing requirements when a fund changes its fiscal year end? If not, how should the general instructions be revised, or in the alternative, should a transition period rule be provided in connection with

Form N-CEN? If so, how should a transition period be defined and what deadlines or timeframes should such a rule address?

- Should a fund be required to file an amendment to its Form N-CEN report or file a current report within a certain period of time if previously reported information changes? If so, what types of changes should trigger an amendment requirement? What filing period should be required for such an amendment requirement?

4. Information Required on Form N-CEN

a. Part A — General Information

Part A of Form N-CEN, which would be completed by all funds, would collect information about the reporting period covered by the report. It would require funds to report the fiscal-year end date and indicate if the report covers a period of less than 12 months.[386]

We request comment on the information items proposed to be reported in Part A.

b. Part B — Information About The Registrant

Part B of Form N-CEN, which would also be completed by all funds, would require certain background and other identifying information about the fund. In the case of funds offering multiple series, if the response to an item in Part B of the form differs between series, the fund would be instructed to provide a response for each series, as applicable, and label the response with the name and series identification number of the series to which a response relates.[387] This background information would allow the staff to quickly categorize filers by fund type and will assist with our oversight of funds.

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[386] Item 1 of proposed Form N-CEN.

[387] *See* Instruction to Part B: of proposed Form N-CEN.

Included in this background information would be the fund's name,[388] Investment Company Act filing number,[389] and other identifying information, such as its CIK[390] and LEI.[391] In addition, the form would require the fund's address, telephone number, and public website (if any),[392] and the location of the fund's books and records.[393] While the fund's name, address, and filing number are currently required by Form N-SAR,[394] some of the additional information, such as the fund's CIK, LEI, public website and location of books and records would be new. As discussed in the Form N-PORT section above, information such as the CIK and LEI would assist the Commission with organizing the data received by the Commission and allow the staff to cross-reference the data reported on Form N-CEN with data received from other sources.[395] For tracking purposes, the proposed form would require information relating to whether the filing was the initial or final filing.[396]

As discussed above, funds would be required to include the location of their books and records in reports on proposed Form N-CEN. We note that books and records

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[388] Item 2.a of proposed Form N-CEN.

[389] Item 2.b of proposed Form N-CEN.

[390] Item 2.c of proposed Form N-CEN.

[391] Item 2.d of proposed Form N-CEN; *see also supra* note 43 (discussing comment letters received on the FSOC Notice supporting the use of LEIs).

[392] Item 3 of proposed Form N-CEN.

[393] Item 4 of proposed Form N-CEN.; *see also infra* notes 397-399 and accompanying text.

[394] Items 1 and 2 of Form N-SAR.

[395] *See supra* Part II.A.2.a. As discussed above, commenters to the FSOC Notice expressed support for the regulatory acceptance of LEI identifiers. *See supra* note 43.

[396] Item 5 of proposed Form N-CEN.

information is currently required by fund registration forms;[397] however, this information is not filed with us in a structured format. We believe that having books and records information in a structured format would increase our efficiency in preparing for exams as well as our ability to identify current industry trends and practices and, thus, we are proposing to include this information in proposed Form N-CEN.[398] In addition, so as not to create unnecessary burdens, we are proposing to amend Forms N-1A, N-2, N-3, N-4, and N-6 to exempt funds from those forms' respective books and records disclosure requirements if the information is provided in a fund's most recent report on proposed Form N-CEN.[399]

Similar to Form N-SAR,[400] Form N-CEN would require information regarding whether the fund is part of a "family of investment companies." The form, which would include a substantially similar definition as Form N-SAR,[401] would define a "family of investment companies" to mean, except with respect to insurance company separate accounts, any two or more registered investment companies that (i) share the same investment adviser or principal underwriter; and (ii) hold themselves out to investors as

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[397] *See* Item 33 of Form N-1A, Item 32 of Form N-2, Item 36 of Form N-3, Item 30 of Form N-4, and Item 31 of Form N-6.

[398] Additionally, by including books and records information in Form N-CEN, we may receive more frequently updated books and records information from closed-end funds. Closed-end funds do not update their registration statements as regularly as open-end funds and, thus, the information regarding their books and records may not always be up-to-date.

[399] Funds that have not yet filed a report on proposed Form N-CEN would have to continue to include this information in their registration statement filings.

[400] Items 19, 94 and 116 of Form N-SAR; *see also* General Instruction H of Form N-SAR (defining "family of investment companies").

[401] *See id.*; *see also* instruction 1 to Item 17 of Form N-1A.

related companies for purposes of investment and investor services.[402] This item would assist Commission staff with analyzing multiple funds across the same family of investment companies.

Similar to Form N-SAR, proposed Form N-CEN would also require the fund to provide its classification (*e.g.*, open-end fund, closed-end fund).[403] In addition, unlike Form N-SAR, the proposed form would specifically ask whether the fund issues a class of securities registered under the Securities Act.[404] These questions are intended to elicit background information on the fund, which will assist us in our monitoring and oversight functions (for example, identifying those funds that have not issued securities registered under the Securities Act).

Under proposed Form N-CEN, a management company would report information about its directors, including each director's name, whether they are an "interested person" (as defined by section 2(a)(19) of the Investment Company Act), and the Investment Company Act file number of any other registered investment company for

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[402] Instruction to Item 6 of proposed Form N-CEN. The instruction, like the definition of "family of investment companies" in Form N-SAR, would also clarify that insurance company separate accounts that may not hold themselves out to investors as related companies (products) for purposes of investment and investor services should consider themselves part of the same family if the operational or accounting or control systems under which these entities function are substantially similar. *See* General Instruction H to Form N-SAR.

[403] Item 7 of proposed Form N-CEN; *see also* Items 5, 6, 27, 58, 59 and 117 of Form N-SAR. If the registrant is an open-end fund, proposed Form N-CEN would also require information on the total number of series of the registrant and, if a series of the registrant was terminated during the reporting period, information regarding that series. Item 7.a.i-Item 7.a.ii of proposed Form N-CEN. In addition, registrants that indicate they are management companies registered on Form N-3 are directed by Item 7 to respond to certain additional items in Part F of the form that relate to insurance company separate accounts. Item 7.c.i of proposed Form N-CEN.

[404] Item 8 of proposed Form N-CEN.

which they serve as a director.[405] Although this information is reported in a management company's Statement of Additional Information and provided in annual reports to shareholders, providing this information to the Commission in a structured format will allow the Commission and other potential users to sort and analyze the data more efficiently.[406] In addition, the fund would be required to provide the chief compliance officer's ("CCO's") name, CRD number (if any), address, and phone number,[407] as well as indicate if the CCO has changed since the last filing.[408] If the fund's CCO is compensated or employed by any person other than the fund, or an affiliated person of the fund, for providing CCO services, the fund would also be required to report the name and Employer Identification Number of the person providing such compensation.[409] Although some funds provide information relating to their CCO in their registration statements, not all funds do.[410] This new requirement would provide staff with information on all fund CCOs and would allow the staff to contact a fund's CCO directly.

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405 Item 9 of proposed Form N-CEN.

406 *See, e.g.*, Items 17 and 27(b)(5) of Form N-1A.

407 Because we expect that funds will provide the CCO's direct phone number in response to this information request, the CCO's phone number would be a non-public field in all Form N-CEN filings.

408 Item 10 of proposed Form N-CEN

409 Item 10.j of proposed Form N-CEN.

410 *See, e.g.,* Item 17 of Form N-1A (requesting information regarding fund officers). For example, Form N-1A defines the term "officer" to mean "the president, vice-president, secretary, treasurer, controller, or any other officer who performs policy-making functions." It is our understanding that in some fund complexes, the CCO does not fit within the category of officers covered by this definition (*i.e.*, the CCO does not perform a policy-making function), and therefore, information as to their CCO is not provided pursuant to the item.

Part B would also include an item regarding matters that have been submitted to a vote of security holders during the relevant period.[411] Information regarding submissions of matters to a vote of securities holders is currently reported in Form N-SAR by management companies in the form of an attachment with multiple reporting requirements.[412] In order to alleviate the burden on filers, we are proposing to reduce the information to be reported regarding votes of security holders to a yes/no question that is primarily meant to allow staff to quickly identify funds with such votes, so that they can follow up as appropriate, such as by reviewing more detailed information required by other filings.[413] Like Form N-SAR, the proposed form would also include an item relating to material legal proceedings during the reporting period.[414]

Form N-SAR currently requires management companies to report a number of data points relating to fidelity bond and errors and omissions insurance policy coverage.[415] In order to limit the number of items to those most useful to the Commission staff and reduce burdens on filers, we are proposing to limit this request to

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[411] *See* Item 11 of proposed Form N-CEN.

[412] *See* Item 77.C of Form N-SAR; *see also* Instruction to Specific Items for Item 77C.

[413] This information request would apply to UITs as well as management companies. The Form N-SAR requirement applies only to management companies. *See id.* We believe it is important for the Commission to have information for all registered investment companies on matters submitted for security holder vote in order to assist us in our oversight and examination functions.

[414] Item 12 of proposed Form N-CEN. As in Form N-SAR Item 77.E, if there were any material legal proceedings, or if a proceeding previously reported had been terminated, the registrant would file an attachment as required by Part G: of proposed Form N-CEN. *See* Item 79.a.i of proposed Form N-CEN. We note that Form N-CEN, unlike Form N-SAR, would require UITs to respond to the information request related to material legal proceedings. For the same reasons discussed above with respect to matters submitted for security holder vote, we believe it is important to have information on material legal proceedings of all registered investment companies. *See supra* n.413.

[415] Form N-SAR Items 80-85 and 105–110.

two separate items in Form N-CEN. One item would ask if any claims were filed under the management company's fidelity bond and the aggregate dollar amount of any such claims.[416] The other item would ask if the management company's officers or directors are covered under any directors and officers/errors and omissions insurance policy and, if so, whether any claims were filed under the policy during the reporting period with respect to the registrant.[417] These questions will help alert Commission staff to insurance claims made by the fund or its officers and directors as a result of legal issues related to the fund.[418]

In order to better understand instances when funds receive financial support from an affiliated entity, our proposal would also require new information regarding the provision of such financial support.[419] We recently adopted disclosure requirements relating to fund sponsors' support of money market funds as part of our money market reform amendments in 2014, including a new requirement that money market funds file reports on Form N-CR disclosing, among other things, the receipt of financial support.[420] As with money market funds, we believe that it is important that the Commission understand the nature and extent that a fund's sponsor provides financial support to a fund, and are therefore proposing to extend this requirement to all funds that would file reports on Form N-CEN. Although we believe it is an infrequent practice, based on staff

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[416] Item 13 of proposed Form N-CEN; *cf.* Item 83 of Form N-SAR.

[417] Item 14 of proposed Form N-CEN; *cf.* Item 85 of Form N-SAR.

[418] For example, a fund is required to provide and maintain a fidelity bond against larceny and embezzlement, which in general covers each officer and employee of the fund who has access to securities or funds. *See* rule 17g-1(a) under the Investment Company Act [17 CFR 270.17g-1].

[419] Item 15 of proposed Form N-CEN.

[420] *See* Money Market Fund Reform 2014 Release, *supra* note 13.

experience, non-money market funds have received sponsor support in the past and we believe this item would allow Commission staff to readily identify any funds that have received such support for further analysis and review, as appropriate. For consistency, Form N-CEN would include a substantially similar definition of "financial support" as provided by Form N-CR.[421] In addition, the definition in Form N-CEN would also explicitly exclude certain routine transactions from the definition of financial support, as is the case for money market funds.[422] If the fund received financial support, it would also be required to provide more detailed information in the form of an attachment as required by Part G of Form N-CEN.[423]

In addition, Form N-CEN would include a new item requiring reporting as to whether the fund relied on orders from the Commission granting the fund an exemption from one or more provisions of the Investment Company Act, Securities Act or Securities Exchange Act during the reporting period.[424] Funds would identify any such order by release number.[425] We are proposing to collect this information in a structured format to better monitor fund reliance on exemptive orders, which will assist us with our oversight functions.

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[421] *See* Instruction to Item 15 of proposed Form N-CEN; *see also* Part C of Form N-CR.

[422] *See id.*

[423] Item 79.a.ii of proposed Form N-CEN. This requirement would not apply to money market funds, as money market funds currently provide this information through reports on Form N-CR.

[424] Item 16 of proposed Form N-CEN. Form N-SAR currently requires funds to attach information required to be reported on Form N-1Q pursuant to an existing exemptive order. *See* Instructions to Specific Items 77P and 102O of Form N-SAR. Form N-CEN would require the fund to file as an attachment any information required to be filed pursuant to exemptive orders issued by the Commission and relied on by the fund. Instruction to Item 79.a.vi of proposed Form N-CEN.

[425] *See* Item 16.a.i of proposed Form N-CEN.

As with Form N-SAR,[426] proposed Form N-CEN would require identifying information for the fund's principal underwriters[427] and independent public accountants,[428] including, as applicable, name, SEC file number, CRD number, PCAOB number, LEI (if any), state or foreign country, and whether a principal underwriter was hired or terminated or if the independent public accountant changed since the last filing.[429] If the independent public accountant changed since the last filing, the fund would have to provide a detailed narrative attachment to Form N-CEN.[430]

We are proposing to include for all funds several other accounting and valuation related items that are currently required for management companies by Form N-SAR, and that provide important information to the Commission regarding possible accounting and valuation issues related to a fund. These items include a question relating to material changes in the method of valuation of the fund's assets.[431] However, unlike reports on Form N-SAR, proposed Form N-CEN would not require a separate attachment detailing the circumstances surrounding a change in valuation methods.[432] Instead, to facilitate

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[426] Items 11, 13, 77.K, 91, 102.J, 114, 115 of Form N-SAR.

[427] Item 17 of proposed Form N-CEN.

[428] Item 18 of proposed Form N-CEN.

[429] Item 17 and Item 18 of proposed Form N-CEN.

[430] Item 79.a.iii of proposed Form N-CEN.

[431] Item 21 of proposed Form N-CEN. Valuation methodologies are approved by fund directors for use by funds to determine, in good faith, the fair value of portfolio securities (and other assets) for which market quotations are not readily available. For example, valuation methodology changes may include, but are not limited to, changing from use of bid price to mid price for fixed income securities or changes in the trigger threshold for use of fair value factors on international equity securities.

[432] *See* Item 77.J and Item 102.I of Form N-SAR. Also unlike Form N-SAR, this requirement would apply to UITs as well as management investment companies. We believe it is important for the Commission to have information on accounting and valuation for all

review of this information in a structured format, our proposal would include specific items in the form itself, including the date of change, explanation of change, type of investment, statutory or regulatory basis for the change, and the fund(s) involved.[433] We would also carry over to proposed Form N-CEN the requirement from Form N-SAR[434] that the fund identify whether there have been any changes in accounting principles or practices, and, if any, to provide more detailed information in a narrative attachment to the form.[435]

Form N-CEN would also require, like Form N-SAR, that management companies, other than SBICs, file a copy of their independent public accountant's report on internal control as an attachment to their reports on the form.[436] However, Form N-CEN would also include a new question that asks whether the report on internal control

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registered investment companies in order to assist us in our oversight and examination functions.

433 *Compare* Item 77.J of Form N-SAR *with* Item 21 of proposed Form N-CEN. An instruction to Item 21 of proposed Form N-CEN would clarify that we do not expect responses to this item to include changes to valuation techniques used for individual securities (*e.g.,* changing from market approach to income approach for a private equity security). Form N-SAR does not elaborate on the type of information it is seeking by asking for changes in the method of valuation of the registrant's assets. We are proposing to include this instruction to provide clarity for filers and because we believe that responding to Item 21 of proposed Form N-CEN for individual securities may be overly burdensome for filers.

434 *See* Item 77.L and Item 102.K of Form N-SAR.

435 Item 22 and Item 79.a.v of proposed Form N-CEN. Like the information requested regarding changes in valuation methods, Form N-SAR only requests information from management companies regarding changes in accounting principles and practices. Unlike Form N-SAR, Form N-CEN would require this information from UITs as well, for the same reasons as discussed above with respect to changes in valuation methods. *See supra* n.432

436 *See* Item 77.B of Form N-SAR; Item 79.a.iv of proposed Form N-CEN. As noted above, management companies (other than SBICs) are currently required to file a copy of the independent public accountant's report on internal control with their reports on Form N-SAR. We continue to believe that a copy of the management company's report on internal control should be filed with the Commission and thus are proposing to carry over the filing requirement to Form N-CEN.

found any material weaknesses.[437] Form N-CEN would also contain a new requirement that the fund disclose if the certifying accountant issued an opinion other than an unqualified opinion with respect to its audit of the fund's financial statements.[438] These questions will elicit information on potential accounting issues identified by a fund's accountant.

Unlike Form N-SAR, proposed Form N-CEN would also include an item relating to whether, during the reporting period, an open-end fund made any payments to shareholders or reprocessed shareholder accounts as a result of an NAV error.[439] Proposed Form N-CEN would also require information from management companies regarding payments of dividends or distributions that required a written statement pursuant to section 19(a) of the Investment Company Act and rule 19a-1 thereunder.[440] These questions will assist the staff in monitoring valuation of fund assets and the calculation of the fund's NAV, as well as compliance with distribution requirements under section 19(a) and rule 19a-1.

We request comment on the proposed information items to be reported in Part B:

- Should any additional information regarding the fund be requested? Should any of the information that would be requested by proposed Form N-CEN be

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[437] Item 19 of proposed Form N-CEN.

[438] Item 20 of proposed Form N-CEN.

[439] Item 23 of proposed Form N-CEN.

[440] Item 24 of proposed Form N-CEN. Section 19(a) of the Investment Company Act generally prohibits a fund from making a distribution from any source other than the fund's net income, unless that payment is accompanied by a written statement that adequately discloses the source or sources of the payment. *See* 15 U.S.C. 80a-19(a). Rule 19a-1 under the Investment Company Act specifies the information required to be disclosed in the written statement. *See* 17 CFR 270.19a-1; *see also* 2013-11 IM Guidance Update, *supra* note 289.

excluded? Should any of the information requested for all Registrants be limited to only certain Registrants?

- Should any other identifying number other than file number and LEI be requested?
- Should another definition or term be used to capture affiliations across related funds rather than "family of investment companies"? Should a broader term, such as "fund complex" as defined by instruction 1(b) to Item 17 of Form N-1A, be used instead? If so, why would a broader definition be better?
- Should Form N-CEN request any additional information concerning the board of directors or individual directors? For example, should Form N-CEN request information about the length of service of directors?
- Should Form N-CEN request information regarding a fund's CCO, as proposed? Should we, as proposed, make the CCO's phone number a non-public data field on all Form N-CEN filings? Are there any privacy concerns with the other information that would be requested? Would these concerns still exist if the information is reported in a non-public data field? Are there any other concerns with the information that would be requested? Is there other information we should request in lieu of information that presents such concerns?
- The current proposal eliminates Form N-SAR's attachment regarding matters submitted to a vote of security holders. Should we retain this requirement in Form N-CEN? Why or why not? Are there any costs to eliminating Form N-SAR's attachment in Item 77C in favor of yes/no type questions? Should the item regarding votes submitted to security holders apply to UITs?

- We request comment on Item 12 of proposed Form N-CEN. Should this item apply to UITs? Should "legal proceedings" be defined? Should it include administrative, mediated, or arbitrated matters? Are there any other litigation matters that should be deemed inherently material besides those enumerated in the instructions to the item? Is there any additional information that should be requested regarding material legal proceeding matters?
- Should Form N-CEN request information about the fidelity bond beyond what has been proposed (*e.g.*, bond amount, the cost of the bond, or the number of insured persons)? Should any additional information regarding claims filed or that could have been filed under the fidelity bond be requested? For example, should dates of claims filed or that could have been filed be requested? Should the nature of the claim be disclosed?
- Is the term "errors and omissions insurance" clear or should the form include a definition? In addition to requesting information on whether any errors and omissions insurance claim was made as proposed, should dates of insurance claims and amounts of claims be requested? Should Form N-CEN permit funds to exclude the advancement of expenses under a policy from disclosure as a claim?
- The definition of "financial support" in proposed Form N-CEN would include a non-exclusive list of examples of actions that would (and would not) be deemed "financial support." Money market funds currently report this information in reports on Form N-CR. Should the definition in proposed Form N-CEN be further expanded or limited from our definition in Form N-CR, and if so, how and

why? For example, should we include a requirement to report information relating to inter-fund lending? Should we require non-money market funds to report receipt of financial support on a more timely basis? For example, should we require non-money market funds to file reports on Form N-CR or a similar form if they receive financial support?

- Should any additional information concerning exemptive or other orders be requested?
- We also considered whether to require funds to disclose reliance on no-action letters. If we were to require this information, should we limit it to certain no-action letters and, if so, which ones?
- Should we request additional information regarding fund accounting and valuation? If so, what information? Should the items relating to changes in valuation methods and changes in accounting principles and practices apply to UITs, as proposed?
- We request comment on Items 23 and 24 of proposed Form N-CEN. Should we request information regarding NAV errors and/or dividend and distribution payments that required a written statement pursuant to section 19(a) and rule 19a-1? Why or why not? Is there additional information we should request?

c. Part C — Items Relating to Management Investment Companies

i. Background and Classification of Funds

Part C of Form N-CEN would be completed by management investment companies other than SBICs. For management companies offering multiple series, this information would be completed separately as to each series.[441] The proposed information requirements in this section are intended to provide the Commission and its staff with background information on the fund industry and to assist us in meeting our legal and regulatory requirements, such as requirements under the Paperwork Reduction Act. Additionally, certain demographic information would allow the Commission to better identify particular types of management companies for monitoring and analysis if, for example, an issue arose with respect to a particular fund type.

Similar to Form N-SAR, proposed Form N-CEN would include general identifying information on management companies and any series thereof, including the full name of the fund, the fund's series identification number and LEI, and whether it is the fund's first time filing the form.[442] Unlike Form N-SAR, we are proposing to request specific information on the classes of open-end management companies, including information relating to the number of classes authorized, added, and terminated during the relevant period.[443] Form N-CEN would also include a new requirement to specifically provide identifying information for each share class outstanding, including the name of the class, the class identification number, and ticker symbol.[444]

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[441] General Instruction A to proposed Form N-CEN.

[442] Item 25 of proposed Form N-CEN; *see also* supra n.43 (discussing comment letters received on the FSOC Notice supporting the use of LEIs). The proposed requirements relating to the name of the fund and if this is the first filing with respect to the fund are currently required by Form N-SAR. *See* Items 3 and 7.C of Form N-SAR.

[443] Item 26.a–Item 26.c of proposed Form N-CEN.

[444] Item 26.d of proposed Form N-CEN.

Pursuant to proposed Form N-CEN, a management company also would be required to identify if it is any of the following types of funds:[445] ETF or exchange-traded managed fund ("ETMF");[446] index fund;[447] fund seeking to achieve performance results that are a multiple of a benchmark, the inverse of a benchmark, or a multiple of the inverse of a benchmark; interval fund;[448] fund of funds;[449] master-feeder fund;[450] money

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445 Item 27 of proposed Form N-CEN. As discussed herein, many of the types of funds listed in Item 27 are defined in proposed Form N-CEN. With the exception of "index fund" and "money market fund," these terms are not currently defined in Form N-SAR. *See* General Instruction H and Item 69 of Form N-SAR.

446 For purposes of reporting on proposed Form N-CEN, we propose to define "exchange-traded fund" as an open-end management investment company (or series or class thereof) or UIT, the shares of which are listed and traded on a national securities exchange at market prices, and that has formed and operates under an exemptive order under the Investment Company Act granted by the Commission or in reliance on an exemptive rule under the Act adopted by the Commission. We also propose to defined "exchange-traded managed fund" as an open-end management investment company (or series or class thereof) or UIT, the shares of which are listed and traded on a national securities exchange at NAV-based prices, and that has formed and operates under an exemptive order under the Investment Company Act granted by the Commission or in reliance on an exemptive rule under the Act adopted by the Commission. General Instruction F of proposed Form N-CEN. We believe these are appropriate definitions as they are similar to the one used for determining the applicability of ETF registration statement disclosure requirements for open-end funds. *See* General Instruction A to Form N-1A. Currently, all ETFs and exchange-traded managed funds rely on relief from certain provisions of the Investment Company Act that is granted by Commission order. *See* ETF Proposing Release, *supra* note 5; Eaton Vance Management, et al.; Notice of Application, Investment Company Act Release No. 31333 (Nov. 6, 2014) [79 FR 67471 (Nov. 13, 2014)] (Notice); Eaton Vance Management, et al.; Order, Investment Company Act Release No. 31361 (Dec. 2, 2014) (Order). The Commission has, however, proposed to codify the exemptive relief previously granted to ETFs by order. *See* ETF Proposing Release, *supra* note 5 (proposing rule 6c-11).

447 For purposes of reporting on proposed Form N-CEN, we propose to define "index fund" as an investment company, including an ETF, which seeks to track the performance of a specified index. *See* Instruction 2 of Item 27 of proposed Form N-CEN. We believe this is an appropriate definition as it is substantively similar to the definition of "index fund" in Form N-SAR, but also takes into account the emergence of ETFs. *See* Instruction to Item 69 of Form N-SAR. Additionally, the proposed definition is largely similar to the definition of "index fund" in rule 2a19-3 under the Investment Company Act. *See* 17 CFR 270.2a19-3 (referring to an index fund for purposes of the rule as a fund that has "an investment objective to replicate the performance of one or more broad-based securities indices....").

448 For purposes of reporting on proposed Form N-CEN, we propose to define "interval fund" as a closed-end management company that makes periodic repurchases of its shares pursuant to

market fund; target date fund;[451] and underlying fund to a variable annuity or variable life insurance contract. ETFs and ETMFs, index funds and master-feeder funds would also be required to provide the additional information discussed below.[452]

First, proposed Form N-CEN would require a management company to further indicate if it is an ETF or an ETMF.[453] Second, index funds would be required to report certain standard industry calculations of relative performance. In particular, index funds would be required to report a measure of the difference between the index fund's total

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rule 23c-3 under the Investment Company Act. *See* Instruction 3 of Item 27 of proposed Form N-CEN. We believe this is an appropriate definition because the term "interval fund" is commonly used to refer to funds that rely on rule 23c-3. *See* 17 CFR 270.23c-3.

449 For purposes of reporting on proposed Form N-CEN, we propose to define "fund of funds" as a fund that acquires securities issued by another investment company in excess of the amounts permitted under section 12(d)(1)(A) of the Investment Company Act. *See* 15 U.S.C 80a-12(d)(1)(A); Instruction 1 of Item 27 of proposed Form N-CEN. We believe this is an appropriate definition because "funds of funds" is a term typically used to refer to funds that invest in other funds beyond the limits of the Investment Company Act. Additionally, the proposed definition of "fund of funds" largely tracks FINRA's definition of "fund of funds" in its rules. *See* FINRA Code of Conduct Rule 2830(b)(11) (defining "fund of funds").

450 For purposes of reporting on proposed Form N-CEN, we propose to define "master-feeder fund" as a two-tiered arrangement in which one or more funds holds shares of a single fund in accordance with section 12(d)(1)(E) of the Investment Company Act. *See* Instruction 4 of Item 27 of proposed Form N-CEN. We believe this is an appropriate definition as it is the same definition as used for purposes of Form N-1A. *See* General Instruction A to Form N-1A.

451 For purposes of reporting on proposed Form N-CEN, we propose to define "target date fund" as an investment company that has an investment objective or strategy of providing varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures that changes over time based on an investor's age, target retirement date, or life expectancy. *See* Instruction 5 of Item 27 of proposed Form N-CEN. We believe this is an appropriate definition as it is the same definition as proposed by the Commission in our 2010 proposing release relating to target date funds. *See* Investment Company Advertising Release, *supra* note 6.

452 *See* Item 27.a; Item 27.b; and Item 27.f of proposed Form N-CEN.

453 *See* Item 27.a.i and Item 27.a.ii.

return during the reporting period[454] and the index's return both before and after fees and expenses—commonly called the "tracking difference"— [455] and also a measure of the volatility of the day-to-day tracking difference over the course of the reporting period—commonly called the fund's "tracking error." [456]

Specifically, the proposed tracking difference data item would equal the annualized difference between the index fund's total return during the reporting period and the index's return during the reporting period, and the proposed tracking error data item would equal the annualized standard deviation of the daily difference between the index fund's total return and the index's return during the reporting period.[457] Reporting of these measures will help data users, including the Commission, investors, and other potential users, evaluate the degree to which particular index funds replicate the

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[454] With respect to index funds that are ETFs, we would expect a fund to use its NAV-based total return, rather than market-based total return, in responding to Items 27.b.i. and ii.

[455] Item 27.b.i of proposed Form N-CEN. The tracking difference is the return difference between the fund and the index it is following, annualized. Johnson, Ben, et al., On the Right Track: Measuring Tracking Efficiency in ETFs, Morningstar ETF Research, at 29 (Feb. 2013), *available at* http://media.morningstar.com/uk/MEDIA/Research_Paper/Morningstar_Report_Measuring_Tracking_Efficiency_in_ETFs_February_2013.pdf ("Morningstar Paper"), at 29. Thus, tracking difference = $(1 + R_{NAV} - R_{INDEX})^{1/N} - 1$, where R_{NAV} is the total return for the fund over the reporting period, R_{INDEX} is the total return for the index for the reporting period, and N is the length of the reporting period in years. N will equal to 1 if the reporting period is the fiscal year. *Id.*

[456] *See* Item 27.b.ii of proposed Form N-CEN. Tracking error is commonly understood as the standard deviation of the daily difference in return between the fund and the index it is following, annualized. Morningstar Paper, *supra* note 455, at 29. Thus, tracking error = std $(R_{NAV} - R_{INDEX}) \times \sqrt{n}$, where R_{NAV} is the daily return for the fund, R_{INDEX} is the daily return for the index, std(·) represents the standard deviation function, and n is the number of trading days in the fiscal year. *Id.*

[457] *See* Morningstar Paper, *supra* note 455, at 29.

performance of the target index.[458] In addition, tracking difference and tracking error before fees and expenses[459] would allow data users to better understand the effect of factors other than fees and expenses on the degree to which the index fund replicates the performance of the target index.[460]

Finally, master funds would be required to provide identifying information with respect to each feeder fund, including information on unregistered feeder funds (*i.e.*, feeder funds not registered as investment companies with the Commission), such as offshore feeder funds.[461] Similarly, a feeder fund would provide identifying information of its master fund.[462]

Proposed Form N-CEN would also require the management company to report if it seeks to operate as a non-diversified company, as defined in section 5(b)(2) of the Investment Company Act.[463] Form N-SAR, however, asks if the management company was a diversified investment company at any time during the period or at the end of the reporting period.[464] We are proposing to require reporting on the non-diversified status of a management company, rather than the diversified status, because it is less common

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458 *See* Morningstar Paper, *supra* note 455, at 5. We believe this information would help data users understand which funds are best tracking their target indices and could highlight outlier funds.

459 *See* Item 27.b.i.1 and Item 27.b.ii.1 of proposed Form N-CEN.

460 *See* Morningstar Paper, *supra* note 455, at 9.

461 Item 27.f.i of proposed Form N-CEN.

462 Item 27.f.ii of proposed Form N-CEN.

463 Item 28 of proposed Form N-CEN.

464 *See* Item 60 of Form N-SAR.

for funds to be non-diversified.[465] Additionally, the question in proposed Form N-CEN is forward looking rather than backward looking as in Form N-SAR. This change is intended to include as part of the universe of non-diversified funds those funds that seek to operate as non-diversified companies even if they should happen to meet the definition of a "diversified company" as of the end of a particular reporting period.[466] We believe this change will allow our staff to more accurately pinpoint the universe of non-diversified funds and, thus, better able the staff to assist us in our analysis and inspection functions.

We request comment on the Part C questions relating to the fund's background and classification:

- Should additional identifying information be requested with regard to series or classes of management investment companies? Should any of the information proposed to be included in proposed Form N-CEN be excluded?
- We request comment on our list of types of fund. Are there any types of funds that we should add to or remove from the list? If so, which ones and why? Should we include additional categories based on investment strategy, as proposed? If so, which categories? Are the definitions in proposed Form N-CEN of the type of funds listed appropriate? Should any different definitions be used for types of funds? If so, what definitions and why? Are any terms that are not

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[465] Based on Form N-SAR data between July 2014 – December 2014, 74% of funds were diversified during the reporting period.

[466] For example, if a fund generally operates as a non-diversified fund, but as a result of market conditions or other reasons, happens to meet the definition of "diversified fund" as of the end of the reporting period, it would still be required to indicate that it was a non-diversified fund for purposes of this item.

defined sufficiently clear or should we provide definitions? If so, what terms and what definitions?

- We request comment on the information to be required for index funds. Should we require the difference between the fund's total return during the reporting period and the index's return during the reporting period? Is this a meaningful methodology? Is there a better methodology for calculating tracking difference or tracking error?
- Should the form solicit information about the intent of a management company to operate as a non-diversified fund or should it request information about past operations during the reporting period?

ii. Investments in Certain Foreign Corporations

We are also proposing to require a management company to identify if it invests in a controlled foreign corporation for the purpose of investing in certain types of instruments, such as commodities, including the name and LEI of such corporation, if any.[467] As discussed *supra* Part II.A.2.b, some funds use CFCs for making certain investments, particularly in commodities and commodity-linked derivatives, often for tax purposes. Information regarding assets invested in a controlled foreign corporation for the purpose of investing in certain types of instruments would provide investors greater insight into special purpose entities, such as CFCs, that may have certain legal, tax, and country-specific risks associated with them. Combined with the information that we are proposing to collect in Form N-PORT, Commission staff would likewise benefit from

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[467] Item 29 of proposed Form N-CEN. An instruction to Item 29 of proposed Form N-CEN would define "controlled foreign corporation" as having the meaning provided in section 957 of the Internal Revenue Code.

this information by better understanding the use of CFCs and other similar entities, which could allow for more efficient collaboration with foreign regulatory authorities to the extent the Commission may need books and records or other information for specific funds or general inquiries related to CFCs.

We request comment on the Part C questions relating to the fund's investments in certain foreign corporations:

- Should we request additional information on whether the management company invested in a foreign corporation or subsidiary, including CFCs? For example, should we request information on the types of investing activities the CFCs engage in or certain balance sheet items from the CFC?

iii. Securities Lending

As discussed above, we are proposing that funds provide certain securities lending information in reports on Form N-PORT to help inform the Commission, investors and other market participants about the scale of securities lending activity by funds and their collateral reinvestments.[468] Additionally, we are proposing to require that funds include in their financial statements certain information concerning their income and expenses associated with securities lending activities in order to increase the transparency of this information to investors and other potential users.[469] We believe, however, that some important information concerning securities lending activity by funds should be reported in a structured format, but on a less frequent basis than reports on proposed Form N-PORT. In this regard, we believe an annual reporting requirement on Form N-CEN

[468] *See supra* Parts II.A.2.d and II.A.2.g.v.

[469] *See* proposed rule 6-03(m) of Regulation S-X.; *see also supra* Parts II.C.3 and II.C.5.

may yield sufficiently timely data and may more appropriately balance the requirements' benefits with their associated costs than would additional monthly reporting requirements on Form N-PORT.

Accordingly, we propose to require that each management company report annually on new Form N-CEN, in addition to whether it is authorized to engage in securities lending transactions and whether it loaned securities during the reporting period,[470] information about the fees associated with securities lending activity and information about the management company's relationship with certain securities-lending-related service providers. First, we propose to require that management companies that loaned any securities during the reporting period disclose certain information that would illuminate the commonality of borrower default. Specifically, we propose to require that those management companies disclose annually whether any borrower of securities had defaulted on its obligations to the management company to return loaned securities or return them on time in connection with a security on loan during that period.[471]

Under proposed Form N-CEN, management companies would also be required to disclose whether a securities lending agent or any other entity indemnifies the fund against borrower default on loans administered by the agent and certain identifying information about the entity providing indemnification if not the securities lending agent.[472] Together, these reporting requirements would yield data that would allow the

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[470] Item 30.a–Item 30.b of proposed Form N-CEN.

[471] Item 30.b.i of proposed Form N-CEN.

[472] Item 30.c.iv and Item 30.c.v.1–Item 30.c.v.2 of proposed Form N-CEN.

Commission, investors, and other potential users to assess the counterparty risks associated with borrower default in the securities lending market and the extent to which those risks are mitigated by—or concentrated in—third parties that provide indemnification against default.[473]

Because management companies sometimes engage external service providers as securities lending agents or cash collateral managers, we believe that some of the risks associated with securities lending activities by management companies could be impacted by these service providers and the nature of their relationships with the management companies and one another. Accordingly, we propose to require that management companies report some basic identifying information about each securities lending agent and cash collateral manager.[474] In addition, we propose to require that funds disclose whether each of these service providers is a first- or second-tier affiliated person of the management company,[475] which data would highlight those funds that might be expected to rely on Commission exemptive relief with respect to those transactions.[476] We also

473 As discussed above, commenters to the FSOC Notice suggested that enhanced securities lending disclosures could be beneficial to investors and counterparties. *See supra* note 71.

474 Item 30.c.i–Item 30.c.ii and Item 30.d.i–Item 30.d.ii of proposed Form N-CEN.

475 Item 30.c.iii and Item 30.d.iv of proposed Form N-CEN.

476 Section 17(d) of the Investment Company Act makes it unlawful for first- and second- tier affiliates, among others, acting as principal, to effect any transaction in which the fund, or a company it controls, is a joint or a joint and several participant in contravention of Commission rules. 15 U.S.C. 80a-17(d). Rule 17d-1(a) prohibits first- and second-tier affiliates of a registered fund, among others, acting as principal from participating in or effecting any transaction in connection with any joint enterprise or other joint arrangement or profit-sharing plan in which the fund (or any company it controls) is a participant unless an application or arrangement or plan has been filed with the Commission and has been granted. 17 CFR 270.17d-1. These provisions would prohibit a fund from compensating a securities lending agent that is a first- or second-tier affiliate with a share of loan revenue or lending to a borrower that is a first- or second-tier affiliate without an exemptive order, and generally from investing cash collateral in a first- or second-tier affiliated liquidity pool unless the fund

propose to require each management company to disclose whether it has made each of several specific types of payments, including a revenue sharing split, non-revenue sharing split (other than an administrative fee), administrative fee, cash collateral reinvestment fee, and indemnification fee, to one or more securities lending agents or cash collateral managers during the reporting period.[477] These disclosures will allow the Commission, investors and other management company boards of directors to understand better the type of fees a management company pays in connection with securities lending activities and whether, for example, the revenue sharing split that the company pays to a securities lending agent includes compensation for other services such as administration or cash collateral management.[478] Finally, our proposed disclosure of whether the cash collateral

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satisfies the conditions in rule 12d1-1 under the Investment Company Act, which provides exemptive relief for fund investments in an affiliated registered money market fund and pooled investment vehicle that would be an investment company but for sections 3(c)(1) and 3(c)(7) of the Investment Company Act and that operate in compliance with money market fund regulations subject to certain conditions. A management company that has a service agreement with an affiliated securities lending agent, under which compensation is not based on a share of loan revenue generated by the lending agent's efforts, generally is not a joint enterprise or other joint arrangement or profit-sharing plan and, thus, does not need an exemptive order. *See* Norwest Bank Minnesota, N.A., SEC Staff No-action Letter (pub. avail. May 25, 1995) *available at* http://www.sec.gov/divisions/investment/noaction/1995/norwest052595.pdf.

[477] Item 30.e of proposed Form N-CEN. Management companies that report that other payments were made to one or more securities lending agents or cash collateral managers during the reporting period would also be required to describe the type or types of other payments. Item 30.e.vi of proposed Form N-CEN.

[478] In evaluating the fees and services of any securities lending agent, the board of directors of a management company that engages in securities lending may be assisted by reviewing and comparing information on securities lending agent fee arrangements of other management companies. *See, e.g.,* SIFE Trust Fund, SEC No-action Letter (publ. avail. Feb. 17, 1982) (management company's board of directors determines that the securities lending agent's fee is reasonable and based solely on the services rendered); Neuberger Berman Equity Funds, et al., Investment Company Act Release No. 25880 (Jan. 2, 2003) (notice), Investment Company Act Release No. 25916 (Jan. 28, 2003) (order) (management company's board of directors, including a majority of independent directors, will determine initially and review annually, among other things, that (i) the services to be performed by the affiliated securities

manager is a first- or second-tier affiliate of the securities lending agent[479] could alert the Commission, investors, and other market participants to potential conflicts of interest when an entity managing a cash collateral reinvestment portfolio is affiliated with a securities lending agent that is compensated with a share of revenue generated by the cash collateral reinvestment pool. Together, the data that these proposed requirements would yield would allow the Commission to monitor the interaction of these service providers with management companies. In addition to informing the Commission's risk analysis and, potentially, future policymaking concerning securities lending activity by management companies, we believe that this information could also help inform other data users about the use of, and possible risks associated with, the lending of portfolio securities by management companies.

We request comment on the Part C questions relating to the management company's securities lending activities:

- Should management companies be required to report any or all of the proposed information concerning securities lending activity? If not, which items should not be required, and why? Should we collect any additional information?
- Should we require, as proposed, that management companies disclose annually whether any borrower of securities defaulted on its obligations to the management company? Why or why not? Should we instead, or additionally, require

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lending agent are appropriate for the lending fund, (ii) the nature and quality of the services to be provided by the agent are at least equal to those provided by others offering the same or similar services; and (iii) the fees for the agent's services are fair and reasonable in light of the usual and customary charges imposed by others for services of the same nature and quality).

[479] Item 30.d.iii of proposed Form N-CEN.

management companies to report monthly on Form N-PORT whether any borrower of securities defaulted on its obligations to the management company?

- Should we require, as proposed, that management companies report certain information about each securities lending agent and each cash collateral manager? Why or why not? Should we require that these funds disclose whether each of these external service providers is a first- or second-tier affiliate of the fund?
- In addition to requiring management companies to report whether they made each of the proposed types of payments associated with securities lending, should the Commission also require disclosure of specific rates and/or amounts paid during the reporting period of each enumerated type of compensation, similar to the disclosures we are proposing to require in the financial statements concerning the terms governing the compensation of the securities lending agent and collateral manager? Would that additional information be useful in proposed Form N-CEN in a structured format for risk monitoring and use by investors or other market participants, including other management company boards of directors that are evaluating securities lending agent services?
- Would the proposed reporting requirements regarding securities lending yield beneficial information? If not, what information should the Commission collect instead to conduct appropriate risk monitoring of securities lending activity by management companies? How should this information be collected?
- Would the proposed reporting requirements concerning securities lending activity be burdensome?

- Should proposed Form N-CEN include a specific definition for "securities lending agent"? Why or why not? If so, how should the term be defined? Should the form include a specific definition for "cash collateral manager"? Why or why not? If so, how should the term be defined?
- Are there other reporting requirements that the Commission should adopt for securities lending activity? If so, would these additional reporting requirements assist with Commission risk monitoring, inform the public, or both?

iv. Reliance on Certain Rules

Like Form N-SAR, proposed Form N-CEN would include a requirement that management companies report whether they relied on certain rules under the Investment Company Act during the reporting period.[480] However, proposed Form N-CEN would require this information with respect to additional rules not currently covered by Form N-SAR.[481] We are proposing to collect information on these additional rules to better monitor reliance on exemptive rules and to assist us with our accounting, auditing and oversight functions, including, for some rules, compliance with the Paperwork Reduction

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[480] Item 31 of proposed Form N-CEN

[481] *Compare id.* (requiring management companies to identify if they relied upon any of the following rules: rule 10f-3 (exemption for the acquisition of securities during the existence of an underwriting or selling syndicate), rule 12d1-1 (exemptions for investments in money market funds), rule 15a-4 (temporary exemption for certain investment advisers), rule 17a-6 (exemption for transactions with portfolio affiliates), rule 17a-7 (exemption of certain purchase or sale transactions between an investment company and certain affiliated persons thereof), rule 17a-8 (mergers of affiliated companies), rule 17e-1 (brokerage transactions on a securities exchange), rule 22d-1 (exemption from section 22(d) to permit sales of redeemable securities at prices which reflect sales loads set pursuant to a schedule), rule 23c-1 (repurchase of securities by closed-end companies), rule 32a-4 (independent audit committees)) *with* Items 40, 77.N, 77.O, 102.M, 102.N of Form N-SAR (requiring information regarding rules 2a-7 (money market funds), 10f-3 (see above for description) and 12b-1 (distribution of shares by registered open-end management investment company).

Act. For example, reporting of reliance on rules 15a-4 and 17a-8 under the Investment Company Act will allow the staff to monitor significant events relating to interim investment advisory agreements and affiliated mergers, respectively.

In addition, we are proposing to amend rule 10f-3 to eliminate the requirement that funds provide the Commission with reports on Form N-SAR regarding any transactions effected pursuant to the rule.[482] Rule 10f-3 currently requires funds to maintain and preserve certain information—the same information also required to be filed pursuant to Form N-SAR—in its records regarding rule 10f-3 transactions.[483] Our proposed amendments to rule 10f-3 would eliminate the requirement to periodically report this information,[484] but would not alter the requirement to maintain and preserve it. The Commission believes it is unnecessary for funds to continue to file this information because Commission staff can request the information in connection with staff inspections, examinations and other inquiries.[485]

We request comment on the Part C questions relating to the management company's reliance on certain exemptive rules and orders:

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482 *See* proposed amendments to rule 10f-3.

483 *See* rule 10f-3(c)(12) under the Investment Company Act [17 CFR 270.10f-3(c)(12)].

484 *See* rule 10f-3(c)(9).

485 Similar exemptive rules take this approach and do not require filings with the Commission. *See* rule 17a-7 under the Investment Company Act [17 CFR 270.17a-7] and rule 17e-1 under the Investment Company Act [17 CFR 270.17e-1]. We note that we previously proposed deleting this filing requirement from rule 10f-3 in 1996. *See* Exemption for the Acquisition of Securities During the Existence of an Underwriting Syndicate, Investment Company Act Release No. 21838 (Mar. 21, 1996) [61 FR 13620 (Mar. 27, 1996)]. We chose not to adopt it in light of the other amendments to the rule at that time, including the increase in the percentage limit on the principal amount of an offering that an affiliated fund could purchase. *See* Exemption for the Acquisition of Securities During the Existence of an Underwriting of Selling Syndicate, Investment Company Act Release No. 22775 (July 31, 1997) [62 FR 42401 (Aug. 7, 1997)].

- Should any additional information concerning exemptive or other rules be requested?
- We request comment on our proposal to eliminate the requirement under rule 10f-3 that funds provide the Commission with periodic reports on Form N-SAR. Should we eliminate this requirement or continue it under Form N-CEN? Why or why not? Are there any costs or benefits associated with eliminating this requirement?

v. *Expense Limitations*

As in Form N-SAR,[486] Form N-CEN would require information regarding expense limitations.[487] The requirements in Form N-CEN, however, would be modified from Form N-SAR by requiring information on whether the management company had an expense limitation arrangement in place, whether any expenses of the fund were waived or reduced pursuant to the arrangement, whether the waived fees are subject to recoupment, and whether any expenses previously waived were recouped during the period.[488] We believe that more specific questions relating to management company expense limitation arrangements would reduce burdens and limit uncertainty for management companies when responding to these items.

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486 *See* Items 53.A-C of Form N-SAR (requiring the fund to identify if expenses of the Registrant/Series were limited or reduced during the reporting period by agreement, and, if so, identify if the limitation was based upon assets or income).

487 Item 32 of proposed Form N-CEN.

488 *Id.* Proposed Form N-CEN would also include an instruction that filers should provide information in response to the item concerning any direct or indirect limitations, waivers or reductions, on the level of expenses incurred by the fund during the reporting period. The instructions would also provide an example of how an expense limit may be applied – when an adviser agrees to accept a reduced fee pursuant to a voluntary fee waiver or for a temporary period such as for a new fund in its start-up phase. *See* Instruction to Item 32 of proposed Form N-CEN.

We request comment on the Part C questions relating to the management company's expense limitations and fee waivers:

- Are the proposed Form N-CEN items relating to expense limitations appropriate? Is there any additional information that we should request on the management company's expense limitations? If so, what items and why?

vi. *Service Providers*

Similar to Form N-SAR,[489] Form N-CEN would collect identifying information on the management company's service providers, including its advisers and sub-advisers,[490] transfer agents,[491] custodians (including sub-custodians),[492] shareholder servicing agents,[493] third-party administrators,[494] and affiliated broker-dealers.[495] We are also proposing new requirements that the management company provide information on whether the service provider was hired or terminated during the reporting period and whether it is affiliated with the fund or its adviser(s).[496] In addition, like Form N-SAR, Form N-CEN would ask custodians to indicate the type of custody, but would expand upon the types of custody listed.[497] Together, these items would assist the Commission in

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489 *See* Items 8 and 10–15 of Form N-SAR.

490 Item 33 of proposed Form N-CEN.

491 Item 34 of proposed Form N-CEN. Form N-SAR equates a "shareholder servicing agent" with a "transfer agent." *See* Instruction to Item 12 of Form N-SAR.

492 Item 37 of proposed Form N-CEN.

493 Item 38 of proposed Form N-CEN.

494 Item 39 of proposed Form N-CEN.

495 Item 40 of proposed Form N-CEN.

496 *See, e.g.*, Items 33.a.vii, b and c.vii; 34.a.vi and b of proposed Form N-CEN.

497 *Compare* Items 15.E and 18 of Form N-SAR *with* Item 37.a.vii.6-Item 37.a.vii.7 of proposed Form N-CEN.

analyzing the use of third-party service providers by management companies, as well as identify service providers that service large portions of the fund industry.

Based on staff experience, management companies and their boards often rely on pricing agents to help price securities held by the fund. Therefore, we are proposing a new requirement that management companies provide identifying information on persons that provided pricing services during the reporting period,[498] as well as persons that formerly provided pricing services to the management company during the current and immediately prior reporting period that no longer provide services to that company.[499] This would assist the Commission in assessing the use of pricing services by the fund industry and the role they play in valuing fund investments.

Part C would also require identifying information on the ten entities that, during the reporting period, received the largest dollar amount of brokerage commissions from the management company[500] and with which the management company did the largest dollar amount of principal transactions.[501] Form N-SAR also requests identifying information on these entities[502] – information that is not available elsewhere in a structured format. Moreover, we continue to believe that brokerage commission and principal transaction information provides valuable information to Commission staff

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498 Item 35 of proposed Form N-CEN.

499 Item 36 of proposed Form N-CEN.

500 Item 41 of proposed Form N-CEN.

501 Item 42 of proposed Form N-CEN.

502 Items 20–23 of Form N-SAR. Form N-SAR includes an instruction designed to help filers distinguish between agency and principal transactions for purposes of reporting information regarding brokerage commissions and principal transactions. *See* Instruction to Items 20-23 of Form N-SAR. A substantially similar instruction would be included in Form N-CEN. *See* Instructions to Item 41-Item 42 of proposed Form N-CEN.

about management company brokerage practices, and would assist the staff in identifying the types of broker-dealers who service management company clients, monitoring for changes in business practices, and assessing the types of trading activities in which funds are engaged. Finally, similar to Form N-SAR, we are proposing to ask whether the management company paid commissions to broker-dealers for "brokerage and research services" within the meaning of section 28(e) of the Exchange Act.[503]

We request comment on the Part C questions relating to the fund's service providers:

- Are the proposed Form N-CEN items relating to service providers appropriate? Should any of the service providers or information regarding the service providers included in proposed Form N-CEN be excluded from the form? Are there other service providers for which we should require information? For example, should we request information on index providers and, in particular, affiliated index providers?
- Are the service providers identified in proposed Form N-CEN sufficiently clear or should we provide definitions for each provider? If so, what definitions should we use and why?

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[503] Item 43 of proposed Form N-CEN; *see also* Item 26.B of Form N-SAR (requiring disclosure if the fund's receipt of investment research and statistical information from a broker or dealer was a consideration which affected the participation of brokers or dealers or other entities in commissions or other compensation paid on portfolio transactions of Registrant). Section 28(e) of the Exchange Act establishes a safe harbor that allows money managers to use client funds to purchase "brokerage and research services" for their managed accounts under certain circumstances without breaching their fiduciary duties to clients. *See* 15 U.S.C. 78bb(e); *see also* Commission Guidance Regarding Client Commission Practices Under Section 28(e) of the Securities Exchange Act of 1934, Release No. 33-54165 (July 18, 2006) [71 FR 41978 (July 24, 2006)]. We continue to believe that an item indicating whether a fund uses soft dollars will assist our staff in their examinations and provide census data as to the number and type of funds that rely on the safe harbor provided by section 28(e).

- Should additional information be requested regarding advisers or sub-advisers? Should the form provide a definition of the term sub-adviser?
- Should any additional specific service provider information be requested? Is there any proposed service provider information that should not be requested? Should proposed Form N-CEN request information on whether the service provider was hired or terminated, or on the affiliation of the service provider, as proposed?
- In addition to requesting service provider city and state or foreign country information as proposed, should street address, phone or email information be requested? Would inclusion of this additional information in proposed Form N-CEN raise any privacy or other concerns?
- Should the form request information regarding sub-transfer agents or other shareholder servicers?
- Should any additional information on service provider fees be requested? For example, should custodian, audit, or administrator fees be requested? Is certain service provider fee information unnecessary as redundant with financial statements?
- Is the use of the term "pricing service" appropriate as proposed? Should the form provide a definition of "pricing service"?
- Should we, as proposed, include custody pursuant to rules 17f-6 and 17f-7 under the Investment Company Act (types of custody not currently listed in Form N-SAR) on the list of types of custody in proposed Form N-CEN?

- Is there additional information regarding broker-dealers that should be requested? Should we use a different methodology other than largest amount of brokerage commissions or collect information for a larger or smaller number of brokers?
- Is there additional information regarding payments by the management companies to brokers or dealers for "brokerage and research services" that should be requested?

We request comment on Part C, generally:

- Are there any additional questions regarding management companies that we should include in proposed Form N-CEN?

d. Part D — Closed-End Management Companies and Small Business Investment Companies

Proposed Form N-CEN would, as Form N-SAR does, recognize that closed-end funds and SBICs have particular characteristics that warrant questions targeted specifically to them.[504] Like Form N-SAR, Form N-CEN would require additional information to be reported by closed-end funds in Part D of the form and would also treat SBICs differently than other management investment companies, requiring them to complete Part D of the form in lieu of Part C.[505] The information requested in Part D would provide us with information that is particular to closed-end funds and SBICs and, thus, would assist us in monitoring the activities of these funds and our examiners in their preparation for exams of these funds.

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504 *See* Items 86-88 of Form N-SAR (relating specifically to closed-end funds) and Items 89-110 of Form N-SAR (relating specifically to SBICs).

505 As discussed above, SBICs are unique investment companies that operate differently than other management investment companies. *See supra* note 35.

Similar to Form N-SAR, we are proposing to require in Part D of proposed Form N-CEN information on the securities that have been issued by the closed-end fund or SBIC, including the type of security issued (common stock, preferred stock, warrants, convertible securities, bonds, or any security considered "other"), title of each class, exchange where listed, and ticker symbol.[506] We are also proposing to require new information relating to rights offerings[507] and secondary offerings by the closed-end fund or SBIC,[508] including whether there was such an offering during the reporting period and if so, the type of security involved.[509] Together, this information will allow the staff to quickly identify and track the securities and offerings of closed-end funds and SBICs when monitoring and examining these funds.

Like Form N-SAR,[510] we are also proposing to require that each closed-end fund or SBIC report information on repurchases of its securities during the reporting period.[511] However, unlike Form N-SAR, which requires information on the number of shares or principal amount of debt and net consideration received or paid for sales and repurchases for common stock, preferred stock, and debt securities, Form N-CEN would only require

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506 Item 44 of proposed Form N-CEN; *cf.* Items 87-88 and 96 of Form N-SAR (requesting information on the title and ticker of each class of securities issued on an exchange and information regarding certain specific types of securities). An instruction to Item 44 of proposed Form N-CEN would indicate that the fund should provide the ticker symbol for any security not listed on an exchange, but that has a ticker symbol.

507 Item 45 of proposed Form N-CEN.

508 Item 46 of proposed Form N-CEN.

509 *See* Item 45 and Item 46 of proposed Form N-CEN. Item 45.c of proposed Form N-CEN would also ask for the percentage of participation in a primary rights offering and an accompanying instruction to this item would address the method of calculating such percentage.

510 *See* Items 86 and 95 of Form N-SAR.

511 Item 47 of proposed Form N-CEN.

the closed-end fund or SBIC to indicate if it repurchased any outstanding securities issued by the closed-end fund or SBIC during the reporting period and indicate which type of security.[512]

We are also proposing to carry over Form N-SAR's requirements[513] relating to default on long-term debt[514] and dividends in arrears.[515] However, unlike Form N-SAR, which requires an attachment stating detailed information on defaults and arrears on senior securities,[516] we are proposing that Form N-CEN only require a yes/no question and text-based responses directly in the form.[517] We are similarly proposing to carry over the Form N-SAR requirement[518] regarding modifications to the constituent's instruments defining the rights of holders.[519] Similar to Form N-SAR, if a closed-end fund or SBIC made modifications to such an instrument, it would also be required to file an attachment

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[512] We note that, with respect to closed-end funds, financial information relating to monthly sales and repurchases of shares would be reported monthly on proposed Form N-PORT. *See* Item B.6 of proposed Form N-PORT (requiring the aggregate dollar amounts for sales and redemptions/repurchases of fund shares during each of the last three months).

[513] *See* Items 77.G and 102.F of Form N-SAR.

[514] Item 48 of proposed Form N-CEN.

[515] Item 49 of proposed Form N-CEN.

[516] Items 77.G and 102.F of Form N-SAR.

[517] Item 48 of proposed Form N-CEN would require, with respect to any default on long-term debt, the nature of the default, the date of the default, the amount of the default per $1000 face amount, and the total amount of default. An instruction to this item would define "long-term debt" to mean a debt with a period of time from date of initial issuance to maturity of one year or greater. Item 49 of proposed Form N-CEN would require, with respect to any dividends in arrears, the title of the issue and the amount per share in arrears. This item would define "dividends in arrears" to mean dividends that have not been declared by the board of directors or other governing body of the fund at the end of each relevant dividend period set forth in the constituent instruments establishing the rights of the stockholders.

[518] Items 77.I and 102.H of Form N-SAR.

[519] Item 50 of proposed Form N-CEN.

in Part G of Form N-CEN with a more detailed description of the modification.[520] This item provides the Commission with information on and copies of documents reflecting changes to shareholders' rights.

Part G of proposed Form N-CEN would also require closed-end funds or SBICs to file attachments regarding material amendments to organizational documents,[521] new or amended investment advisory contracts,[522] information called for by Item 405 of Regulation S-K,[523] and, for SBICs only, senior officer codes of ethics.[524] Where possible, we sought to eliminate the need to file attachments with the census reporting form in order to simplify the filing process and maximize the amount of information we receive in a data tagged format. However, the attachments proposed to be required with reports on Form N-CEN, provide us with information that is not otherwise updated or filed with the Commission and, thus, we believe they should continue to be filed in attachment form. All of the attachments in proposed Form N-CEN that are specific to closed-end funds and SBICs are also currently required by Form N-SAR.[525]

Similar to Form N-SAR, we are proposing to require other census-type information relating to management fees and net operating expenses. Closed-end funds

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520 Item 79.b.ii of proposed Form N-CEN.

521 Item 79.b.i of proposed Form N-CEN.

522 Item 79.b.iii of proposed Form N-CEN.

523 Item 79.b.iv of proposed Form N-CEN.

524 Item 79.b.v of proposed Form N-CEN. This item applies only to SBICs because other management investment companies, including closed-end funds, provide this information in filings on Form N-CSR. *See* Items 2 and 3 of Form N-CSR; *see also* rule 30d-1 under the Investment Company Act [17 CFR 270.30d-1].

525 *Compare* Item 79.b of proposed Form N-CEN *with* Items 77.Q.1, 77.Q.2, 102.P.1, 102.P.2, and 102.P.3 of Form N-SAR; *see also* Instructions to Specific Items 77Q1(a), 77Q1(e), 77Q2, 102P1(a), 102P1(e), 102P2, and 102P3 of Form N-SAR.

would be required to report the fund's advisory fee as of the end of the reporting period as a percentage of net assets.[526] Additionally, closed-end funds and SBICs would both be required to report the fund's net annual operating expenses as of the end of the reporting period (net of any waivers or reimbursements) as a percentage of net assets.[527] Unlike open-end funds, which provide management fee and net expense information to the Commission in a structured format,[528] such information is not reported to or updated with the Commission in a structured format by closed-end funds or SBICs. This information would allow the Commission to track industry trends relating to fees. Like Form N-SAR, proposed Form N-CEN also would require, for the end of the reporting period, the market price per share[529] and NAV per share[530] of the fund's common stock.

Finally, like Form N-SAR, proposed Form N-CEN would require information regarding an SBIC's investment advisers, transfer agents, and custodians.[531] This information is the same as what would be reported by open-end and closed-end funds in Part C of proposed Form N-CEN, but SBICs would not be required to fill out Part C of the proposed form. As noted above, proposed Form N-CEN, like Form N-SAR, would

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[526] Item 51 of proposed Form N-CEN; *cf.* Items 47-52 and 72.F of Form N-SAR (requesting advisory fee information for management companies, including closed-end funds). Whereas Form N-SAR requests information regarding the advisory fee rate and the dollar amount of gross advisory fees, an instruction to Item 51 of proposed Form N-CEN would explain that the management fee reported should be based on the percentage of amounts incurred during the reporting period.

[527] Item 52 of proposed Form N-CEN; *cf.* Items 72.X and 97.X of Form N-SAR (requesting total expenses in dollars for closed-end funds and SBICs).

[528] Management fee information for open-end funds is currently tagged in XBRL format in the fund's risk return summary and is therefore not required by proposed Form N-CEN. *See* General Instruction C.3.G of Form N-1A.

[529] Item 53 of proposed Form N-CEN; *see* Items 76 and 101 of Form N-SAR

[530] Item 54 of proposed Form N-CEN; *see* Items 74.V.1 and 99.V of Form N-SAR.

[531] Item 55-Item 57 of proposed Form N-CEN.

recognize that SBICs have particular characteristics that warrant questions targeted specifically to them. The majority of questions in Part C of proposed Form N-CEN would be inapplicable to SBICs or otherwise request information that would not be helpful to us in carrying out our regulatory functions with respect to SBICs. Accordingly, we propose to except SBICs from filling out Part C of the form and instead would include certain service provider questions from Part C in Part D of the form as response items for SBICs.

We request comment on the following information requirements relating to closed-end funds and SBICs:

- Are the proposed Form N-CEN items relating to closed-end funds and SBICs appropriate? Are there other information items relating to closed-end funds and SBICs that we should require? If so, what information and why? Are there any items relating to closed-end funds and SBICs in proposed Form N-CEN that should be excluded from the form?
- Is there additional information regarding trading in closed-end fund or SBIC securities that should be requested?
- Is there additional information regarding repurchases that should be requested?
- Should the form provide specific instructions on the calculation of management fees?
- Should net annual operating expenses be defined? Should they include amortization and depreciation expenses?
- Should the management fee for closed-end funds be requested as proposed or should other information such as the absolute amount of fees be requested?

Should we request this information for SBICs? Should the form request information on what the fee is based upon, such as a percentage of income or performance? Should breakpoints used in calculating the management fee be reported at each breakpoint level or should an average management fee be provided? Should the management fee information requested be forward-looking or should it be backward looking, as proposed, providing a management fee based on fees charged during the reporting period and, if so, which NAV (*e.g.*, year-end or average) should be used?

- If a closed-end fund or SBIC pays a performance fee, should the form provide instructions regarding how they should calculate the fees to be disclosed?
- In connection with defaults, is reference to a $1,000 face amount appropriate? Would this requirement appropriately provide meaningful information not only on the amount of principal default but default on interest payments? Should the form also require information on the amount of debt outstanding to provide additional context and information related to the default?
- Regarding dividends in arrears, should the form request per share amounts as proposed or should it request the aggregate amount in arrears?

e. Part E — Exchange-Traded Funds and Exchange-Traded Managed Funds

We are proposing to include a section in Form N-CEN related specifically to ETFs—Part E—which ETFs would complete in addition to Parts A, B, and G, and either Part C (for open-end funds) or Part F (for UITs). For purposes of Form N-CEN, an ETF is a special type of investment company that is registered under the Investment Company Act as either an open-end fund or a UIT. Unlike other open-end funds and UITs, an ETF does not sell or redeem its shares except in large blocks (or "creation units") and with broker-dealers that have contractual arrangements with the ETF (called "authorized participants").[532] However, national securities exchanges list ETF shares for trading, which allows investors to purchase and sell individual shares throughout the day in the secondary market. Thus, ETFs possess characteristics of traditional open-end funds and UITs, which issue redeemable shares, and of closed-end funds, which generally issue shares that trade at negotiated prices on national securities exchanges and that are not redeemable.[533]

Currently, ETFs are subject to the same comprehensive information reporting requirements on Form N-SAR as are other open-end funds or UITs, and they are not required to report additional, more specialized information because Form N-SAR predates the introduction of ETFs to the market and has not been amended to address ETFs' distinct characteristics. In 2009, the Commission amended its registration statement disclosure requirements for ETFs[534] that are open-end funds to better meet the

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[532] For purposes of Form N-CEN, "creation unit" is defined as "a specified number of Exchange-Traded Fund or Exchange-Traded Managed Fund shares that the fund will issue to (or redeem from) an authorized participant in exchange for the deposit (or delivery) of specified securities, cash, and other assets." Instruction 8 to Item 60 of proposed Form N-CEN. For purposes of Form N-CEN, "authorized participant" is defined as "a broker-dealer that is also a member of a clearing agency registered with the Commission, and which has a written agreement with the Exchange-Traded Fund or Exchange-Traded Managed Fund or one of its designated service providers that allows it to place orders to purchase or redeem creation units of the Exchange-Traded Fund or Exchange-Traded Managed Fund." Instruction to Item 59 of proposed Form N-CEN.

[533] *See generally* Actively Managed Exchange-Traded Funds, Investment Company Act Release No. 25258 (Nov. 8, 2001) [66 FR 57614 (Nov. 15, 2001)]; ETF Proposing Release, *supra* note 446.

[534] *See* General Instruction A to Form N-1A (defining "exchange-traded fund").

needs of investors who purchase those ETF shares in secondary market transactions.[535] We believe that it is appropriate—and accordingly propose—to similarly tailor some of the comprehensive information reporting requirements in proposed new Form N-CEN to the special characteristics of ETFs. Funds and UITs meeting the definition of "exchange-traded fund" in Form N-CEN would be required to disclose information pursuant to the items in Part E of the form, as would certain similar investment products known as "exchange-traded managed funds."[536]

Some of the new reporting requirements for ETFs that we are proposing today as part of Form N-CEN relate to an ETF's (or its service provider's) interaction with authorized participants. These entities have an important role to play in the orderly distribution and trading of ETF shares and are significant to the ETF marketplace.[537]

Because of the importance of authorized participants, we are proposing new reporting requirements concerning these entities. Currently, the information we have regarding reliance by ETFs on particular authorized participants is limited, and we believe that collecting information concerning these entities on an annual basis would allow us to understand and better assess the size, capacity, and concentration of the authorized participant framework and also inform the public about certain characteristics of the ETF primary markets. Accordingly, we propose to require each ETF to report

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[535] *See* Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Securities Act Release No. 8998 (Jan. 13, 2009) [74 FR 4546, 4558 (Jan. 26, 2009)].

[536] General Instruction A to proposed Form N-CEN; *see also supra* note 446.

[537] *See* ETF Proposing Release, *supra* note 446, at 14620–21.

identifying information about its authorized participants[538] and the dollar value of the ETF shares the authorized participant purchased and redeemed from the ETF during the reporting period.[539] More specifically, proposed Form N-CEN would require an ETF to report the name of each of its authorized participants (even if the authorized participant did not purchase or redeem any ETF shares during the reporting period),[540] certain other identifying information,[541] the dollar value of the ETF's shares that the authorized participant purchased from the ETF during the reporting period,[542] and the dollar value of the ETF's shares that the authorized participant redeemed during the reporting period.[543] Collection of this additional information may allow the Commission staff to monitor how ETF purchase and redemption activity is distributed across authorized participants and, for example, the extent to which a particular ETF—or ETFs as a group—may be reliant on one or more particular authorized participants.

Other proposed new reporting requirements relate to certain characteristics of ETF creation units—the large blocks of shares that authorized participants may purchase from or redeem to the ETF. In the primary market, ETF shares, bundled in creation units, are sold or redeemed either primarily "in kind"—*i.e.*, in the form of the ETF's constituent portfolio securities—or primarily in cash. When transacting in kind or in cash, the particular authorized participant wishing to purchase (or redeem) shares typically bears,

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538 Item 59.a–Item 59.d of proposed Form N-CEN.

539 Item 59.e–Item 59.f of proposed Form N-CEN.

540 Item 59.a of proposed Form N-CEN.

541 Item 59.b–Item 59.d of proposed Form N-CEN.

542 Item 59.e of proposed Form N-CEN.

543 Item 59.f of proposed Form N-CEN.

in the form of a fixed fee, the transactional costs associated with assembling (or disassembling) creation units. Those costs, therefore, are not mutualized to non-transacting shareholders. When an authorized participant purchases (or redeems) ETF shares all or partly in cash, absent a countervailing effect, the ETF would experience additional costs (*e.g.*, brokerage, taxes) involved with buying the securities with cash or selling portfolio securities to satisfy a cash redemption. Therefore, in order to ensure that the purchasing or redeeming party bears these costs rather than the non-transacting shareholders, the ETF may charge a "variable" fee, so called because it is often computed as a percentage of the value of the creation unit. We understand that such variable fees also can take the form of a dollar amount.

In order to better understand the capital markets implications of different creation unit requirements, primary market transaction methods, and transaction fees, we are proposing to require that ETFs annually report summary information about these characteristics of creation units and primary market transactions. ETFs are not currently required to report the information discussed below in a structured format, and public availability of many of the proposed data items is limited and indeterminable. To better understand the commonality of different transaction methods and the degree to which it varies across ETFs and over time, we propose to require that ETFs report the total value (i) of creation units that were purchased by authorized participants primarily in exchange for portfolio securities on an in-kind basis;[544] (ii) of those that were redeemed primarily on an in-kind basis;[545] (iii) of those purchased by authorized participants primarily in

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[544] Item 60.a of proposed Form N-CEN.

[545] Item 60.c of proposed Form N-CEN.

exchange for cash;[546] and (iv) of those that were redeemed primarily on a cash basis.[547] For purposes of these proposed reporting requirements concerning transaction methods and transaction fees, "primarily" would mean greater than 50% of the value of the creation unit.[548] To better understand the effects of primary market transaction fees on ETF pricing and trading and to better inform the public about such fees, we also propose to require that ETFs report applicable transactional fees—including each of "fixed" and "variable" fees—applicable to the last creation unit purchased and the last creation unit redeemed during the reporting period of which some or all of the creation unit was transacted on a cash basis, as well as the same figures for the last creation unit purchased and the last creation unit redeemed during the reporting period of which some or all of the creation unit was transacted on an in-kind basis.[549]

We also propose to require ETFs to report the number of ETF shares required to form a creation unit as of the last business day of the reporting period,[550] which we believe would also allow the Commission and other data users to better analyze any effects that ETFs' creation unit size requirements may have on ETF pricing and trading. We are proposing that this information be as of the last business day of the reporting period because we understand that these fees sometimes vary over the course of the reporting period, and the fee level information is likely to be most current if provided as of the last business day of the period. In addition to information about authorized

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[546] Item 60.b of proposed Form N-CEN.

[547] Item 60.d of proposed Form N-CEN.

[548] Instruction 9 to Item 60 of proposed Form N-CEN.

[549] Item 60.e–Item 60.h of proposed Form N-CEN.

[550] Item 60 of proposed Form N-CEN.

participants and creation units, we propose to require that ETFs, like closed-end funds, disclose the exchange on which the ETF is listed so that Commission staff may be better able to quickly gather information as to which ETFs may be effected should an idiosyncratic risk or market event arise in connection with a particular exchange.[551]

Finally, with respect to ETFs that are UITs, we ask for information regarding tracking difference and tracking error.[552] This information is requested of open-end index funds in Item 27(b) and, for the same reasons discussed in Part II.E.4.c.i of this release, the proposed form would request this information of ETFs that are UITs.

Taken together, we believe that, in addition to informing the Commission's risk analysis and, potentially, future policymaking concerning ETFs, the information these proposed requirements would yield could also help inform the interested public about the operation of, and possible risks associated with, these funds.

We request comment on the proposed reporting requirements for ETFs and ETMFs:

- Should ETFs be required to report the proposed additional information in Part E of proposed Form N-CEN that other funds would not be required to report?
- Should ETFs that are UITs and ETFs that are open-end funds be subject to the same special reporting requirements, or should the requirements be different from one another? If so, how? Should ETFs and ETMFs be subject to the same special reporting requirements, or should the requirements be different from one another? If so, how and why?

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551 Item 58 of proposed Form N-CEN.

552 Item 61 of proposed Form N-CEN.

- Should the proposed items concerning authorized participants be required? Why or why not? Should we require additional information about authorized participants? For example, should we require funds to report the volume of shares purchased and redeemed in each month of the reporting period by each authorized participant, in order to better understand how primary market transactions are distributed across authorized participants and over the course of the reporting period? Should we require funds to report information on purchases and redemptions by each authorized participant on days when the most primary or secondary market activity is observed, which could be used to better understand how primary market activity responds to periods of unusual activity? Why or why not? If so, what specific information should be required?
- Should the proposed items concerning creation unit characteristics and primary market transactions be required? Why or why not?
- Should the ETFs and ETMFs that are subject to the proposed special reporting requirements be defined as proposed? If not, how should the group be defined? Are there certain entities that are not included in the proposed definitions that should be? Are there certain entities that are included in the proposed definitions that should not be?
- Would the proposed reporting requirements yield beneficial information? If not, what information should the Commission collect instead to conduct appropriate risk monitoring of ETFs? How should this information be collected?
- Would any of the proposed reporting requirements conflict with agreements between private parties, such as ETFs and authorized participants, to keep

information confidential? If so, should the information nonetheless be required to be disclosed?

- How might the proposed reporting requirements concerning ETF primary market transaction fees be used by others outside the Commission, if at all? Are the proposed fee categories (*viz.*, fixed fees and variable fees) appropriate, or would alternative categories be more suitable? If so, what should those categories be?
- How costly would the proposed reporting requirements for ETFs be? In addition to reporting and recordkeeping costs, are there competitive or other costs that should be considered in connection with these proposed requirements?
- Are there other reporting requirements that the Commission should adopt for ETFs? If so, would these additional reporting requirements assist with Commission risk monitoring, inform the public, or both?

f. Part F — Unit Investment Trusts

Part F of Form N-CEN would require information specific to UITs. Like Form N-SAR, proposed Form N-CEN would recognize that UITs have particular characteristics that warrant questions targeted specifically to them.[553] The information requested in Part F would inform us further about the scope and composition of the UIT industry and, thus, would assist us in monitoring the activities of UITs and our examiners in their preparation for exams of UITs. Accordingly, similar to Form N-SAR,[554] proposed Form N-CEN would require certain identifying information relating to a UIT's

[553] *See* Items 111-133 of Form N-SAR (relating specifically to UITs).

[554] *See* Items 111 (depositor information), 112 (sponsor information), 113 (trustee information), and 114 (principal underwriter information) of Form N-SAR.

service providers and entities involved in the formation and governance of UITs, including its depositor,[555] sponsor,[556] trustee,[557] and third party administrator.[558]

Proposed Form N-CEN would also ask whether a UIT is a separate account of an insurance company.[559] Depending on a UIT's response to this item, it would proceed to answer certain additional questions in Part F.[560] While Form N-SAR generally does not differentiate between UITs that are and are not separate accounts of insurance companies, proposed Form N-CEN would make this distinction. We believe that by distinguishing between these different types of UITs, the form will allow us to better target the information requests in the form appropriate to the type of UIT. We also believe this new approach will allow filers to better understand the information being requested of them because it will be more reflective of their operations and should thus improve the consistency of the information reported.

Accordingly, similar to Form N-SAR,[561] a UIT that is not a separate account of an insurance company would provide the number of series existing at the end of the

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[555] Item 62 of proposed Form N-CEN.

[556] Item 65 of proposed Form N-CEN (only applies to UITs that are not insurance company separate accounts).

[557] Item 66 of proposed Form N-CEN (only applies to UITs that are not insurance company separate accounts).

[558] Item 63 of proposed Form N-CEN. Form N-SAR does not request information about a UIT's third-party administrator.

[559] Item 64 of proposed Form N-CEN; *see* Item 117.A of Form N-SAR.

[560] If a UIT answers "yes" to this item, it would proceed to answer Items 73 through 78 of the form. However, if a UIT answers "no" to this item, it would proceed to Items 65 through 72, and 78. *Id.*

[561] *See* Items 118-120 of Form N-SAR (all UITs are required to complete these items).

reporting period that had securities registered under the Securities Act[562] and, for new series, the number of series for which registration statements under the Securities Act became effective during the reporting period[563] and the total value of the portfolio securities on the date of deposit.[564] Proposed Form N-CEN would also carry over from Form N-SAR[565] requirements relating to the number of series with a current prospectus,[566] the number of existing series (and total value) for which additional units were registered under the Securities Act,[567] and the value of units placed in portfolios of subsequent series.[568] Our proposal would also require that a UIT that is not a separate account of an insurance company provide the total assets of all series combined as of the reporting period,[569] which is also currently required by Form N-SAR.[570]

As proposed, Form N-CEN would also require certain new information to be reported by separate accounts offering variable annuity and variable life insurance contracts. Specifically, if the UIT is a separate account of an insurance company, proposed Form N-CEN would require disclosure of its series identification number[571] and, for each security that has a contract identification number assigned pursuant to rule

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562 Item 67 of proposed Form N-CEN.

563 Item 68.a of proposed Form N-CEN.

564 Item 68.b of proposed Form N-CEN.

565 *See* Items 121-124 of Form N-SAR (all UITs are required to complete these items).

566 Item 69 of proposed Form N-CEN.

567 Item 70 of proposed Form N-CEN.

568 Item 71 of proposed Form N-CEN.

569 Item 72 of proposed Form N-CEN.

570 *See* Item 127.L of Form N-SAR (all UITs are required to complete this item). Proposed Form N-CEN would not require UITs to report certain assets held by a UIT as required by Item 127 of Form N-SAR. *See* Items 127.A-K of Form N-SAR.

571 Item 73 of proposed Form N-CEN.

313 of Regulation S-T, the number of individual contracts that are in force at the end of the reporting period.[572]

With respect to insurance company separate accounts, our proposal would also require new identifying and census information for each security issued through the separate account.[573] This requirement would include the name of the security,[574] contract identification number,[575] total assets attributable to the security, [576] number of contracts sold,[577] gross premiums received,[578] and amount of contract value redeemed.[579] This item would also require additional information relating to section 1035 exchanges, including gross premiums received pursuant to section 1035 exchanges,[580] number of contracts affected in connection with such premiums,[581] amount of contract value redeemed pursuant to section 1035 redemptions[582] and the number of contracts affected by such redemptions.[583] In addition, insurance company separate accounts would be required to provide information on whether they relied on rules 6c-7[584] and 11a-2[585]

[572] Item 74 of proposed Form N-CEN.

[573] Item 75 of proposed Form N-CEN.

[574] Item 75.a of proposed Form N-CEN.

[575] Item 75.b of proposed Form N-CEN.

[576] Item 75.c of proposed Form N-CEN.

[577] Item 75.d of proposed Form N-CEN.

[578] Item 75.e of proposed Form N-CEN.

[579] Item 75.h of proposed Form N-CEN.

[580] Item 75.f of proposed Form N-CEN.

[581] Item 75.g of proposed Form N-CEN.

[582] Item 75.i of proposed Form N-CEN.

[583] Item 75.j of proposed Form N-CEN.

[584] Item 76 of proposed Form N-CEN. Rule 6c-7 under the Investment Company Act provides exemptions from certain provisions of sections 22(e) and 27 of the Act for registered separate

under the Investment Company Act. This information, which is specific to UITs that are separate accounts of insurance companies and is either not otherwise filed with the Commission or is not filed in a structured format, will further assist the Commission in its oversight of UITs, including monitoring trends in the variable annuity and variable life insurance markets.

Finally, Form N-CEN would carry over the Form N-SAR[586] requirement that a UIT provide certain information relating to divestments under section 13(c) of the Investment Company Act.[587] Thus, if a UIT intends to avail itself of the safe harbor provided by section 13(c) with respect to its divestment of certain securities, it will continue to make the following disclosures on Form N-CEN: identifying information for the issuer, total number of shares or principal amount divested, date that the securities were divested, and the name of the statute that added the provisions of section 13(c) in

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accounts offering variable annuity contracts to participants in the Texas Optional Retirement Program. *See* 17 CFR 270.6c-7.

[585] Item 77 of proposed Form N-CEN. Rule 11a-2 under the Investment Company Act relates to offers of exchange by certain registered separate accounts or others, the terms of which do not require prior Commission approval. *See* 17 CFR 270.11a-2.

[586] Item 133 of Form N-SAR. Section 13(c) of the Investment Company Act provides a safe harbor for registered investment companies and its employees, officers, directors and investment advisers, based solely upon the investment company divesting from, or avoiding investing in, securities issued by persons that the investment company determines, using credible information that is available to the public, engage in certain investment activities in Iran or Sudan. The safe harbor, however, provides that this limitation on actions does not apply unless the investment company makes disclosures about the divestments in accordance with regulations prescribe by the Commission. *See* 15 U.S.C. 80a-13(c)(2)(B). Management investment companies are required to provide the disclosure on Form N-CSR, pursuant to Item 6(b) of the form, and UITs are required to provide the disclosure on Form N-SAR, pursuant to Item 133 of the form. *See* Technical Amendments to Forms N-CSR and N-SAR in Connection With the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010, Exchange Act Release No. 34-63087 (Oct. 13, 2010) [75 FR 64120 (Oct. 19, 2010)].

[587] Item 78 of proposed Form N-CEN.

accordance with which the securities were divested.[588] If the UIT holds any securities of the issuer on the date of the filing, it would also provide the ticker symbol, CUSIP number, and total number of shares or, for debt securities, the principal amount held on the date of the filing.[589]

We request comment on the following information requirements relating to UITs:

- Is there any additional information regarding series of UITs that should be requested? For example, are there other special UIT account types that should also be included in the form? Is there any information regarding UITs that is included in proposed Form N-CEN that should be excluded from the form?
- Is there any additional information regarding those involved in the formation and governance of the UIT and service providers to the UIT that should be requested? Should the form provide instructions or a definition regarding depositor or sponsor?
- Is there any additional information regarding the number of series that should be requested?
- We request comment on the requirement to provide asset information for the UIT. Is there any other information regarding the series' assets that should be provided? Form N-SAR item 127 contains a detailed list of asset types held by the UIT. The requirement in Form N-CEN is limited to total assets. Should we

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588 Item 78.a of proposed Form N-CEN.

589 Item 78.b of proposed Form N-CEN. An instruction to Item 78 would address when the UIT should report divestments pursuant to this item.

require more granular asset information in Form N-CEN, as we did in Form N-SAR item 127? If so which items should we include?

- We request comment on our items relating specifically to insurance company separate accounts. Should we include items relating solely to insurance company separate accounts? Are there any UIT items that insurance company separate accounts should be subject to that they would not be subject to under our proposal? Is there any other information that we should require for insurance company separate accounts?

g. Part G — Attachments

Like Form N-SAR,[590] we are proposing that Part G of Form N-CEN require some descriptive attachments to the filing in order to provide the staff with more granular information regarding certain key issues.[591] Where possible, we sought to eliminate the need to file attachments with the census reporting form in order to simplify the filing process and maximize the amount of information we receive in a data tagged format.[592] Accordingly, we have attempted to limit the number of attachments to the form to those that are most useful to the staff, either because of investor protection issues or because

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[590] *See* Items 77.E, 77.I, 77.K, 77.L, 77.N, 77.P, 77.Q.1, 77.Q.2, 102.D, 102.H, 102.J, 102.K, 102.M, 102.O, 102.P.1, 102.P.2, and 102.P.3 of Form N-SAR.

[591] Form N-SAR requires only management companies to file attachments to reports on the form, whereas proposed Form N-CEN would require certain attachments for all Registrants.

[592] With respect to certain attachments currently in Form N-SAR, we propose to integrate the data requirements into the form itself, rather than keep the attachment requirements. *See, e.g.,* Items 77.G and 102.F of Form N-SAR; Item 48 and Item 49 of proposed Form N-CEN.. However, not all of the attachments currently required by Form N-SAR lend themselves to integration into the form, either because of the amount of information reported in the attachment or because the attachment is a standalone document (*e.g.,* the accountant's report on internal control).

the information is not available elsewhere. Moreover, all except one of the proposed attachments to Form N-CEN are current requirements in Form N-SAR.[593]

Thus, all funds that would be required to file Form N-CEN would, where applicable, be required to file attachments regarding legal proceedings,[594] provision of financial support,[595] changes in the fund's independent public accountant,[596] independent public accountant's report on internal control,[597] and changes in accounting principles and practices.[598] In addition, all funds would be required, where applicable, to provide attachments relating to information required to be filed pursuant to exemptive orders,[599] and other information required to be included as an attachment pursuant to Commission rules and regulations.[600] Moreover, closed-end funds and SBICs would also be required, where applicable, to provide attachments relating to material amendments to organizational documents,[601] instruments defining the rights of the holders of any new or amended class of securities,[602] new or amended investment advisory contracts,[603]

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593 *But see supra* note 591.

594 Item 79.a.i of proposed Form N-CEN.

595 Item 79.a.ii of proposed Form N-CEN.

596 Item 79.a.iii of proposed Form N-CEN.

597 Item 79.a.iv of proposed Form N-CEN. As noted in Item 79.a.iv, this item would only apply to management companies, other than SBICs.

598 Item 79.a.v of proposed Form N-CEN.

599 Item 79.a.vi of proposed Form N-CEN.

600 Item 79.a.vii of proposed Form N-CEN.

601 Item 79.b.i of proposed Form N-CEN. Unlike open-end funds, closed-end funds and SBICs do not otherwise update or file the information requested by this item with the Commission and, thus, we believe the information should continue to be filed as an attachment to the census reporting form.

602 Item 79.b.ii of proposed Form N-CEN.

information called for by Item 405 of Regulation S-K,[604] and, for SBICs only, senior officer codes of ethics.[605] Each attachment proposed to be required by Form N-CEN includes instructions describing the information that should be provided in the attachment.[606]

As noted earlier, all of the attachments, except one, are currently required by Form N-SAR.[607] The new attachment relates to the provision of financial support and would be filed by a fund if an affiliate, promoter or principal underwriter of the fund, or affiliate of such person, provided financial support to the fund during the reporting period. As discussed in Part II.E.4.b, we are proposing to include this requirement in Form N-CEN because we believe that it is important that the Commission understand the nature and extent that a fund's sponsor provides financial support to a fund.

We request comment on the following information requirements relating to attachments to the Form:

- Should any additional attachments be required to be attached to Form N-CEN? Are any proposed attachments unnecessary and, if so, why? Should any of the attachments requested for all Registrants be limited to only certain Registrants?

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[603] Item 79.b.iii of proposed Form N-CEN. Unlike open-end funds, closed-end funds and SBICs do not otherwise update or file the information requested by this item with the Commission and, thus, we believe the information should continue to be filed as an attachment to the census reporting form.

[604] Item 79.b.iv of proposed Form N-CEN.

[605] Item 79.b.v of proposed Form N-CEN.

[606] For example, the instructions to Item 79.b.v require SBICs to attach detailed information regarding the senior officer code of ethics and certain information regarding the audit committee. The instructions also require SBICs to meet certain requirements regarding the availability of their senior office code of ethics.

[607] *See supra* note 593 and accompanying text.

- Should we require that the information be reported as attachments to the form or in narrative text-boxes embedded in the form?
- Should attachment requirements concerning copies of all constituent instruments defining the rights of the holders of any new class of securities and of any amendments to constituent instruments be limited to closed-end funds and SBICs as proposed? Should such requirements apply to all funds?
- Should the attachments regarding material amendments to organizational documents and new or amended advisory contracts apply only to closed-end funds and SBICs as proposed? Should these requirements apply to all funds? Should the advisory contract requirement apply only to advisory contracts to which the fund is a party or should it include all advisory contracts, including subadvisory contracts?
- Should any of the attachment filing requirements without materiality qualifiers be limited by materiality qualifiers?
- With Form N-CEN, we are proposing to eliminate a number of attachments currently required by items 77 and 102 of Form N-SAR. Are there any attachments to Form N-SAR, that are proposed to be eliminated, that should be included in Form N-CEN? Which attachments and why? Are there any costs associated with eliminating these attachments?

5. Items Required by Form N-SAR That Would be Eliminated by Form N-CEN

As we discussed above, with proposed Form N-CEN, we seek to improve the information that we collect in order to reflect changes in the fund industry since Form N-SAR's adoption in 1985. With that in mind, we are proposing to eliminate certain items from Form N-SAR that we believe are no longer needed by Commission staff or are outdated in their current form. For example, we are proposing not to include Form N-SAR's requirement relating to considerations which affected the participation of brokers or dealers or other entities in commissions or other compensation paid on portfolio transactions.[608]

Form N-CEN would similarly eliminate a number of Form N-SAR items where the information is (or would be, under our proposed reforms) reported elsewhere – for example, items relating to fees and expenses, including front-end and deferred/contingent sales loads, redemption and account maintenance fees, rule 12b-1 fees, and advisory fees.[609] Many of the fee and expense items required by Form N-SAR are already disclosed, in a structured format, in the risk-return summary required by Form N-1A for open-end funds, as well as in an unstructured format in other places in fund registration statements.[610] For other fee and expense items, the information is either not frequently used by Commission staff or we believe that the benefit of having such information is minimal while the burden to funds of reporting such information is costly.[611] For similar

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[608] Item 26 of Form N-SAR. Proposed Form N-CEN does, however, contain information relating to funds that paid commissions to brokers and dealers for research services. *See* Item 43 of proposed Form N-CEN.

[609] *See generally* Items 29-44, 47-52 of Form N-SAR. Proposed Form N-CEN does, however, contain items relating to information regarding expense limitations, reductions, and waivers. *See* Item 32 of proposed Form N-CEN. As discussed above, proposed Form N-CEN would also require information on management fees and net operating expenses for closed-end funds, as that information is not available elsewhere in a structured format. *See* Item 51 and Item 52 of proposed Form N-CEN; *see also supra* Part II.E.4.d.

[610] *See* General Instruction C.3.G of Form N-1A; *see generally* Form N-1A, Form N-2, Form N-4, Form N-5, Form N-6.

[611] We acknowledge that some of the information reported in reports on Form N-SAR related to loads paid to captive or unaffiliated broker-dealers has been used by interested third-parties, including researchers. *See, e.g.,* Susan E. K. Christoffersen, Richard Evans, and David K.

reasons as above, we are also proposing not to require other information in proposed Form N-CEN, including information relating to adjustments to shares outstanding by stock split or stock dividend, minimum initial investments, investment practices, portfolio turnover, number of shares outstanding, number of shareholder accounts, average net assets, and certain other condensed balance sheet data items.[612]

We are also proposing to eliminate certain information requirements specifically relating to SBICs and UITs that we no longer believe are necessary to collect on a census form because, much like the items discussed above, the benefit of having such information is minimal to the Commission's oversight and examination functions while the burdens to these funds of reporting such information is costly.[613] Additionally, with respect to the Form N-SAR[614] item relating to closed-end fund monthly sales and repurchases of shares, this information would be reported on proposed Form N-PORT,[615] rather than proposed Form N-CEN.

The full list of items from Form N-SAR that would be included in Form N-CEN, as proposed, or would be eliminated is listed in Figure 2 below.

Musto, 2013. *What do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives*. The Journal of Finance, Vol. 68(1), 201-235 (2013). While this is evidence of a discrete instance where such information has been useful to a third party, based on staff experience with this information and Form N-SAR information generally, we believe that no longer requiring funds to gather and report this information appropriately balances the burden on funds of providing this information and the overall utility of the information to the Commission, investors and third parties. As noted below, we request comment generally on whether any information items not currently being proposed to be carried over from Form N-SAR should be included on Form N-CEN.

612 *See generally* Items 57, 61, and 70-75 of Form N-SAR.

613 *See* Items 86, 93, 95, 97-100, 103-104, 109, 125-132 of Form N-SAR.

614 *See* Item 86 (closed-end funds) of Form N-SAR; *see also* Item 28 (management investment companies generally) of Form N-SAR.

615 *See* Item B.6 of proposed Form N-PORT.

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
1	Registrant information	✓			
2	Registrant address	✓			
3	First filing	✓			
4	Final filing	✓			
5	SBIC identification	✓			
6	UIT information	✓			
7	Series or multiple portfolio company		✓		
	ALL MANAGEMENT INVESTMENT COMPANIES EXCEPT SBICS				
8	Investment adviser	✓			
10**	Administrator	✓			
11	Principal underwriter	✓			
12	Shareholder servicing agent	✓			
13	Independent public accountant	✓			
14	Broker or dealer which is an affiliated person	✓			
15	Custodian arrangements	✓			
18**	Central depository or book-entry system		✓		
19	Family of investment companies		✓		
20	Brokerage commissions paid on portfolio transactions		✓		

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
21	Aggregate brokerage commissions	✓			
22	Portfolio transactions with entities acting as principal		✓		
23	Aggregate principal purchase/sale transactions		✓		
24	Holding of securities of registrant's regular brokers or dealers			✓	
25	Holding of securities of registrant's regular brokers or dealers			✓	
26	Considerations affecting participation of brokers or dealers				✓
27	Open-end investment company	✓			
28	Monthly sales and repurchases of registrant's/serie s' shares			✓	
29	Registrant/series imposing a front-end sales load			✓	
30	Total front-end sales load collected by underwriters and sales load rates				✓

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
31	Net sales loads retained and paid out by underwriters				✓
32	Net amount paid to unaffiliated dealers				✓
33	Net amount paid to retail sales force				✓
34	Deferred or contingent deferred sales loads			✓	
35	Deferred or contingent deferred sales loads collected				✓
36	Deferred or contingent deferred sales loads retained				✓
37	Redemption fees			✓	
38	Redemption fees collected				✓
39	Account maintenance fees			✓	
40	Registrant/series using its assets directly to make payments under a 12b-1 plan			✓	
41	Direct use of assets under 12b-1 plan			✓	
42	Percentage of payments under the 12b-1 plan			✓	
43	Payments under the 12b-1 plan			✓	

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
44	Unreimbursed payments under the 12b-1 plan				✓
45	Advisory contract		✓		
46	More than one investment adviser		✓		
47	Advisory fee based on percentage of assets			✓	
48	Contractual advisory fee rate			✓	
49	Advisory fee based on percentage of income			✓	
50	Advisory fee based on percentage of income and assets			✓	
51	Performance based advisory fee			✓	
52	Advisory fee based on assets, income or performance			✓	
53	Expense limitations or reductions		✓		
54	Services supplied by investment advisers or administrators				✓
55	Overdrafts and bank loans				✓
56	Advisory clients			✓	
57	Stock splits or stock dividends				✓
58	Fund classifications		✓		

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
59	Management investment company		✓		
60	Diversified investment company		✓		
61	Minimum required investment			✓	
62	Percentage of portfolio in various debt securities			✓	
63	Dollar weighted average maturity			✓	
64	Insured or guaranteed securities				✓
65	Insured or guaranteed securities attributed to value used in computing NAV				✓
66	Classification of funds investing in equity securities			✓	
67	Registrant/series investing primarily and regularly in a balanced portfolio of debt and equity securities			✓	
68	Investments in issuers engaged in production or distribution of precious metals or located outside the United States			✓	
69	Registrant/series as an index fund	✓			

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
70	Investment policies and practices			✓	
71	Portfolio purchases, sales, monthly average value, and turnover rate			✓	
72	Income and expenses			✓	
73	Dividends and distributions			✓	
74	Assets, liabilities, net assets			✓	
75	Computation of average net assets			✓	
76	Market price per share for closed-end investment companies	✓			
77	Attachments		✓		
78	Wholly-owned subsidiaries consolidated in report			✓	
79	"811" numbers for wholly-owned investment company subsidiaries consolidated in report				✓
80	Fidelity bonds in effect			✓	
81	Joint fidelity bond			✓	
82	Fidelity bond deductible			✓	
83	Fidelity bond claims	✓			
84	Losses that could have been filed as a claim under the fidelity bond				✓

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
85	Errors and omissions insurance policy	✓			
CLOSED-END MANAGEMENT INVESTMENT COMPANIES EXCEPT SBICs					
86	Sales, repurchases, and redemptions of securities		✓		
87	Securities of registrant registered on a national securities exchange or listed on NASDAQ		✓		
88	Senior securities		✓		
SBICs					
89	Investment adviser		✓		
90	Transfer agent	✓			
91	Independent public accountant	✓			
92	Custodian arrangements		✓		
93	Advisory clients other than investment companies			✓	
94	Family of investment companies		✓		
95	Sales, repurchases, and redemptions of securities		✓		

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
96	Securities of registrant registered on a national securities exchange or listed on NASDAQ		✓		
97	Income and expenses				✓
98	Dividends and distributions				✓
99	Assets, liabilities and shareholders' equity				✓
100	Computation of average net assets				✓
101	Market price per share	✓			
102	Attachments		✓		
103	Wholly-owned subsidiaries consolidated in report				✓
104	"811" numbers for wholly-owned investment company subsidiaries consolidated in report				✓
105	Fidelity bonds in effect			✓	
106	Joint fidelity bond			✓	
107	Fidelity bond deductible			✓	
108	Fidelity bond claims		✓		

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
109	Losses that could have been filed as a claim under the fidelity bond				✓
110	Errors and omissions insurance policy	✓			
			UITs		
111	Depositor	✓			
112	Sponsor		✓		
113	Trustee		✓		
114	Principal underwriter	✓			
115	Independent public accountant	✓			
116	Family of investment companies		✓		
117	Separate account of an insurance company		✓		
118	Series having effective registration statements	✓			
119	New series having effective registration statements	✓			
120	Value of new series that became effective	✓			
121	Series for which a current prospectus existed at the end of the period	✓			

INCLUSION OF FORM N-SAR DATA ITEMS IN PROPOSED FORM N-CEN

FORM N-SAR ITEM NO.	DESCRIPTION	INCLUDED WITHOUT CHANGE	INCLUDED BUT MODIFIED	SIMILAR DATA WOULD BE AVAILABLE THROUGH OTHER SOURCES*	NO LONGER REQUIRED TO BE REPORTED BY ALL FUNDS
122	New units of existing series	✓			
123	Value of new securities deposited in existing series	✓			
124	Value of units of prior series placed in portfolio of subsequent series	✓			
125	Amount of sales loads collected				✓
126	Amount of sales loads collected from secondary market operations				✓
127	Classification of series and assets			✓	
128	Insured or guaranteed securities				✓
129	Insured or guaranteed securities				✓
130	Insured or guaranteed securities				✓
131	Total expenses			✓	
132	811 number of series included in filing			✓	
133	Divestment of securities	✓			

* While not available in proposed Form N-CEN, similar data is or would be available through other sources, such as proposed Form N-PORT or a fund's prospectus, statement of additional information, or financial statements.

** Items 9, 16, and 17 are reserved in Form N-SAR.

Figure 2

We request comment on the information requirements relating to items required in Form N-SAR, but not required in proposed Form N-CEN, including the following:

- Should proposed Form N-CEN require more detailed information relating to the fund's 12b-1 plan, as required by items 40 through 44 of Form N-SAR, considering detailed information regarding the fund's 12b-1 plan is otherwise disclosed in response to other reporting requirements?
- Should proposed Form N-CEN include financial information or balance sheet items, such as those required by item 72 of Form N-SAR?
- Despite the fact that certain items relating to fee information are required by other forms, should we include fee information in proposed Form N-CEN? If so, what specific information and why?
- Should proposed Form N-CEN include information relating to number of shares outstanding, total number of shareholder accounts, or average net assets during the reporting period as required by Items 74.U.1, 74.X, and 75 of Form N-SAR?
- Are there any other items currently in Form N-SAR that are proposed to be eliminated, which should be included in Form N-CEN? Which items and why? Are there any costs associated with eliminating these items?

F. Technical and Conforming Amendments

We are also proposing technical and conforming amendments to various rules and forms. As discussed above, our proposal would rescind Form N-Q and create new Form N-PORT. In order to implement this proposed change, we propose to revise Forms N-1A, N-2, and N-3 to refer to the availability of portfolio holdings schedules attached to reports on Form N-PORT and posted on fund websites rather than on reports on Form N-

Q.[616] In addition, we propose to rescind 17 CFR 249.332 and revise the following rules to remove references to Form N-Q: 17 CFR 232.401, 17 CFR 270.8b-33, 17 CFR 270.30a-2, 17 CFR 270.30a-3, and 17 CFR 270.30d-1.

Our proposal would also rescind Form N-SAR and replace it with new Form N-CEN. In order to implement this proposed change, we propose to revise the following rules and sections to remove references to Form N-SAR and replace them with references to Form N-CEN: 17 CFR 232.301, 17 CFR 240.10A-1, 17 CFR 240.12b-25, 17 CFR 249.322, 17 CFR 249.330, 17 CFR 270.8b-16, 270.30d-1, and 17 CFR 274.101.[617]

Currently, reports on Form N-SAR are filed semi-annually by management investment companies as required by 17 CFR 270.30b1-1, and annually by UITs as required by 17 CFR 270.30a-1. Because our proposal would require reports on Form N-CEN to be filed annually by all registered investment companies, we propose to rescind 17 CFR 270.30b1-1 and revise 17 CFR 270.30a-1 to require all registered investment companies to file reports on Form N-CEN. We also propose to revise the following rules to remove references to 17 CFR 270.30b1-1 and add references to proposed rule 17 CFR 270.30a-1: 17 CFR 240.13a-10, 17 CFR 240.13a-11, 17 CFR 240.13a-13, 17 CFR 240.13a-16, 17 CFR 240.15d-10, 17 CFR 240.15d-11, 17 CFR 240.15d-13, and 17 CFR 240.15d-16.

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616 *See* Form N-1A, Item 16(f), Instruction 3(b) (we would remove references to Form N-Q) and Item 27(d)(3) (we would replace references to portfolio schedules reported on Form N-Q with references to portfolio schedules attached to reports on Form N-PORT or posted on fund websites); Form N-2, Item 24, Instruction 6.b (same); Form N-3, Instruction 6(ii) to Item 28(a) (same).

617 Although we are proposing to delete references to Form N-SAR in 17 CFR 232.301, we are not proposing to replace them with references to Form N-CEN because the references in that section relate to specific portions of the EDGAR Filer Manual that would not be relevant to Form N-CEN.

In addition, as a result of the proposed new annual reporting requirement that would apply to all registered investment companies, we propose to rescind 17 CFR 270.30b1-2—which currently permits wholly-owned management investment company subsidiaries of management investment companies to not file Form N-SAR under certain circumstances—and propose new rule 17 CFR 270.30a-4—which would permit wholly-owned management investment company subsidiaries of management investment companies to not file Form N-CEN under those same circumstances. We also propose to amend 17 CFR 200.800 to display control numbers assigned to information collection requirements for Forms N-PORT and N-CEN by the Office of Management and Budget pursuant to the Paperwork Reduction Act. As discussed further below, an agency may not conduct or sponsor, and a person is not required to respond to a collection of information unless it displays a currently valid OMB control number.[618]

Our proposed amendments to Regulation S-X would, among other things, require management investment companies to report new schedules for certain derivatives holdings.[619] To implement these changes, we propose to renumber the sections for schedules required to be reported by management investment companies and renumber the list of schedules provided in 17 CFR 210.6-10, which outlines the schedules to be reported by investment companies.[620] We propose conforming changes to references to

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[618] *See infra* Part V.

[619] Our proposal would require new schedules to be filed to report open futures contracts, open forward foreign currency contracts, and open swap contracts. *See* proposed new rules 12-13A, B, and C of Regulation S-X.

[620] Among other things, our proposed amendments would renumber the CFR sections for open option contracts and the summary schedule of investments in unaffiliated issuers from 17 CFR 210.12-12B and 17 CFR 210.12-12C to 17 CFR 210.12-13 and 17 CFR 210.12-B, respectively. These amendments would group the schedule for open option contracts written

Regulation S-X in the following forms: Form N-1A, Form N-2, Form N-3, and Form N-14.[621]

We also propose to amend Form N-CSR to delete instructions addressing how certifications as to changes in the registrant's internal control over financial reporting should be handled during the transition period when certifications were being implemented on Form N-Q, because those instructions are no longer applicable.[622]

We also propose to remove paragraph (a) of 17 CFR 232.105, which currently requires electronic filers to submit Forms N-SAR and 13F in ASCII, and redesignate paragraphs (b) and (c) as (a) and (b), respectively. Our proposal would rescind Form N-SAR, and Form 13F has been submitted by electronic filers in XML, rather than ASCII, since 2013.[623]

We request comment on these technical and conforming amendments.

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together with the new schedules for open futures contracts, open forward foreign currency contracts, and open swap contracts, and would list the summary schedule sequentially after the investments in securities of unaffiliated issuers. We would also amend 17 CFR 210.6-10 to, among other things, add new schedules V, VI, and VII for open futures contracts, open forward foreign currency contracts, and open swap contracts, respectively, and renumber schedule II for investments other than securities and schedule VI for summary of investments in securities of unaffiliated issuers as schedules VIII and IX, respectively. *See* proposed rule 6-10 of Regulation S-X (listing the schedules required to be filed by management investment companies, UITs, and face-amount certificate companies).

[621] *See* Form N-1A, Item 27(b)(1) (reference to Schedule VI would be changed to Schedule IX and reference to schedule I would be corrected to cite to the appropriate CFR section); Form N-2, Instruction 7 to Item 24 (we would update references to schedule VI); Form N-3, Instruction 7(i) and (ii) to Item 28(a) (we would update references to schedule VI).

[622] Form N-CSR, Item 12 (the instruction to paragraph (a)(2) of that item would be removed).

[623] *See* Notice to EDGAR Form13 Filers, *available at* http://www.sec.gov/divisions/investment/imannouncements/notice-form-13f-im.htm (requiring funds to file Form 13F according to EDGAR XML Technical Specifications beginning on April 29, 2013).

G. Compliance Dates

Currently, we anticipate the following compliance dates for our proposed amendments, as set forth below.

1. Form N-PORT, Rescission of Form N-Q, and Amendments to the Certification Requirements of Form N-CSR

Given the nature and frequency of filings on proposed Form N-PORT, if Form N-PORT is adopted, the Commission expects to provide for a tiered set of compliance dates based on asset size. Specifically, for larger entities—namely, funds that together with other investment companies in the same "group of related investment companies"[624] have net assets of $1 billion or more as of the end of the most recent fiscal year—we are proposing a compliance date of 18 months after the effective date to comply with the new reporting requirements. For these larger entities, we expect that eighteen months would provide an adequate period of time for funds, intermediaries, and other service providers to conduct the requisite operational changes to their systems and to establish internal processes to prepare, validate, and file reports on proposed new Form N-PORT with the Commission.[625]

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[624] For these purposes, we expect that the threshold would be based on the definition of "group of related investment companies," as such term is defined in rule 0-10 under the Investment Company Act. Rule 0-10 defines the term as "two or more management companies (including series thereof) that: (i) Hold themselves out to investors as related companies for purposes of investment and investor services; and (ii) Either: (A) Have a common investment adviser or have investment advisers that are affiliated persons of each other; or (B) Have a common administrator; and (2) In the case of a unit investment trust, the term group of related investment companies shall mean two or more unit investment trusts (including series thereof) that have a common sponsor." We believe that this broad definition would encompass most types of fund complexes and therefore is an appropriate definition for compliance date purposes.

[625] We believe that an eighteen month compliance period for larger groups of investment companies is an adequate amount of time for funds to implement proposed new Form N-PORT and make the necessary system and operational changes. We adopted a nine month

For smaller entities (*i.e.*, funds that together with other investment companies in the same "group of related investment companies" have net assets of less than $1 billion as of the end of the most recent fiscal year),[626] we are proposing to provide for an extra 12 months (or 30 months after the effective date) to comply with the new reporting requirements. We believe that smaller groups would benefit from this extra time to comply with the filing requirements for Form N-PORT and would potentially benefit from the lessons learned by larger investment companies and groups of investment companies during the adoption period for Form N-PORT.[627]

2. Form N-CEN and Rescission of Form N-SAR

If Form N-CEN and the related proposals are adopted, we are proposing a compliance date of 18 months after the effective date to comply with the new reporting requirements. We expect that eighteen months would provide an adequate period of time for funds, intermediaries, and other service providers to conduct the requisite operational changes to their systems and to establish internal processes to prepare, validate, and file reports on proposed Form N-CEN with the Commission. We are proposing the same

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compliance periods when we first required money market funds to report their portfolio holdings to the Commission on a monthly basis on Form N-MFP. Based upon our Form N-MFP compliance experience, and the larger number of non-money market fund filers, we believe that doubling the Form N-MFP compliance period to eighteen months for filing reports on Forms N-PORT is appropriate. *See* Money Market Fund Reform 2010 Release, *supra* note 13, at 10087.

626 Based on staff analysis of data obtained from Morningstar Direct, as of March 31, 2015, we estimate that a $1 billion assets threshold would provide an extended compliance period to more than 66% of the fund groups, but only 0.6% of all fund assets. We therefore believe that the $1 billion threshold would appropriately balance the need to provide smaller groups of investment companies with more time to prepare for the initial filing of reports on Form N-PORT, while still including the vast majority of fund assets in the initial compliance period.

627 We likewise intend to rescind Form N-Q (referenced in 17 CFR 274.130) and the amendments to the certification requirements of Form N-CSR (referenced in 17 CFR 274.128) with a timing that is consistent with this proposal.

compliance date for the related amendments to other rules and forms we are proposing today.[628]

Unlike Form N-PORT, we do not expect to provide for a tiered compliance date based on asset size. We believe that it is less likely that smaller fund complexes would need additional time to comply with the requirements to file Form N-CEN because the requirements are similar to the current requirements to file Form N-SAR, and we expect that filers will prefer the updated, more efficient filing format of Form N-CEN. We are therefore proposing to require all funds, regardless of size, to file reports on Form N-CEN with the same compliance period.

3. Option for Website Transmission of Shareholder Reports

Proposed rule 30e-3, if adopted, would permit (but not require) a fund to satisfy requirements under the Act and rules thereunder to transmit reports to shareholders if the fund makes the reports and certain other materials accessible on its website. As reliance on the rule would be optional, we believe a compliance period would not be necessary. Therefore, we expect that funds would be able to rely on the rule immediately after the effective date.

4. Regulation S-X and Related Amendments

As discussed above, our proposed amendments to Regulation S-X are largely consistent with existing fund disclosure practices. As such, we do not expect that fund, intermediaries, or service providers would require significant amounts of time to modify systems or establish internal processes to prepare financial statements in accordance with

[628] We similarly intend to rescind Form N-SAR (referenced in 17 CFR 274.101) with a timing that is consistent with this proposal.

our proposed amendments to Regulation S-X. Accordingly, we are proposing a compliance date for our proposed amendments to Regulation S-X of eight months after the effective date. We expect the same compliance date would apply to conforming amendments related to our proposed amendments to Regulation S-X, including the related amendment we are proposing today.

5. Request for Comment

We request comment on the compliance dates discussed above.

- How, if at all, should the proposed compliance dates be modified? What factors should we consider when setting the compliance dates for the proposed rules and forms?
- We request comment on our proposed tiered compliance dates for filings on Form N-PORT. Is a threshold of $1 billion based on the net assets of funds together with other investment companies in the same "group of related investment companies" as of the end of the most recent fiscal year appropriate? Should the threshold be higher or lower?[629] Should the threshold include aggregation of net assets with other investment companies in the same "group of related investment companies?" Why or why not? In lieu of "group of related investment companies," should aggregation be based on a different set of related companies? For example, should aggregate assets be based on "family of investment companies," as such term defined in instruction 1(a) to Item 17 of Form N-1A or

[629] Based on staff analysis of data obtained from Morningstar Direct, as of March 31, 2015, we estimate that a threshold of $100 million would include 38% of fund firms and 0.1% of all fund assets. A threshold of less than $3 billion would include 76.9% of fund firms and 1.5% of fund assets.

"fund complex" as defined in instruction 1(b) to Item 17 of Form N-1A? Should we require administrator-sponsored funds to aggregate assets for purposes of this threshold regardless of whether the individual funds (or series thereof) do not hold themselves out to investors as related companies for purposes of investment and investor services? Why or why not?

- With respect to Form N-PORT, is our compliance date of eighteen months for larger filers appropriate? If not, what length of time would be appropriate for compliance with Form N-PORT? Would a shorter or longer compliance date be appropriate? For example, would a compliance date of 15 months be sufficient? Conversely, would funds need more time to comply, such as 20 months? Is our 12 month extension of the compliance period for smaller entities appropriate? If not, what length of time would be appropriate for compliance with Form N-PORT? Would a shorter or longer extension, such as 9 months or 15 months, be appropriate? How do we appropriately consider the benefits and costs to receiving the information more quickly and the potential costs and benefits associated with a shorter or longer compliance period?
- Should the Commission consider the implementation of reporting on Form N-PORT initially through a voluntary pilot program? If so, what length of time would be needed for funds and their service providers to appropriately test their reporting procedures?
- Is our eighteen-month compliance period for Form N-CEN appropriate? If not, what length of time would be appropriate? Would a shorter or longer compliance date be appropriate? For example, would a compliance date of 15 months be

sufficient? Conversely, would funds need more time to comply, such as 20 months? Should the compliance period for Form N-CEN mirror that for Form N-PORT, or should we consider different compliance periods? Should we adopt a tiered compliance period for Form N-CEN? Why or why not?

- We are proposing to not have a compliance period for the option for website transmission of shareholder reports under proposed rule 30e-3. Is this appropriate?
- Is our eight-month compliance period for our proposed amendments to Regulation S-X adequate? If not, what length of time would be adequate and why?

III. GENERAL REQUEST FOR COMMENT

We request and encourage any interested person to submit comments regarding the proposed rules and forms, specific issues discussed in this release, and other matters that may have an effect on the proposed rules and forms. With regard to any comments, we note that such comments are of particular assistance to our rulemaking initiative if accompanied by supporting data and analysis of the issues addressed in those comments.

IV. ECONOMIC ANALYSIS

A. Introduction

The Commission is sensitive to the economic effects, including the benefits and costs and the effects on efficiency, competition, and capital formation that will result from the proposed changes to the current reporting regime. Changes to the current reporting regime include proposed Form N-PORT, the rescission of Form N-Q, amendments to the certification requirements for Form N-CSR, amendments to Regulation S-X, the proposed rule governing electronic transmission of shareholder reports, proposed Form N-CEN, and the rescission of Form N-SAR. The economic effects of the proposed changes are discussed below.

The Commission is proposing to modernize the content and format requirements of reports and disclosures by funds, and the manner in which information is filed with the Commission and disclosed to the public. The intent of the proposal is to enhance the Commission's ability to effectively oversee and monitor the activities of investment companies in order to better carry out its regulatory functions and to aid investors and other market participants to better assess the benefits, costs, and risks of investing in different fund products. In summary, and as discussed in greater detail in Part II above, the Commission is proposing the following changes to its rules and forms:

- We propose to require registered management investment companies and ETFs organized as UITs, other than money market funds or SBICs, to report monthly portfolio information in a structured data format on a proposed new form, Form N-PORT.
- Because we believe that monthly portfolio reports on Form N-PORT would render quarterly portfolio reports on current Form N-Q unnecessarily duplicative, we are proposing to rescind Form N-Q. We also propose to lengthen the look-back for Sarbanes-Oxley certifications on Form N-CSR to six months to cover the gap in certification coverage that would otherwise occur once Form N-Q is rescinded.
- We propose to revise Regulation S-X to require new, standardized enhanced disclosures regarding fund holdings in certain derivatives instruments; update the

disclosures for other investments; and amend the rules regarding the general form and content of fund financial statements.

- We propose new rule 30e-3 under the Investment Company Act, which would allow funds to satisfy shareholder report transmission requirements by posting such reports on their own websites if they meet certain conditions, including posting quarterly portfolio holdings on their websites and notifying investors of its availability.
- We propose to rescind Form N-SAR, the form on which funds currently report census-type information on a semi-annual basis, and replace it with Form N-CEN, which would require the annual reporting of similar and additional information in an updated, structured format.

The current disclosure of information by funds serves as the baseline against which the costs and benefits as well as the impact on efficiency, competition, and capital formation of this proposal are discussed. The baseline includes the current set of requirements for funds to file reports on Forms N-CSR, N-Q, and N-SAR with the Commission and the content of such reports, including Regulation S-X, and in particular, its schedule of investments. The baseline also includes guidance from Commission staff and other industry groups that has established industry practices for the disclosure of a fund's schedule of investments and financial statements, and includes Commission guidance that permits funds to transmit these materials electronically today provided that certain other conditions are met. Lastly, the baseline includes the current practice of some funds to voluntarily disclose additional information. For example, some funds disclose monthly or quarterly portfolio investment information on their websites or to third-party information providers, and disclose additional information (*e.g.*, particular information on derivative positions) in fund financial statements that is not currently required under Regulation S-X. The parties that would be affected by the proposed amendments are funds that have registered or will register with the Commission; the Commission; and other current and future users of fund information including investors, third-party information providers, and other potential users; and other market participants that could be affected by the change in fund disclosures.

We discuss separately below the economic effects of each part of the proposal: the introduction of Form N-PORT, rescission of Form N-Q, amendments to the certification requirements for Form N-CSR, amendments to Regulation S-X, the electronic transmission of shareholder reports, and the introduction of Form N-CEN and the rescission of Form N-SAR. We identify for each part of the proposal the baseline from which the economic effects will be discussed and the parties most likely to be affected.

As noted above, the assets of registered investment companies exceeded $18 trillion at year-end 2014, having grown from about $4.7 trillion at the end of 1997.[630] In addition, approximately 90 million individuals own mutual funds, representing 53.2 million or 43.3% of U.S. households.[631] Among investment companies, we estimate that, as of December 2014, there were 3,146 investment companies registered with the Commission, of which 1,636 were open-end funds, 780 were closed-end funds (including

[630] *See supra* note 4.

[631] *See id.*

one SBIC), and 727 were UITs.[632] We further estimate that those registered funds included 16,619 series thereof, of which 1,411 were exchange-traded funds, 528 were money market funds, 5,381 were UITs, and 9,299 were other funds.[633] The following table summarizes the entities likely to be affected by the proposed forms, rescissions, and amendments.

AFFECTED PARTIES

		FUNDS			UITS	
		MONEY MARKET FUNDS	SBICs	OTHER FUNDS	ETFs	OTHER UITs
CURRENT	FORM N-SAR	✓	✓	✓	✓	✓
	FORM N-CSR	✓	✓	✓		
	FORM N-Q	✓		✓		
AS PROPOSED	FORM N-PORT			✓	✓	
	FORM N-CEN	✓	✓	✓	✓	✓
	FORM N-CSR	✓	✓	✓		
	FORM N-SAR	RESCINDED				
	FORM N-Q	RESCINDED				

Figure 3

The Commission relies on information included in reports filed by funds to monitor trends, identify risks, inform policy and rulemaking, and assist Commission staff in examination and enforcement efforts of the asset management industry. An essential factor to the Commission's ability to carry out its regulatory functions is regular, timely information about portfolio holdings and general, census information about funds. In

632 Based on data obtained from registrants' filings with the Commission on Form N-SAR.

633 Based on data obtained from the Investment Company Institute. *See* http://www.ici.org/research/stats.

general, this proposal would modernize the fund reporting regime and, among other effects, would result in an increased transparency of fund portfolios and investment practices. The increased transparency would improve the ability of the Commission to fulfill its regulatory functions. These functions include the development of policy and guidance, the staff's review of fund registration statements and disclosures, and the Commission's examination and enforcement programs. The increased transparency would also improve the ability of investors to select funds for investment, and therefore improve their ability to allocate capital across funds and other investments to more closely reflect their investment risk preferences. Increased transparency would also enhance competition among funds to attract investors.

At the outset, the Commission notes that, where possible, it has sought to quantify the costs, benefits, and effects on efficiency, competition, and capital formation expected to result from each part of the proposal and its reasonable alternatives. As discussed in further detail below, in many cases the Commission is unable to quantify the economic effects because it lacks the information necessary to provide a reasonable estimate.

The economic effects of the proposal depend upon a number of factors that we cannot estimate or quantify, such as the extent to which investor protection would increase along with the ability of the Commission to oversee the fund industry; the amount of new information that would become available as a result of requiring such information in regulatory filings (as opposed to information that is provided voluntarily); the increase in the availability of the information to all investors, institutional and individual, as a result of the improved structured format of the information; and the extent to which investors are able to use the information to make more informed investment decisions either through direct use or through third-party service providers. Therefore, much of the discussion below is qualitative in nature although we try to describe where possible the direction of these effects.

B. Form N-PORT, Rescission of Form N-Q, and Amendments to Form N-CSR

a. Introduction and Economic Baseline

Form N-PORT, as proposed, would require registered management investment companies and ETFs organized as UITs, other than money market funds or SBICs, to report portfolio investment information to the Commission on a monthly basis. As discussed, only information reported for the last month of each fiscal quarter would be made available to the public in order to minimize potential costs associated with making the information public, including front-running or reverse engineering of a fund's investment strategies. Reports would be filed in a structured format using XML to allow for easier aggregation and manipulation of the data. As discussed above, we are also proposing to rescind Form N-Q but require that funds attach their complete portfolio holdings to Form N-PORT for the first and third fiscal quarters in accordance to Regulation S-X. We are also proposing to amend the form of certification in Form N-CSR to require each certifying officer to state that he or she has disclosed in the report any change in the registrant's internal control over financial reporting that occurred during the most recent fiscal half-year to fill the gap in certification coverage that would otherwise occur once Form N-Q is rescinded.[634]

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[634] Proposed Item 11(b) of Form N–CSR; proposed paragraph 5(b) of certification exhibit of Item 11(a)(2) of Form N–CSR.

The current set of requirements under which registered management investment companies (other than money market funds and SBICs) and ETFs organized as UITs publicly report their complete portfolio investments to the Commission on a quarterly basis and certain other information on a semi-annual basis,[635] as well as the current practice of some investment companies to voluntarily disclose portfolio investment information either on their websites or to third-party information providers on a more frequent basis, is the baseline from which we will discuss the economic effects of new Form N-PORT.[636] The parties that could be affected by the introduction of Form N-PORT are registered management investment companies (other than money market funds and SBICs) and ETFs organized as UITs, that have registered or will register with the Commission; the Commission; and other current and future users of investment company portfolio investment information including investors, third-party information providers, other interested potential users; and other market participants that could be affected by the change in fund disclosure of portfolio investment information.

Currently, the Commission requires registered management investment companies (other than money market funds and SBICs) to report their complete portfolio investments to the Commission on a quarterly basis.[637] These funds are required to

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[635] Form N-PORT would also require information that is currently being reported on Form N-SAR such as information on fund flows, assets, and liabilities. The current requirement to report this information as part of Form N-SAR is also part of this baseline.

The baseline also includes the current obligation of Form N-Q filers to make certifications regarding (1) the accuracy of the portfolio holdings information reported on that form, and (2) the fund's disclosure controls and procedures and internal control over financial reporting.

[636] Additionally, many funds currently provide additional information concerning derivatives investments, based on industry guidance and practices. *See* discussion *supra* Part II.C.2.

[637] *See* General Instruction A to Form N-CSR; Item 6 of Form N-CSR; General Instruction A to Form N-Q; Quarterly Portfolio Holdings Adopting Release, *supra* note 19.

provide this information in reports on Form N-Q as of the end of the first and third fiscal quarters of each year[638] and in reports on Form N-CSR as of the end of the second and fourth fiscal quarters of each year.[639] Both forms require that the reported schedule of portfolio investments conform to the requirements of Regulation S-X, and the schedule for the close of the fiscal year must be audited (but those schedules for the other three fiscal quarters need not be).[640] These reports are generally required to be filed on the EDGAR system and are made publicly available upon receipt.[641] Reports on Form N-CSR may be filed up to 70 days after the end of the reporting period,[642] and reports on Form N-Q may be filed up to 60 days after the end of the reporting period.

Forms N-CSR and N-Q are required to be filed in HTML or ASCII/SGML format.[643] In order to prepare reports in HTML and ASCII/SGML, reporting persons generally need to reformat information from the way the information is stored for normal business use.[644] The resulting format, when rendered in an end user's web browser, is comprehensible to a human reader, but it is not suitable for automated processing. These formats do not allow the Commission or other interested data users to combine

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638 Item 1 of Form N-Q.

639 Item 6 of Form N-CSR.

640 Instruction to Item 6(a) of Form N-CSR; Item 1 of Form N-Q.

641 *See* rule 101(a)(i) of Regulation S-T [17 CFR 232.101(a)(i)].

642 Form N-CSR must be filed within 10 days after the shareholder report is sent to shareholders, and the shareholder report must be sent within 60 days after the end of the reporting period. Rule 30b2-1(a); rule 30e-1(c).

643 *See* rule 301 of Regulation S-T; EDGAR Filer Manual (Volume II) version 27 (June 2014), at 5-1.

644 In so doing, reporting persons typically strip out incompatible metadata (*i.e.*, syntax that is not part of the HTML or ASCII/SGML specification) that their business systems use to ascribe meaning to the stored data items and to represent the relationships among different data items.

information from more than one report in an automated way to, for example, construct a database of fund portfolio positions without additional formatting.

The economic effects from the introduction of new Form N-PORT would largely result from the disclosure of portfolio investment information in a structured format, as well as the additional information that investment companies would report. The economic effects would depend on the extent to which the portfolios and investment practices of investment companies become more transparent as a result of the increase in the amount and availability of portfolio investment information, and the ability of Commission staff and all investors to utilize the structured data. The current reporting requirements for investment companies, however, reduce the ability of Commission staff to evaluate the potential economic effects. For example, the non-structured format of reported portfolio investment information, the absence of information to identify securities, and reporting inconsistencies between investment companies all reduce the ability of Commission staff to aggregate information across the fund industry and to evaluate the economic effects of the proposal.

The proposal would increase the amount of portfolio investment information available for some investment companies more so than others. For example, investment companies that utilize derivatives as part of their investment strategy, or that otherwise engage in alternative strategies, would have more information become available describing their businesses than other investment companies. Information from Form N-SAR provides some indication as to the current use of derivatives by investment companies. Form N-SAR requires investment companies to identify permitted investment policies, and if permitted, investment policies engaged in during the reporting period. As of the second half of 2014, on average 75.4% of investment companies reported as permitted investment policies involving the writing or investing in options or futures, and on average 5.2% of investment companies reported engaging in each one of these policies during the report period.[645] In addition, the total net assets of alternative funds from which more information would become available were as of year-end 2014 approximately $200 billion or 1.2% of the total net assets of the mutual fund market.[646] Although the percentage of net assets of alternative funds relative to the mutual fund market is currently small, the percentage of flows to alternative funds was 10.2% in 2013 and 4.3% in 2014.[647]

b. Benefits

As discussed, Form N-PORT would improve the information that registered management investment companies and ETFs organized as UITs (other than money market funds and SBICs) disclose to the Commission. The increase in the reporting

645 *See* Item 70 of Form N-SAR for a list of permitted investment policies, and if permitted, the investment policies engaged in during the reporting period. The percentages are calculated from the percentage of funds that report affirmatively to either of the two parts for Items 70.B though 70.I. There is little difference in the proportion of investment companies that reported as permitted the investment practices relating to Items 70.B through 70.I. The greatest proportion of funds reported engaging in writing or investing in stock index futures (13.1%) and engaging in writing or investing in interest rate futures (12.0%), and the smallest proportion of funds reported engaging in writing or investing in other commodity futures (1.7%) and engaging in writing or investing in options on stock index futures (0.9%). Aggregate condensed balance sheet information reported on Form N-SAR indicates that funds held $2.6 billion in options on equities and options on all futures (Items 74.G and 74.H) or 0.013% of net assets from the second half of 2014. Aggregate condensed balance sheet information reported on Form N-SAR from the second half of 2014 also indicates that funds had $55.9 billion in short sales (Item 74.R.(2)) and $4.2 billion in written options (Item 74.R.(3)), or 0.285% and 0.021% of net assets, respectively. The estimates are approximate.

646 *See supra* note 30. These statistics were obtained from staff analysis of Morningstar Direct data, and are based on fund categories as defined by Morningstar.

647 *See id.*

frequency, the update to the structure of the information that reporting funds would disclose, and the additional information not currently disclosed, discussed in further detail below, would improve the ability of the Commission to understand, analyze, and monitor the fund industry. We believe that the information we receive on these reports would facilitate the oversight of funds and would assist the Commission, as the primary regulator of such funds, to better effectuate its mission to protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation, through better informed policy decisions, more specific guidance and comments in the disclosure review process, and more targeted examination and enforcement efforts.

To the extent that monthly portfolio investment information is not currently available, the requirement that all investment companies make available portfolio investment information on a monthly basis to the Commission would improve the ability of the Commission to oversee investment companies by increasing the timeliness of the information available, and by providing a larger number of data points, would increase the ability of Commission staff to identify trends in investment strategies and fund products as well as industry outliers.[648] As discussed above, the quarterly portfolio reports that the Commission currently receives on Forms N-Q and N-CSR could become stale due to the turnover of portfolio securities and fluctuations in the values of the

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648 *See, e.g., supra* text following note 169. Although likely not a significant effect, the increase in the frequency of portfolio investment disclosure to the Commission could also reduce the ability of investment companies to alter or "window-dress" portfolio investments in an attempt to disguise investment strategies and risk profiles that are not consistent with the disclosures in registration statements and shareholder reports. The incentives for managers to window-dress in an attempt to mislead investors would not change because the frequency of public disclosure of portfolio investment information would remain the same. *See, e.g.,* Vikas Agarwal, Gerald D. Gay, and Leng Ling, *Window Dressing in Mutual Funds*, The Review of Financial Studies, Vol. 27(11), 3133-3170 (2014).

portfolio's investments. Requiring monthly reports on Form N-PORT would decrease the delay between fund reports, so that the Commission would have more timely information than it has currently; portfolio investment information that is more timely would improve the ability of Commission staff to identify risks a fund is facing, particularly during times of market stress.

The ability of Commission staff to effectively use the information reported in Form N-PORT is dependent on the ability of staff to compile and aggregate information into a single database that can then be utilized to conduct industry-wide analyses. Otherwise, the information would only improve the ability of staff to analyze a single or a small number of funds at any one time. The structuring of the information in an XML format would improve the ability of the Commission to compile and aggregate information across all funds, and to analyze individual funds, a subset of funds, or the fund industry as a whole, and would increase the overall efficiency of staff to analyze the information. For example, the ability to compare portfolio investment information across reporting funds or for a single fund across report dates would improve the ability of the Commission to identify funds for examination and to identify trends in the fund industry.

The structuring of portfolio investment information may also improve the quality of the information disclosed by imposing constraints on how the information would be provided. A feature of XML is a built-in validation framework that can provide precise constraints as to how the information could be provided. These data checks, which are not available in the current formats for Form N-CSR and Form N-Q, are important to ensure that the reports contain information that is accurate and consistent across filings, and therefore usable by Commission staff. An improved, structured format may also promote additional efficiency among investment companies to the extent that the new reporting requirements encourage an update and integration of systems, and standardized formats for the disclosure and transmission of filings.

Form N-PORT would require information that is not currently required to be reported to the Commission, including portfolio and position level risk-sensitivity measures and additional information describing derivatives, securities lending activities, repurchase and reverse repurchase agreements, the pricing and liquidity of securities, and information regarding fund returns and flows. The information would increase the ability of Commission staff to understand the use of these products and activities as part of a fund's investment strategy, as well as the risks of a particular fund, a group of funds, and the fund industry.

The proposed requirement to report portfolio- and position-level risk sensitivity measures would provide Commission staff with a set of estimates that summarizes the risk exposures of a fund. The risk sensitivity measures improve the ability of Commission staff to efficiently analyze information for all funds and identify those funds not only with specific risk exposures but also risk exposures that appear to be outliers among peer funds. An ability to efficiently identify funds based on exposure to certain risks would improve the Commission's ability to analyze fund industry trends, monitor funds, and, as appropriate, engage in further inquiry or timely outreach in case of a market or other event. Commission staff could also use these measures to determine whether additional guidance or policy measures are appropriate to improve disclosures.

The calculation of portfolio- or position-level measures of risk for some derivatives, including derivatives with unique or complicated payoff structures, sometimes requires time-intensive computational methods or additional information that Form N-PORT would not require. As discussed above, based on staff experience and outreach, we understand that most funds calculate risk measures for such securities. Accordingly, we believe that requiring funds to provide these measures is more efficient than requiring funds to provide all of the information that might be necessary for the Commission, investors, or other potential users to calculate these measures. The requirement for investment companies to provide risk measures for derivatives, at the position-level and at the portfolio-level, would therefore improve the ability of staff to efficiently identify the risk exposures of funds regardless of the types of derivatives held or that could be introduced to the marketplace. In addition, the requirement for investment companies to provide portfolio-level measures of risk would also improve the ability of staff to efficiently identify interest rate and credit spread exposures at the fund level and conduct analyses without first aggregating position-level measures.

Form N-PORT would require funds to provide the contractual terms for debt securities and many of the more common derivatives including options, futures, forwards, and swaps; the reference instrument for all convertible debt securities and derivatives, and information describing the size of the position. The information would provide Commission staff an ability to identify funds with interest rate risk exposure or exposure to other risks such as those pertaining to a company, industry, or region.

As discussed, for securities lending activities and reverse repurchase agreements, Form N-PORT would require counterparty identification information, contractual terms, and information describing the collateral and reinvestment of the collateral. The additional information could improve the ability of Commission staff to assess fund compliance with the conditions that they must meet to engage in securities lending, as well as better analyze the extent to which funds are exposed to the creditworthiness of counterparties, the loss of principal of the reinvested collateral, and leverage creation through the reinvestment of collateral.

Form N-PORT would also require additional identification information regarding the reporting fund, the issuers of fund investments, and the investments themselves, including the reference instruments for convertible debt securities and derivatives investments. The additional identification information would benefit the Commission by improving the ability of staff to link the information from Form N-PORT with information from other sources, such as Form N-CEN, that also identify market participants and investments with these identifiers. The additional identification information would be especially important to identify the issuers of fund investments and the investments themselves. The information would improve the ability of Commission staff, from the current requirement to provide just the issuer name, to identify and compare funds that have exposures to particular investments or issuers regardless of the whether the exposure is direct or indirect such as through a derivative security.

Investors, third-party information providers, and other potential users would also experience benefits from the introduction of Form N-PORT. While the frequency of public disclosure of portfolio information would not change, we believe that the structured format of this information would allow investors and other potential users to more efficiently analyze portfolio information. Investors and other potential users would also have quarterly disclosure of additional information that is currently not included in the schedule of investments reported on Form N-Q and Form N-CSR. The additional information as well as the structure of the information would increase the transparency of funds' investment strategies and improve the ability of investors and other potential users to more efficiently identify the risk exposures of the fund.

Form N-PORT would benefit investors, to the extent that they use the information, to better differentiate investment companies based on their investment strategies and other activities. For example, investors would be able to more efficiently identify funds that use derivatives and the extent to which they use derivatives as part of their investment strategies.[649] In general, we expect that institutional investors and other market participants would directly use the information from Form N-PORT more so than individual investors. As discussed, the format of Form N-PORT is not designed to be human readable and the amount of information could result in reports that are voluminous. The Commission therefore has endeavored to mitigate the potential loss of information to individual investors from the rescission of From N-Q through the additional disclosure requirements for investment companies as part of this proposal, including the requirement for investment companies to attach to Form N-PORT complete portfolio holdings in accordance with Regulation S-X for the first and third fiscal quarters.[650] Individual investors, however, could indirectly benefit from the information in Form N-PORT to the extent that third-party information providers and other interested parties are able to obtain, aggregate, provide, and report on the information. Individual investors could also indirectly benefit from the information in Form N-PORT to the

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[649] Form N-PORT would also eliminate the reporting gap between money market funds, which report portfolio investment information in an XML format on Form N-MFP, and funds engaging in similar investment strategies such as ultra-short bond funds, which would be required to file reports on Form N-PORT.

[650] *See* discussion *supra* Part II.A.2.j.

extent that other entities, including investment advisers and broker-dealers, utilize the information to help investors make more informed investment decisions.

Portfolio investment information that investment companies report to the Commission is informative in describing the ongoing investment strategy of the fund,[651] and investors could use the information to select funds based on security selection, industry focus, level of diversification, and the use of leverage and derivatives.[652] An increase in the ability of investors to differentiate investment companies would allow investors to allocate capital across reporting funds more in line with their risk preferences and increase the competition among funds for investor capital. In addition, by improving the ability of investors to understand the risks of investments and hence their ability to allocate capital across funds and other investments more efficiently, the introduction of Form N-PORT could promote capital formation.

Rescission of Form N-Q, along with its certifications of the accuracy of the portfolio schedules reported for each fund's first and third fiscal quarters, may result in some cost savings by funds in terms of administrative or filing costs. However, we expect any such savings, if any, to be minimal, because under our proposal each fund would still be required to file portfolio schedules prepared in accordance with §§210.12-

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651 Academic research indicates that the portfolio investment information funds provide to the Commission, such as on Form N-CSR and Form N-Q, has value even though the information is publicly available only after a time-lag. *See infra* notes 664-667. Just as investors can use the information to front-run or copycat/reverse engineer the investment strategy of a reporting fund, investors of funds can also use the information to identify funds for investment.

652 Empirical research shows that fund flows are sensitive to many factors including past fund performance and investor search costs. *See, e.g.,* Erik R. Sirri and Peter Tufano, *Costly Search and Mutual Fund Flows*, The Journal of Finance, Vol. 53(5), 1589-1622 (1998); Zoran Ivković and Scott Weisbenner, *Individual Investor Mutual Fund Flows*, Journal of Financial Economics, Vol. 92, 223-237 (2009); George D Cashman, *Convenience in the Mutual Fund Industry*, Journal of Corporate Finance, Vol. 18, 1326-1336 (2012).

12 to 12-14 of Regulation S-X for the fund's first and third fiscal quarters, by attaching those schedules as attachments to its reports on Form N-PORT for those reporting periods.

c. Costs

Form N-PORT, as proposed, would require registered management investment companies and ETFs organized as UITs, other than money market funds or SBICs, to incur one-time and ongoing costs to comply with the new filing requirements. Funds would incur additional ongoing costs to report portfolio investment information on a monthly basis on Form N-PORT instead of a quarterly basis as currently reported on Forms N-Q and N-CSR. Funds that voluntarily provide information to third-party information providers and on its website, including monthly portfolio investments, and additional information in fund financial statements, including additional information regarding derivatives similar to the requirements that we are proposing today, would bear fewer costs as a result of the proposal than those that do not.[653] The Commission is aware that these funds would nonetheless likely incur additional costs on reports on proposed Form N-PORT than on voluntary submissions, such as validation and signoff processes, given that reports on Form N-PORT would be a required regulatory filing and would possibly require different data than the funds are currently providing to third-party

[653] Monthly portfolio investment information is available for approximately 45% of funds covered by The CRSP Survivor-Bias-Free US Mutual Fund Database as of the third quarter of 2014. The database covers more than 9,000 open-ended mutual funds during this time period. This estimate suggests that a large proportion of funds already report monthly portfolio investment information, although it is unclear whether monthly information is reported following each month or if information relating to several months is periodically reported at a later date. Calculated based on data from The CRSP Survivor-Bias-Free US Mutual Fund Database © 2015 Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business.

information providers. Over time, the filings could become highly automated and could involve fewer costs.[654]

Funds would also incur costs to file reports on Form N-PORT in a structured format. Based on staff experience with other XML filings, however, these costs are expected to be minimal given the technology that would be used to structure the data.[655] XML is a widely used data format, and based on the Commission's understanding of current practices, most reporting persons and third party service providers have systems already in place to report schedules of investments and other information. Systems would be able to accommodate an alternative format such as XML without significant costs, and large-scale changes would likely not be necessary to output structured data files. In an effort to reduce some of the potential burdens on smaller entities, we are proposing to extend the compliance period to begin filing reports on Form N-PORT to thirty months after the effective date for groups of funds with assets under $1 billion.[656] The additional time could increase the ability of these investment companies to comply with the filing requirements by providing more time for system and operation changes and from observing larger fund groups.

Form N-PORT would also require the disclosure of certain information that is not currently required by the Commission. In some instances, such as in the case of

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[654] Costs related to such processes are included in the estimate below of the paperwork costs related to Form N-PORT, discussed below.

[655] *See, e.g.,* Form PF Adopting Release, *supra* note 14, at text following n.357 (discussing the costs to advisers to private funds of filing Form PF in XML format); Money Market Fund Reform 2010 Release, *supra* note 13, at nn.341-344 and accompanying text (discussing the costs to money market funds of filing reports on Form N-MFP in XML format).

[656] *See supra* Part II.G.1.

increased disclosures regarding derivatives investments and information concerning the pricing and liquidity of investments, the Commission is proposing to require parallel disclosures in the fund's schedule of investments; accordingly, we expect funds would generally incur one set of costs to adhere to the reporting of new information on Form N-PORT and in its schedule of investments. For other information, such as the reporting of particular asset classifications, identification of investments and reference instruments, and risk measures, the information would be disclosed on Form N-PORT only.

To the extent that our proposal would require information to be reported that is not currently contained in fund accounting or financial reporting systems, funds would bear one-time costs to update systems to adhere to the new filing requirements. The one-time costs would depend on the extent to which investment companies currently report the information required to be disclosed. The one-time costs would also depend on whether an investment company would need to implement new systems, such as to calculate and report risk-sensitivity measures, and to integrate information maintained in separate internal systems or by third parties to comply with the new requirements. Based on staff outreach to funds, we believe that, at a minimum, funds would incur systems or licensing costs to obtain a software solution or to retain a service provider in order to report data on risk metrics, as risk metrics are not required to be reported on the fund financial statements. Our experience with and outreach to funds indicates that the types of systems funds use for warehousing and aggregating data, including data on risk metrics, varies widely.

To the extent possible, we have attempted to quantify these costs. As discussed below, we estimate that funds would incur certain annual paperwork costs associated with preparing, reviewing, and filing reports on Form N-PORT.[657] Assuming that 35% of funds (3,749 funds) would choose to license a software solution to file reports on Form N-PORT, we estimate an upper bound on the initial annual costs to funds choosing this option of $55,970 per fund[658] with annual ongoing costs of $46,745 per fund.[659] We further assume that 65% of funds (6,962 funds) would choose to retain a third-party service provider to provide data aggregation and validation services as part of the preparation and filing of reports on Form N-PORT, and we estimate an upper bound on the initial costs to funds choosing this option of $54,821 per fund[660] with annual ongoing

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657 *See infra* Part V.A.1.

658 *See infra* notes 736-739, 749 and accompanying text. This estimate is based upon the following calculations: $55,970 = $4,805 in external costs + $51,165 in internal costs ($51,165 = 15 hours x $303/hour for a senior programmer) + (39 hours x $312/hour for a senior database administrator) + (30 hours x $266/hour for a financial reporting manager) + (30 hours x $198/hour for a senior accountant) + (30 hours x $157/hour for an intermediate accountant) + (30 hours x $301/hour for a senior portfolio manager) + (24 hours x $283/hour for a compliance manager)). The hourly wage figures in this and subsequent footnotes are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

659 *See infra* notes 740, 749 and accompanying text. This estimate is based upon the following calculations: $46,745 = $4,805 in external costs + $41,940 in internal costs ($41,940 = (30 hours x $266/hour for a financial reporting manager) + (30 hours x $198/hour for a senior accountant) + (30 hours x $157/hour for an intermediate accountant) + (30 hours x $301/hour for a senior portfolio manager) + (24 hours x $283/hour for a compliance manager) + (24 hours x $312/hour for a senior database administrator)).

660 *See infra* notes 743-745, 750 and accompanying text. This estimate is based upon the following calculations: $54,821 = $11,440 in external costs + $43,481 in internal costs ($43,481 = (30 hours x $303/hour for a senior programmer) + (46.5 hours x $312/hour for a senior database administrator) + (16.5 hours x $266/hour for a financial reporting manager) + (16.5 hours x $198/hour for a senior accountant) + (16.5 hours x $157/hour for an intermediate accountant) + (16.5 hours x $301/hour for a senior portfolio manager) + (16.5 hours x $283/hour for a compliance manager)).

costs of $38,746 per fund.[661] In total, we estimate that funds would incur initial annual costs of $515,537,918 and ongoing annual costs of $444,996,657.[662]

Although under the proposal there would be no change to the frequency or time-lag for which investment company security position information is publicly disclosed, the increase in the amount of publicly available information and the greater ability to analyze the information as a result of its structure may facilitate activities such as "front-running," "predatory trading," and "copycatting/reverse engineering of trading strategies" by other investors. For example, Form N-PORT would result in the disclosure of additional information, such as pertaining to derivatives and securities lending activities, which could more clearly reveal the investment strategy of reporting funds and its risk exposures. The structured format of portfolio investments disclosure could also improve the ability of other investors to obtain and aggregate the data, and identify specific funds to front-run or predatory trade. These activities could reduce the profitability from developing new investment strategies, and therefore could reduce innovation and impact competition in the fund industry.

Investors that trade ahead of funds could reduce the profitability of funds by increasing the price of fund purchases and by decreasing the price of fund sales. These activities can reduce the returns to shareholders who invest in actively managed funds,

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661 *See infra* notes 746, 750 and accompanying text. This estimate is based upon the following calculations: $38,746 = $11,440 in external costs + $27,306 in internal costs ($27,306 = (18 hours x $266/hour for a financial reporting manager) + (18 hours x $198/hour for a senior accountant) + (18 hours x $157/hour for an intermediate accountant) + (18 hours x $301/hour for a senior portfolio manager) + (18 hours x $283/hour for a compliance manager) + (18 hours x $312/hour for a senior database administrator)).

662 These estimates are based upon the following calculations: $591,495,332 = (3,749 funds x $55,970 per fund) + (6,962 funds x $54,821 per fund). $444,996,657 = (3,749 funds x $46,745 per fund) + (6,962 funds x $38,746 per fund).

making actively managed funds less attractive investment options.[663] Portfolio investment information, along with flow information, can also create opportunities for other market participants to front-run the sales of funds that experience large outflows and the purchases of funds that experience large inflows,[664] or create opportunities for other market participants to engage in predatory trading that could lead to further fund distress.[665]

A trading strategy that follows the publicly reported holdings of actively managed funds can also earn similar if not higher after expense returns.[666] An implication of this finding is that the public disclosure of portfolio investment information could induce free-riding by investors that use the information and reduce the potential benefit from developing new investment strategies and engaging in proprietary market research. The effect of free-riding would reduce the ability of an investment companies with longer investment horizons to benefit from researching investment opportunities and developing new strategies more so than investment companies with shorter investment horizons because of the increased likelihood that the disclosed portfolio investment information would reveal their long-term investment strategies.[667]

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[663] *See, e.g.,* Potential Effects of More Frequent Disclosure, *supra* note 172.

[664] *See, e.g.,* Joshua Coval and Erik Stafford, *Asset Fire Sales (and Purchases) in Equity Markets*, Journal of Financial Economics, Vol. 86, 479-512 (2007).

[665] *See, e.g.,* Markus K. Brunnermeier and Lasse Heje Pedersen, *Predatory Trading*, The Journal of Finance, Vol. 60(4), 1825-1864 (2005).

[666] *See, e.g.,* Mary Margaret Frank, James M. Poterba, Douglas A. Shackelford, and John B. Shoven, *Copycat Funds: Information Disclosure Regulation and the Returns to Active Management in the Mutual Fund Industry*, The Journal of Law and Economics, Vol. 47(2), 515-541 (2004).

[667] *See, e.g.,* Vikas Agarwal, Kevin Andrew Mullaly, Yuehua Tang, and Baozhong Yang, *Mandatory Portfolio Disclosure, Stock Liquidity, and Mutual Fund Performance*, The Journal

A comparison can be made between the economic effects from the introduction of Form N-PORT and the economic effects from the introduction of Form N-Q in May 2004 which increased the reporting frequency of portfolio investment information to the Commission from semiannual to quarterly. The introduction of Form N-Q resulted in an increase in the amount of information that could have been acted upon by other investors. For example, evidence indicates that the ability of copycat funds to outperform actively managed funds increased after the introduction of Form N-Q,[668] and additional evidence indicates that the performance of those funds with better previous performance or that invest in low-information stocks decreased following the introduction of Form N-Q.[669] The increase in the frequency of portfolio investment information as a result of Form N-Q resulted in an increase in the amount of portfolio investment information available. Although Form N-PORT would not increase the frequency of public disclosure, Form N-PORT would increase the amount of portfolio investment information available. In addition, Form N-PORT, unlike Form N-Q, would also increase the accessibility of the information as a result of its structured format.

We have endeavored to mitigate the potential for front-running, predatory trading, and copycatting/reverse engineering by other market participants by proposing to

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of Finance, ("Agarwal *et al*"), forthcoming (*available at* http://onlinelibrary.wiley.com/doi/10.1111/jofi.12245/pdf); Marno Verbeek and Yu Wang, *Better than the Original? The Relative Success of Copycat Funds*, Journal of Banking and Finance, Vol. 37, 3454-3471 (2013) ("Verbeek and Wang").

668 *See* Verbeek and Wang, *supra* note 667.

669 *See* Agarwal *et al.*, *supra* note 667. Low information stocks include stocks with smaller market capitalization, less liquidity, and less analyst coverage. The authors also find that the liquidity of stocks with higher fund ownership increased following the introduction of Form N-Q. Although the increase in liquidity would benefit investors by reducing trading costs, this benefit stems as a result of the costly disclosure of potential investment opportunities.

maintain the status quo for the frequency and timing of disclosure of publicly available portfolio information. In addition, much, though not all, of the information that Form N-PORT would require, is already disclosed by reporting funds on Form N-CSR and Form N-Q.[670] The additional information and the structure of the information that would be required under Form N-PORT, however, would improve the ability of investors to obtain, aggregate, and analyze all fund investments. Thus, Form N-PORT could negatively affect actively managed funds by increasing the ability of other investors to copycat or front-run investment strategies, and in particular could negatively affect those funds that would have more additional information disclosed, such as funds that use derivatives as part of their investment strategies. The Commission has considered the needs of the Commission, investors, and other users of portfolio investment information and the potential that other investors may use the information to the detriment of the reporting funds.

Form N-PORT would require the disclosure of information that is currently nonpublic that could result in additional costs to funds and market participants. For example, Form N-PORT would require a fund to report the identities and weights of each of the individual components comprising the reference instruments underlying the fund's derivative investments, unless the reference instrument is an index whose components are publicly available on a website and are updated on that website no less frequently than quarterly, or the notional amount of the derivative represents 1% or less of the net asset value of the fund.[671] We understand that many indices used as reference instruments in

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[670] *See supra* note 27 and accompanying text.

[671] *See supra* note 123 and accompanying text.

derivative investments are proprietary to index providers, and are subject to licensing agreements between the index provider and the fund. Disclosing the components of a non-public index could result in costs to both the index provider, whose proprietary indexing strategy could be imitated, and the fund, whose investments could be front-run.[672] Moreover, disclosing the underlying components of such an index could subject the fund to one-time costs associated with renegotiating licensing agreements and the ongoing payment of fees in order to obtain the rights to disclose the components of the index.[673] Additionally, the increased transparency in proprietary indexes could ultimately decrease the incentives of index providers to license the use of such indices to funds as well as fund demand for securities products that incorporate these indices. Likewise, Form N-PORT, as well as the proposed amendments to regulation S-X, would require funds to report certain information regarding fees and financing terms for certain derivatives contracts, particularly OTC swaps, which are not currently required to be publicly disclosed. The increased transparency could increase the competition among swap and security-based swap dealers to offer favorable fees and financing terms, as the fees and financing terms offered to one fund would be known to other funds negotiating the terms of such contracts.

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[672] *See* Antti Petajisto, *The Index Premium and its Hidden Cost for Index Funds*, Journal of Empirical Finance, Vol. 18, 271-288 (2011). Petajisto finds evidence that mechanically induced demand changes to demand, such as index fund rebalancing, can result in price effects. If predictable, then other investors could take advantage of the changes to the proprietary indexes by front-running future trades.

[673] The Commission does not have information available to provide a reliable estimate of the increased costs of such licensing agreements because funds are currently not required to disclose the agreements or the components of the index.

As discussed above, although our proposal would rescind Form N-Q, it would also require funds to file portfolio schedules prepared in accordance with §§210.12-12 to 12-14 of Regulation S-X for the fund's first and third fiscal quarters, by attaching those schedules as attachments to its reports on Form N-PORT for those reporting periods. Although the schedules attached to Form N-PORT would be largely identical to the information currently reported on Form N-Q, under our proposal funds would have 30 days to prepare and file the attachments to Form N-PORT, as opposed to the 60 days that funds currently have to prepare, certify, and file reports on Form N-Q. The faster turnaround time may result in increased costs to funds, but we expect these costs may be mitigated by removing the requirement that funds certify this information.

Rescission of Form N-Q would also eliminate certifications of the accuracy of the portfolio schedules reported for the first and third fiscal quarters, and would also result in funds providing certifications regarding their disclosure controls and procedures and internal control over financial reporting semi-annually rather than quarterly. To the extent that such certifications improve the accuracy of the data reported, removing such certifications could have negative effects on the quality of the data reported. Likewise, if the reduced frequency of the certifications affects the process by which controls and procedures are assessed, requiring such certifications semi-annually rather than quarterly could reduce the effectiveness of the fund's disclosure controls and procedures and internal control over financial reporting are assessed. However, we expect such effects, if any, to be minimal because certifying officers would continue to certify portfolio holdings for the fund's second and fourth fiscal quarters and would further provide semi-annual certifications concerning disclosure controls and procedures and internal control over financial reporting that would cover the entire year.

C. Amendments to Regulation S-X

a. Introduction and Economic Baseline

The proposed amendments to Regulation S-X would require new, standardized disclosures regarding fund holdings in open futures contracts, open forward foreign currency contracts, and open swap contracts, and additional disclosures regarding fund holdings of written and purchased option contracts; update the disclosures for other investments with conforming amendments, as well as reorganize the order in which some investments are presented; and amend the rules regarding the general form and content of fund financial statements, including requiring prominent placement of investments in derivative investments in a fund's financial statements, rather than allowing such schedules to be placed in the notes to the financial statements.[674] Finally, our amendments would require a new disclosure in the notes to the financial statements relating to a fund's securities lending activities.

The current set of requirements under Regulation S-X, as well as the current practice of many funds[675] to voluntarily disclose additional portfolio investment

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674 *See supra* Part II.C. As discussed above, rule 12-13 of Regulation S-X requires limited generic information on the fund's investments other than securities. To address issues of inconsistent disclosures and lack of transparency, our proposal would standardize a fund's disclosures of open futures contacts, foreign currency forward contracts, and swaps. In addition, while many of the proposed amendments to Regulation S-X are similar to the proposed disclosures in Form N-PORT (*e.g*,. enhanced derivatives disclosures), the amendments to Regulation S-X would be investor-friendly, as the financial statements and schedule of investments are human-readable (as opposed to proposed Form N-PORT's structured data).

675 As we discussed *supra* note 180, while "funds" are defined in the preamble as registered investment companies other than face amount certificate companies and any separate series

information in fund financial statements and to follow industry guidance and other industry practices, is the baseline from which we discuss the economic effects of amendments to Regulation S-X.[676] The parties that could be affected by the proposed amendments to Regulation S-X include funds that file or would file reports with the Commission and update or would update registration statements on file with the Commission, the Commission, current and future investors of investment companies, and other market participants that could be affected by the increase in the disclosure of portfolio investment information.

Regulation S-X prescribes the form and content of financial statements required in shareholder reports and registration updates. Today, Regulation S-X does not prescribe specific information to be disclosed under Regulation S-X for many investments in derivatives, which could result in inconsistent reporting between funds and reduced transparency of the information reported, and in some cases could result in insufficient information concerning the terms and underlying reference assets of derivatives to allow investors to understand the investment.

Many of the economic effects from the proposed amendments to Regulation S-X would largely result from an increase in investor ability to make investment decisions dependent on more transparent disclosure in shareholder reports and in the financial statements of registration statements. As discussed above, the economic effects would

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thereof—*i.e.*, management companies and UITs, we note that our proposed amendments to Regulation S-X apply to both registered investment companies and BDCs. *See supra* notes 264 and 265. Therefore, when discussing fund reporting requirements in the context of our proposed amendments to Regulation S-X, we are also including changes to the reporting requirements for BDCs.

676 *See* discussion *supra* Part II.C.

depend on the extent to which the portfolios and investment practices of investment companies become more transparent, and the ability of investors, and in particular individual investors, to utilize shareholder reports to make investment decisions. The economic effects would also depend on the extent to which investment companies already voluntarily provide disclosures that would be required by the proposed amendments. As a result of these factors, some of which are difficult to quantify or unquantifiable, the discussion below is largely qualitative although certain one-time and ongoing costs associated with the proposed amendments are quantified below.

b. Benefits

The amendments to Regulation S-X could benefit investors by updating the information funds disclose in the financial statements of registration statements and shareholder reports. Our proposed amendments could benefit investors through increased transparency into a fund's investments, particularly for individual investors that we would not expect to use the information in Form N-PORT because of its structured format. In particular, the additional information that Regulation S-X would require for open option contracts both written and purchased, open futures contracts, open forward foreign currency contracts, open swap contracts, and other investments would increase the transparency of the fund's portfolio investments and risk exposures.

Other amendments would also improve the transparency into the fund's investments. For example, we are proposing to require funds to identify each investment whose fair value was determined using significant unobservable inputs.[677] Likewise, we

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[677] *See, e.g.,* proposed rule 12-13, n.7 of Regulation S-X; *see also* proposed rules 12-13A, n.5; 12-13B, n.3; 12-13C, n.6; and 12-13D, n.7 of Regulation S-X.

are proposing a requirement that funds identify illiquid securities,[678] as well as to separately identify investments that are restricted.[679] As discussed above, we believe that the effect of these proposed amendments would be to increase transparency into the liquidity of investments and help investors better understand how fund investments are valued.[680]

In certain circumstances, we are also requiring funds to separately list each of the investments comprising the referenced assets underlying swap[681] and option contracts.[682] We believe that increased disclosure of the investments underlying a referenced asset could benefit investors by making it easier for them to understand and evaluate the specific risk exposures of a fund from certain swap and option contracts.

We also believe that our proposed changes to the form and content of financial statements in Article 6 of Regulation S-X will similarly benefit investors, particularly individual investors, through greater transparency in a fund's financial statements. For example, we are proposing to require funds to disclose their investments in derivatives in the financial statements, as opposed to in the notes to the financial statements.[683] To the extent funds do not do this already, we believe that more prominent placement of investments in derivatives in the financial statements (immediately following the

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678 *See, e.g.,* proposed rule 12-13, n.8 of Regulation S-X; *see also* proposed rules 12-13A, n.6; 12-13B, n.4; 12-13C, n.7; and 12-13D, n.8 of Regulation S-X.

679 *See* proposed rule 12-13, n.6 of Regulation S-X; *see also* proposed rules 12-13A, n.4; 12-13B, n.2; 12-13C, n.5; and 12-13D, n.6 of Regulation S-X.

680 *See* Part II.C.2.a

681 *See* proposed rule 12-13C, n.3 of Regulation S-X; *see also* discussion *supra* Part II.C.2.d.

682 *See* proposed rule 12-13, n.3 of Regulation S-X; *see also* discussion *supra* Part II.C.2.a.

683 *See* proposed rule 6-10(a) of Regulation S-X; *see also* discussion *supra* Part II.C.5.

schedules for investments in securities of unaffiliated investors and securities sold short), would benefit investors through increased visibility of fund investments in derivatives. Likewise, we are proposing to eliminate the financial statement disclosure of "Total investments" on the balance sheet under "Assets".[684] As we discuss in more detail in Part II.C.5, recognizing that investments in derivatives could be presented under both assets and liabilities on the balance sheet, eliminating this disclosure would benefit investors by providing a more accurate representation of the effect of these investments on a fund's balance sheet.[685]

Other parties that would be affected by the amendments to Regulation S-X include the Commission and other market participants that would use shareholder reports and registration statements to obtain fund information. Although the amendments to Regulation S-X would primarily benefit investors and particularly individual investors, the Commission and other market participants could use the information reported in a fund's shareholder report such as the proposed notes to financial statement relating to income and expenses from securities lending activities, as well as the terms governing the compensation of securities lending agents, and would benefit from an increase in transparency into a fund's investments and financial statements during examinations. Commission staff believes that a large number of funds currently adhere to industry practices from which the amendments to Regulation S-X are derived. The proposal to amend Regulation S-X, therefore, would effectively standardize the information that all funds disclose in financial statements, and make the schedule of investments and

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684 *See* proposed rule 6-04 of Regulation S-X; *see also* discussion *supra* Part II.C.5.

685 *See id.*

financial statement disclosures consistent and thus more comparable across funds. Similar to the introduction of Form N-PORT, the amendments to Regulation S-X, to the extent that it increases the transparency of shareholder reports, could improve the ability of investors, particularly individual investors, to differentiate investment companies and make investment decisions. An increase in the ability of investors to differentiate investment companies and allocate capital across reporting funds closer to their risk preferences would increase the competition among funds for investor capital. In addition, by improving the ability of investors to understand investment risks and hence their ability to allocate capital across funds and other investments more efficiently, the introduction of Form N-PORT could also promote capital formation.

c. Costs

We believe that registrants on average will likely incur minimal costs from our proposed amendments to Regulation S-X because, as discussed above, based upon staff experience, we believe that a majority of funds are already providing the information that would be required by the proposed amendments to Regulation S-X in their financial statements.[686] The costs to a fund of complying with the proposed rules would depend upon the extent to which funds are already making such disclosures voluntarily. As discussed above, the Commission is proposing to require parallel disclosures in Form N-PORT, and funds would incur one set of costs, both one-time and ongoing, to obtain the information that would be disclosed in Form N-PORT and in shareholder reports and registration statements. In addition, other costs that relate to the disclosure of portfolio

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[686] In order to reduce burdens on funds, we also endeavored, where appropriate, to require consistent derivatives holdings disclosures between Form N-PORT and Regulation S-X.

investment information, including the ability of other investors to front-run or copycat the investment strategies of funds, would primarily relate to Form N-PORT because of the additional ability of other interested third-parties and market participants to efficiently obtain, aggregate, and analyze the information as a result of its structured format as compared to the non-structured format of reported portfolio investment information in shareholder reports.

For example, similar to our disclosures proposed in Form N-PORT,[687] proposed rules 12-13 and 12-13C of Regulation S-X would, under certain circumstances, require funds to list separately each of the investments comprising referenced assets underlying swap[688] and option contracts,[689] such as when the referenced asset is an index whose components are not periodically publicly available on a website. We understand that many indexes are the proprietary property of an index provider, and may be subject to licensing agreements between the index provider and the fund. Disclosing the underlying components of an index could subject the fund to costs associated with negotiating or renegotiating licensing agreements in order to publicly disclose the components of the index. The Commission does not have information available to provide a reliable estimate of the increased costs of licensing agreements because funds currently are not required to disclose the agreements or the components of the index. In addition, disclosing the components of a non-public index may include costs to both the index provider, whose proprietary indexing strategy could be reverse engineered, and the fund,

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687 *See* Item C.11.c.iii and Item C.11.f.i of proposed Form N-PORT.

688 *See* proposed rule 12-13C, n.3 of Regulation S-X; *see also* discussion *supra* Part II.C.2.d.

689 *See* proposed rule 12-13, n.3 of Regulation S-X.; *see also* discussion *supra* Part II.C.2.a.

whose rebalancing trades could be front-run.[690] However, the underlying components may be more accessible in Form N-PORT as a result of its structured format as compared to the non-structured format of the information in shareholder reports, and the costs of disclosing the information would therefore primarily relate to Form N-PORT.

As another example, the proposal includes an instruction to disclose the variable financing rates for swaps which pay or receive financing payments.[691] It is our understanding that variable financing rates for swap contracts are often commercial terms of a deal that are negotiated between the fund and the counterparty to the swap. Disclosure of favorable variable financing rates could result in costs to the fund in the form of less favorable variable financing rates for future transactions, but may also improve the ability of other funds to negotiate more favorable terms. Similar to the introduction of Form N-PORT, the increased transparency could increase the competition among swap and security-based swap dealers to offer favorable fees and financing terms. As with the disclosure of the components of an index, we believe that the majority of the costs associated with disclosures of variable financing rates, including the increase in competition for favorable fees and terms, would instead derive from the similar requirements in proposed Form N-PORT.[692]

Funds would incur one-time and ongoing costs to comply with the amendments to Regulation S-X in addition to the costs attributable to new Form N-PORT. For the amendments to Regulation S-X, funds would incur one-time and ongoing costs to obtain

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[690] *See supra* note 672 and accompanying and following text.

[691] *See* proposed rule 12-13C, n.3 of Regulation S-X.

[692] *See* Item C.11.f.i of proposed Form N-PORT; *see also* discussion *supra* Part II.A.2.g.iv.

the additional information that would be disclosed on shareholder reports and registration statements, and that would also not be disclosed on Form N-PORT; and funds would also incur one-time costs to format for presentation all additional information that would be disclosed on shareholder reports and registration statements. In addition, our proposal would require funds, to the extent they do not already do so, to present the schedules associated with rules 12-13 through 12-13D and 12-14 in the financial statements, as opposed to in the notes to the financial statements.[693] Funds that do not currently present their schedule of investments in this manner would incur a one-time cost of modifying the presentation of their financial statements to conform to our proposal.

To the extent possible, we have attempted to quantify these costs. As discussed below, we estimate that management investment companies would incur certain one-time additional paperwork and other costs associated with preparing, reviewing, and filing semi-annual reports in accordance with our proposed amendments to Regulation S-X in the amount of approximately $2,417 per fund[694] and $27,142,910 in the aggregate.[695] We similarly estimate that management investment companies would incur certain ongoing paperwork and other costs associated with preparing, reviewing, and filing semi-annual reports in accordance with our proposed amendments to Regulation S-X in the amount of

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[693] *See* proposed rule 6-10 of Regulation S-X; *see also* discussion *supra* Part II.C.5.

[694] *See infra* note 778 and accompanying text. The estimate is based upon the following calculations: ($2,417 = ($707 = 4.5 hours x $157/hour for an Intermediate Accountant) + ($1,710 = 4.5 hours x $380/hour for an Attorney)). The hourly wage figures in this and subsequent footnotes are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

[695] *See infra* note 777 and accompanying text. These estimates are based upon the following calculations: $27,142,910 = (11,230 funds x $2,417 per fund).

approximately $806 per fund[696] and $9,051,380 in the aggregate.[697] Likewise, we estimate that UITs would incur certain one-time additional paperwork and other costs associated with preparing, reviewing, and filing semi-annual reports in accordance with our proposed amendments to Regulation S-X in the amount of approximately $2,417 per fund[698] and $1,757,159 in the aggregate.[699] We similarly estimate that UITs would incur certain ongoing paperwork and other costs associated with preparing, reviewing, and filing semi-annual reports in accordance with our proposed amendments to Regulation S-X in the amount of approximately $806 per fund[700] and $585,962 in the aggregate.[701]

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[696] *See infra* note 779 and accompanying text. The estimate is based upon the following calculations: ($806 = ($236 = 1.5 hours x $157/hour for an Intermediate Accountant) + ($570 = 1.5 hours x $380/hour for an Attorney). The hourly wage figures in this and subsequent footnotes are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

[697] *See infra* note 777 and accompanying text. These estimates are based upon the following calculations: $9,051,380 = (11,230 funds x $806 per fund).

[698] *See infra* note 790 and accompanying text. The estimate is based upon the following calculations: ($2,417 = ($707 = 4.5 hours x $157/hour for an Intermediate Accountant) + ($1,710 = 4.5 hours x $380/hour for an Attorney)). The hourly wage figures in this and subsequent footnotes are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

[699] *See infra* note 789 and accompanying text. These estimates are based upon the following calculations: $1,757,159 = (727 UITs x $2,417 per UIT).

[700] *See infra* note 791 and accompanying text. The estimate is based upon the following calculations: ($806 = ($236 = 1.5 hours x $157/hour for an Intermediate Accountant) + ($570 = 1.5 hours x $380/hour for an Attorney). The hourly wage figures in this and subsequent footnotes are from SIFMA's Management & Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

[701] *See infra* note 789 and accompanying text. These estimates are based upon the following calculations: $585,962 = (727 UITs x $806 per UIT).

D. Option for Website Transmission of Shareholder Reports

a. Introduction and Economic Baseline

As discussed above, the Commission is proposing new rule 30e-3 under the Investment Company Act, which would permit, but not require, a fund to satisfy requirements under the Act and rules thereunder to transmit reports to shareholders if the fund meets certain requirements. These requirements include making the reports and certain other materials accessible on its website and periodically notifying investors of the materials' availability.[702] Funds that do not maintain websites or that otherwise wish to transmit shareholder reports in paper or pursuant the Commission's existing electronic delivery guidance would continue to be able to satisfy the transmission requirements by those transmission methods.

The current set of requirements under which funds transmit shareholder reports to investors is the baseline from which we will discuss the economic effects of proposed rule 30e-3. The baseline also includes the current practice of many funds to make some or all of these reports—or other materials listing portfolio investment information such as reports on Form N-Q—accessible on their own websites. The baseline also reflects that some funds transmit these materials electronically today, pursuant to Commission guidance that permits such a transmission method on a shareholder-by-shareholder "opt in" basis, provided that certain other conditions are met.[703] The parties that could be affected by new rule 30e-3 are funds that currently are or would be required to transmit shareholder reports under rule 30e-1 or 30e-2, and other current and future users of fund

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[702] *See supra* Part II.D.

[703] *See supra* note 289 and accompanying text.

portfolio investment information, including investors and third-party information providers.

Today, most funds are required to disclose their portfolio holdings on a quarterly basis, with holdings as of the end of the second and fourth fiscal quarters disclosed in the fund's semiannual and annual reports, respectively, and holdings as of the end of the first and third fiscal quarters disclosed in reports on Form N-Q. Funds are generally required to transmit reports to shareholders on a semiannual basis, and these reports have historically been paper copies mailed to shareholders.[704] As of December 31, 2014, about 11,957 funds could rely on proposed rule 30e-3 if it were in effect.[705] As discussed in detail below, we estimate that these funds—and their shareholders—bear aggregate annual paperwork expenses of about $616 million in connection with the required preparation and transmission of shareholder reports (or about $51,539 for each portfolio).[706] Of those estimated expenses, we estimate that about $116 million are

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[704] *See supra* note 288 and accompanying text.

[705] *See infra* note 799 and accompanying text.

[706] As discussed below, we previously estimated 994,960 aggregate annual internal burden hours associated with rules 30e-1 and 30e-2. *See infra* notes 853 and 855 (estimating 903,000 hours for rule 30e-1 and 91,960 hours for rule 30e-2). The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for attorneys and intermediate accountants, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $268.50. This estimate is based upon the following calculation: ($380 per hour for Attorneys × 0.5) + ($157 per hour for Intermediate Accountants × 0.5) = $268.50. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 994,960 burden hours per year and the estimated wage rate of about $268.50 per hour, the total annual paperwork expenses for funds associated with the internal hour burden of rules 30e-1 and 30e-2 are approximately $267,146,760. This estimate is based upon the following calculation: 994,960 hours × $268.50 per hour = $267,146,760. We have also estimated aggregate annual external cost burden of $349,105,750 associated with rules 30e-1 and 30e-2. *See infra* notes 854 and 856

associated with the printing and mailing of shareholder reports.[707] Reports on Form N-Q are available on EDGAR.[708] Some funds choose to make some or all of these reports—or other materials listing portfolio holdings at particular times—accessible on their own websites, but funds do not do so uniformly.

As technology has developed, so has the need to modernize the manner in which shareholder reports and portfolio investment information are delivered to investors. As discussed above, recent investor testing and Internet usage trends have highlighted that investor preferences about electronic delivery of information have evolved, and that many investors would prefer enhanced availability of fund information on the Internet.[709] In addition, investor testing has suggested that fund investors are much more likely to seek out fund information on the fund's own website than they are to seek it out on EDGAR.[710] Moreover, searching for and retrieving individual reports on Form N-Q on EDGAR may, in many cases, be more difficult than navigating a website with which the investor is likely to be already familiar. We therefore believe that many investors may

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(estimating \$333,905,750 for rule 30e-1 and \$15,200,000 for rule 30e-2). Therefore, we estimate that the total estimated aggregate annual paperwork expenses associated with rules 30e-1 and 30e-2 are \$616,252,510. This estimate is based upon the following calculation: \$267,146,760 expenses associated with internal burden hours + \$349,105,750 external cost burden = \$616,252,510. Using this estimate and our prior estimate of 11,957 funds, we estimate that annual paperwork expenses associated with rules 30e-1 and 30e-2 are about \$51,539 on a per-portfolio basis. This estimate is based upon the following calculation: \$616,252,510 aggregate annual paperwork expenses ÷ 11,957 funds = \$51,539.

707 We estimate that one-third of the external costs attributed to rules 30e-1 and 30e-2 relate to printing and mailing expenses. *See infra* notes 857–858. Therefore, we estimate aggregate annual printing and mailings costs associated with those rules of about \$116,368,583. This estimate is based upon the following calculation: \$349,105,750 aggregate external cost burden ÷ 3 = \$116,368,583.33.

708 *See supra* notes 637–642 and accompanying text.

709 *See supra* note 292 and accompanying text.

710 *See supra* note 292 and accompanying text.

not view the information that is available in reports on Form N-Q. Shareholders also pay, *pro rata*, the expenses associated with printing and mailing reports by default to shareholders, who may nonetheless prefer electronic transmission.

The economic effects of proposed rule 30e-3 are dependent on a number of factors, including the number of funds that would rely on the rule, the number of funds which currently rely on Commission guidance to transmit shareholder reports electronically, and the extent to which shareholders become more aware of the availability of portfolio investment information, view the information, and use the information to make investment decisions. Due to the optionality of the rule, we would expect that, in general, each fund would only rely on the rule if the benefits to that fund exceeded the costs. We have provided estimates of the costs associated with printing and mailing shareholder reports. However, information that would allow the Commission to quantify the other economic effects of the rule, such as how the availability of shareholder reports online will affect investors' use of the information, is not known to us.

Funds can transmit shareholder reports electronically today pursuant to Commission guidance. However, funds wishing to rely on this Commission guidance must satisfy certain conditions, including that shareholders agree to electronic transmission on a shareholder-by-shareholder "opt in" basis. We recognize that express shareholder consent can be difficult to obtain even for practices that many shareholders may prefer.[711] The number of funds that transmit shareholder reports electronically today is unclear to us, because funds are not required to report their reliance on the Commission's electronic delivery guidance or the number of investors that have given opt-in consent to receive electronic delivery. Commission staff is also not aware of information that describes the prevalence of electronic delivery of disclosure documents and other information. In addition, although survey evidence describes certain investor preferences regarding electronic delivery of shareholder report information,[712] we are not aware of information that would describe the effect of this rule on investor ability to choose between funds and allocate capital across all investments. For these reasons, much of the discussion below is qualitative in nature.

b. Benefits

The proposed rule, to the extent that it is relied upon by funds and alters the current transmission of reports, would increase the accessibility of portfolio investment information including information from the first and third fiscal quarters that might otherwise be only available on EDGAR. The proposed rule would thereby increase the awareness of fund shareholders of the availability of portfolio investment information, and therefore also increase the likelihood that fund investors review portfolio investment information. The proposed rule would also increase the likelihood that fund shareholders view the portfolio investment information in their preferred format, and thereby increase

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[711] *See* Investment Company Act Release No. 22884 (Nov. 13, 1997) [62 FR 61933, 61935 (Nov. 20, 1997)] (concerning implied consent to delivery of disclosure documents to households).

[712] *See supra* note 292 and accompanying text.

their use of the information to make investment decisions.[713] Similar to the introduction of Form N-PORT and the amendments to Regulation S-X, greater investor use of shareholder reports could result in more informed investment decisions, particularly for individual investors, and an increase in competition among funds for investor capital. A greater understanding of the investment strategy of the fund, its portfolio composition, and its investment risks could also result in a more efficient allocation of capital across funds and other investments, and could thereby promote capital formation.

Funds and their shareholders would also benefit from a reduction in expenses related to the physical distribution of shareholder reports. Although the proposed rule would not have much of an effect, if any, on the expenses associated with the preparation of reports, we expect that the expenses associated with printing and mailing of shareholder reports would be substantially reduced if the rule is adopted. As discussed in detail below, of the estimated $116 million in annual paperwork expenses associated with the printing and mailing of shareholder reports,[714] we estimate that about $105 million would be eliminated if the proposed rule were adopted.[715] The actual reduction in paperwork expenses would depend, in part, upon reliance on the proposed rule by funds

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[713] *See supra* notes 291–296 and accompanying text (concerning investor Internet usage statistics and transmission method preferences).

[714] *See supra* notes 706–707 and accompanying text.

[715] We estimate that about 90% of the $116,368,583 in paperwork expenses associated with printing and mailing shareholder reports pursuant to rules 30e-1 and 30e-2 would be eliminated if rule 30e-3 were adopted. *See supra* note 707; *infra* notes 857–858. Therefore, we estimate that about $104,731,725 of annual paperwork expenses associated with rules 30e-1 and 30e-2 would be eliminated if rule 30e-3 were adopted. This estimate is based upon the following calculation: $116,368,583 in aggregate annual printing and mailing expenses × 0.90 proportion eliminated = $104,731,724.70 eliminated annual printing and mailing expenses.

and the extent of shareholder consent to electronic transmission of reports, each of which is uncertain.

The expected benefits would not necessarily be distributed uniformly across funds and across a fund's shareholders. Some funds already transmit materials electronically to some or all of their shareholders, and these funds would experience fewer benefits from electing to rely on the proposed rule. Some funds, such as funds that do not currently maintain websites, may choose not to rely on the proposed rule.

c. Costs

Although we believe that permitting electronic delivery "by default" would improve overall alignment of transmission method with investor preferences,[716] there may be some investors who would prefer to receive print copies that do not notify their fund of that preference and may be others that would benefit from print copies even though they prefer electronic transmission. These investors, depending on their ability and preference to access shareholder reports and portfolio investment information electronically, could overlook electronic deliveries or otherwise experience a reduction in

[716] *See supra* note 292. We believe that the change from requiring shareholders to "opt-in" if they wish to receive electronic instead of print copies of shareholder reports, to—as under the proposed rule—"opt-out" if they wish to receive print copies instead of electronic copies would increase the ability of funds to transmit shareholder reports electronically. Although the preferences of shareholders would not change dependent on the form of consent, behavioral economic theory and empirical evidence suggest the likelihood that shareholders receive electronic transmissions of fund reports would be greater under opt-out consent rather than opt-in consent. *See, e.g.,* Richard H. Thaler and Shlomo Bernatzi, *Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving,* Journal of Political Economy, Vol. 112:1, S164-S187 (2004); Richard H. Thaler and Cass R. Sunstein, *Libertarian Paternalism,* The American Economic Review, Vol. 93:2, 175-179 (2003). Thaler and Sunstein argue that a "status quo" bias results in the continuance of existing arrangements even if better options are available. The authors illustrate their argument with higher rates of initial enrollments in employee savings plans when enrollment is automatic as compared to when employees must first complete an enrollment form.

their ability to access portfolio investment information, and could result in a decrease in their ability to efficiently allocate capital across funds and other investments. We have endeavored, through the consent and notice provisions of the proposed rule, to mitigate the potential costs associated with this possibility by requiring a fund wishing to rely on the proposed rule to alert an investor before beginning to transmit reports electronically and to notify the investor around the time each report is made accessible on the website. Although, as discussed above, an increase in investor use of shareholder reports could increase competition among funds for investor capital, funds that do not rely on the rule could be placed at a competitive disadvantage depending on whether investors choose funds based on their preference for website transmission.

As discussed above, reliance on proposed rule 30e-3 would be optional, and funds that rely on the rule would incur costs to adhere to the rule. Relying funds would incur paperwork expenses associated with satisfying the conditions of the proposed rule, such as making the materials publicly accessible; preparing, reviewing, and transmitting a notice to shareholders; soliciting the consent of each shareholder by sending them an initial statement; and printing and mailing shareholder reports and other materials upon request. As discussed in detail below, we estimate that these paperwork expenses would be, in the aggregate, about $32 million each year.[717] Relying funds would also incur

[717] Below, we estimate that 10,761 funds would choose to rely on proposed rule 30e-3. *See infra* note 799 and accompanying text. Below, we estimate that funds that elect to rely on rule 30e-3 will, on average, incur 0.76 burden hours per fund per year to comply with the website accessibility conditions of rule 30e-3. *See infra* note 808 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 8,178 burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.76 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 8,178.36 hours. The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial

Markets Association. The estimated wage figure is based on published rates for senior programmers, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $303. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 8,178 burden hours per year and the estimated wage rate of about $303 per hour, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $2,477,934. This estimate is based upon the following calculation: 8,178 hours × $303 per hour = $2,477,934.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur average annual external costs of $500 per fund in connection with the requirement to provide a complete shareholder report upon request of a shareholder. *See infra* note 816 and accompanying text. We estimate that aggregate external costs to funds in connection with this requirement would therefore be about $5,380,500. This estimate is based upon the following calculation: $500 per fund × 10,761 funds = $5,380,500.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur about 0.38 annual burden hours in connection with the initial statement conditions of the rule. *See infra* note 829 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 4,089 burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.38 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 4,089.18 hours. The Commission estimates the wage rate associated with these burden hours based on salary information for the securities industry compiled by the Securities Industry and Financial Markets Association. The estimated wage figure is based on published rates for compliance attorneys, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding an effective hourly rate of $334. *See* Securities Industry and Financial Markets Association, Report on Management & Professional Earnings in the Securities Industry 2013. Based on the Commission's estimate of 4,089 burden hours per year and the estimated wage rate of about $334 per hour, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the initial statement conditions of rule 30e-3 are approximately $1,365,726. This estimate is based upon the following calculation: 4,089 hours × $334 per hour = $1,365,726. Below, we also estimate that these funds will incur annual cost burden of about $216 per fund to comply with the initial statement conditions. This estimate is based upon the following calculation: $49 per fund per year for services of outside counsel + $333 per year per fund to print and mail initial statements = $382 per fund per year. *See infra* notes 837 and 844. Such funds would therefore incur about $4,110,702 in aggregate annual cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $382 per fund per year × 10,761 funds = $4,110,702 per year. Thus the total estimated annual paperwork expenses associated with the initial statement conditions are $5,476,428. This estimate is based upon the following calculation: $1,365,726 associated with internal burden + $4,110,702 external cost burden = $5,476,428.

Below, we also estimate that funds that elect to rely on proposed rule 30e-3 would incur about 1.5 annual burden hours in connection with the notice conditions of the rule. *See infra* note 832 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 16,142 burden hours to comply with these requirements. This estimate is initial one-time costs associated with establishing systems and procedures for compliance. We estimate that these expenses would be, in the aggregate, about $16 million.[718]

based upon the following calculation: 1.5 burden hours per fund × 10,761 funds expected to rely on rule 30e-3 = 16,141.5 hours. Based on the Commission's estimate of 16,142 burden hours per year and the estimated wage rate of about $334 per hour, the total annual paperwork related expenses for funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $5,391,428. This estimate is based upon the following calculation: 16,142 hours × $334 per hour = $5,391,428. Below, we also estimate that these funds will incur annual cost burden of about $1,190 per fund to comply with the notice conditions. This estimate is based upon the following calculation: $190 per fund per year for services of outside counsel + $1,000 per fund per year to print and mail notices = $1,190 per fund per year. *See infra* notes 840 and 845 and accompanying text. Such funds would therefore incur about $12,805,590 in aggregate annual cost burden to comply with the notice conditions. This estimate is based upon the following calculation: $1,190 per fund per year × 10,761 funds = $12,805,590 per year. Thus the total estimated annual paperwork expenses associated with the notice conditions are $12,816,518. This estimate is based upon the following calculation: $5,391,428 associated with internal burden + $12,805,590 external cost burden = $18,197,018.

Thus, we estimate that the total annual paperwork expenses associated with satisfying the conditions of proposed rule 30e-3 would be $31,531,880. This estimate is based upon the following calculation: $2,477,934 associated with website accessibility conditions + $5,380,500 associated with provision of print report upon request condition + $5,476,428 associated with initial statement condition + $18,197,018 associated with notice condition = $31,531,880.

718 Below, we estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.08 one-time burden hours per fund in the first year to comply with website accessibility conditions. *See infra* notes 807–808 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 861 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.08 hours per fund × 10,761 funds = 860.88 hours. Based on the Commission's estimate of 861 one-time burden hours and the estimated wage rate of about $303 per hour for senior programmers, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the website accessibility conditions of rule 30e-3 are approximately $260,883. This estimate is based upon the following calculation: 861 hours × $303 per hour = $260,883. Below, we also estimate that about 113 funds that wish to rely on proposed rule 30e-3 but that do not currently have a website will incur one-time cost burden of $2,000 per fund to comply with the website accessibility conditions. *See infra* notes 804 and 811 and accompanying text. Such funds would therefore incur about $226,000 in aggregate one-time cost burden to comply with the website accessibility conditions. $2,000 per fund × 113 funds = $226,000. Thus the total estimated one-time paperwork expenses associated with the website accessibility conditions are $486,883. This estimate is based upon the following calculation: $260,883 associated with internal burden + $226,000 external cost burden = $486,883.

We have endeavored to mitigate the costs associated with compliance with the rule's conditions by, for example, requiring that the required schedule of portfolio investment information as of the end of the first and third fiscal quarters be presented

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Below, we also estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.92 one-time burden hours per fund in the first year to comply with the initial statement conditions. *See infra* notes 828–829 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 9,900 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.92 hours per fund × 10,761 funds = 9,900.12 hours. Based on the Commission's estimate of 9,900 one-time burden hours and the estimated wage rate of about $334 per hour, the total annual administrative expenses for funds associated with the internal hour burden imposed by the initial statement conditions of proposed rule 30e-3 are approximately $3,306,600. This estimate is based upon the following calculation: 9,900 hours × $334 per hour = $3,306,600. Below, we also estimate that these funds will incur one-time cost burden of $762 per fund to comply with the initial statement conditions. This estimate is based upon the following calculation: $95 per fund for the services of outside counsel + $667 per fund to print and mail initial statements = $762 per fund. *See* notes 836–843 and accompanying text. Such funds would therefore incur about $8,199,882 in aggregate one-time cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $762 per fund × 10,761 funds = $8,199,882. Thus the total estimated one-time paperwork expenses associated with the initial statement conditions are $11,506,482. $3,306,600 associated with internal burden + $8,199,882 external cost burden = $11,506,482.

Below, we also estimate that funds that elect to rely on rule 30e-3 will, on average, incur an additional 0.8 one-time burden hours per fund in the first year to comply with the notice conditions. *See infra* notes 831–832 and accompanying text. Therefore, in the aggregate, we estimate that such funds would incur about 8,609 one-time burden hours to comply with these requirements. This estimate is based upon the following calculation: 0.8 hours per fund × 10,761 funds = 8,608.8 hours. Based on the Commission's estimate of 8,609 one-time burden hours and the estimated wage rate of about $334 per hour, the total annual paperwork expenses for funds associated with the internal hour burden imposed by the notice conditions of proposed rule 30e-3 are approximately $2,875,406. This estimate is based upon the following calculation: 8,609 hours × $334 per hour = $2,875,406. Below, we also estimate that these funds will incur one-time cost burden of $95 per fund to comply with the notice conditions. *See infra* notes 839–840 and accompanying text. Such funds would therefore incur about $1,022,295 in aggregate one-time cost burden to comply with the initial statement conditions. This estimate is based upon the following calculation: $95 per fund × 10,761 funds = $1,022,295. Thus the total estimated one-time paperwork expenses associated with the notice conditions are $3,897,701. This estimate is based upon the following calculation: $2,875,406 associated with internal burden + $1,022,295 external cost burden = $3,897,701.

Thus, we estimate that the total one-time paperwork expenses associated with satisfying the conditions of proposed rule 30e-3 would be $15,891,066. This estimate is based upon the following calculation: $486,883 associated with website accessibility conditions + $11,506,482 associated with initial statement condition + $3,897,701 associated with notice condition = $15,891,066.

consistent with the reporting requirements of Regulation S-X. Most funds would have established procedures in place to prepare and review such disclosures and would be familiar with the disclosure requirements. Because reliance on the proposed rule would be optional, a particular fund would not be expected to rely on the proposed rule if the costs of the rule to that fund would exceed its benefits. Funds that do not rely on the proposed rule would therefore not incur compliance costs.

E. Form N-CEN and Rescission of Form N-SAR

a. Introduction and Economic Baseline

Form N-CEN, as proposed, would require funds to report census information to the Commission on an annual basis. Although Form N-CEN would include many of the same data elements as the current census-type reporting form, Form N-SAR, it would replace items that are outdated or no longer informative with items of greater importance. Form N-CEN would also eliminate certain items that are reported to the Commission in other forms. Reports would also be filed in a structured, XML format to allow for easier aggregation and manipulation of the data. Form N-SAR would be rescinded.

The current set of requirements—management companies must file reports on Form N-SAR semi-annually,[719] and UITs file such reports annually[720]—is the baseline from which we discuss the economic effects of Form N-CEN. The parties that could be affected by the rescission of Form N-SAR and the introduction of Form N-CEN include funds that currently file reports on Form N-SAR and funds that would file reports on Form N-CEN; the Commission; and, other current and future users of fund census

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[719] *See* rule 30b1-1.

[720] *See* rule 30a-1.

information including investors, third-party information providers, and other interested potential users.

At the time it was adopted, Form N-SAR was intended to reduce reporting burdens and better align the information reported with the characteristics of the fund industry. As the fund industry has developed, including the development of new products, so has the need to update the information the Commission requires in order to improve its ability to monitor the compliance and risks of reporting funds. The format in which information is reported in Form N-SAR is also outdated, which reduces the ability of Commission staff to obtain and aggregate the information. The technology in which Form N-CEN would be filed allows for both the sender and recipient to validate the information against identical definitions, thereby increasing the accuracy of the information and therefore the ability of Commission staff to compare the information across funds.

The economic effects from the introduction of new Form N-CEN and the rescission of Form N-SAR would largely result from an update to the format of the information reported, as well as the update to the census information that investment companies would report. The economic effects would therefore depend on the extent to which investment companies become more transparent, and the ability of Commission staff and investors to utilize the updated disclosures. Form N-CEN would require census information about the fund industry reported in a structured format. However, while Form N-SAR is also reported in a structured format, Form N-CEN would modernize the information funds report and the required format of the filings. Therefore, although the introduction of Form N-CEN would increase the transparency of the fund industry, we do not know the extent to which the transparency would increase or the significance of its economic implications.

b. Benefits

As discussed above, the Commission is proposing to rescind Form N-SAR and replace it with new Form N-CEN in order to improve the quality and utility of the information reported to the Commission. The improvement in the quality and utility of the information would allow Commission staff to better understand industry trends, inform policy, and assist with the Commission's examination program.

Similar to Form N-PORT, the ability of the Commission to most effectively use the information is dependent on the ability of staff to compile and aggregate the information into a single database. The structuring of the information in an XML format would improve the ability and efficiency of Commission staff to obtain and analyze the information. An improved structured format could also promote additional efficiency to the extent that the new reporting requirements encourage modernization of internal systems and standardization for the disclosure and transmission of information. An XML format would also improve its accuracy by providing sophisticated constraints as to how information could be provided and by allowing for built-in validation.

Form N-CEN would also modernize the census information that funds provide and increase its utility to Commission staff, investors, and other interested parties by reflecting the changes to the fund industry. The Commission would use the information in Form N-CEN to improve its understanding of fund industry trends and practices, and assist with the Commission's examination program. Commission staff has identified specific information that could improve its ability to effectively oversee funds including identifying information, when applicable, about the fund's service providers, information describing financial support by an affiliated entity, classification of fund type, and information describing investments in CFCs.

Along with the additional information, Form N-CEN would add new requirements for information specifically relating to the ETF primary markets, including more detailed information on authorized participants and creation unit requirements.[721] We believe that our proposed additional information on ETFs allows the Commission to better understand and assess the ETF market and also inform the public about certain characteristics of the ETF primary markets. Additionally, Form N-CEN, like Form N-SAR, has particular sections for closed-end funds, SIBCs, and UITs in order to obtain information about the particular characteristics of these entities to assist us in monitoring the activities of these funds and our examiners in their preparation for exams of these funds.

Form N-CEN would also add new requirements for information relating to a management company's securities lending activities, including information concerning the management company's securities lending agents and cash collateral managers.[722] Together with the requirements on securities lending activities in proposed Form N-PORT, this information would benefit the Commission's oversight abilities and, potentially, future policymaking concerning securities lending. Moreover, we believe that this information could inform investors and other interested parties about the use of and potential risks associated with a management company's securities lending activities.

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[721] *See* discussion *supra* Part II.E.4.e.

[722] *See* Item 30 of proposed Form N-CEN.; *see also* discussion *supra* Part II.E.4.c.iii.

We expect funds to also benefit from replacing Form N-SAR with Form N-CEN through reduced expenses. First, we estimate that N-CEN has a lower cost per filing than Form N-SAR, as a result of filing in an XML format, as opposed to the outdated format of Form N-SAR, and the elimination of certain information items on Form N-SAR that funds would not be required to report on Form N-CEN. Second, funds that are management investment companies would experience reduced paperwork related costs from decreasing the reporting frequency of census information from semi-annual to annual. We estimate that filers would have an aggregate annual paperwork related expenses of $12,395,064 for reports on Form N-CEN.[723] By contrast, we estimate that the ongoing paperwork related expenses of filing Form N-SAR is $25,299,092 annually.[724] Accordingly, we estimate the annual paperwork related cost savings to funds associated with the adoption of Form N-CEN, compared to Form N-SAR, would be $12,904,028. We recognize that these ongoing annual cost savings would be offset by a one-time cost in the first year to file reports on N-CEN, estimated at $20,040,020.[725]

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[723] This estimate is based on annual ongoing burden hour estimate of 32,294 burden hours for management companies (2,419 management companies x 13.35 hours per filing) plus 6,623 burden hours for UITs (727 UITs x 9.11 burden hours per filing), for a total estimate of 38,917 burden ongoing hours. This was then multiplied by a blended hourly wage of $318.50 per hour, $303 per hour for Senior Programmers and $334 per hour for compliance attorneys, as we believe these employees would commonly be responsible for completing reports on proposed Form N-CEN ($318.50 x 38,917 = $12,395,064.50). *See infra* Part V.B.1.

[724] This estimate is based on an assumption of annual ongoing burden hour estimate to file Form N-SAR of 74,263 burden hours for management investment companies (2,419 management companies x 15.35 hours per filing x 2 filings per year) and 5,169 burden hours for UITs (727 UITs x 7.11 burden hours per filing) for a total estimate of 79,432 ongoing burden hours. This was then multiplied by a blended hourly wage of $318.50 per hour ($318.50 x 79,432 = 25,299,092). *See infra* Part V.B.2.

[725] This estimate is based on an estimate of 20 initial burden hours per filer, multiplied by a blended hourly wage of $318.50 (20 hours x 3,146 filers x $318.50 = $20,040,020)

The rescission of Form N-SAR and the introduction of Form N-CEN, to the extent relevant, could provide similar benefits to investors, to third-party information providers, and to other potential users from an update to the census information that investment companies report and from an update to its structured format. Similar to Form N-PORT, we expect that institutional investors and other market participants could use the information from Form N-CEN more so than individual investors, and that the format of the data may make the information difficult for individual investors to understand. However, individual investors may indirectly benefit from the increase in information to the extent that it becomes available through third-party information providers. For the investors and other potential users that would obtain and use the information reported in Form N-CEN, the update to the structure of the information would improve their ability to efficiently aggregate the information collected on Form N-CEN across all investment companies.

The changes to the reporting of census information, including the reporting of the information in a modern structured format, could improve the ability of investors to differentiate investment companies and could therefore lead to an increase in competition among funds for investor capital. These changes would not significantly relate to the ability of investors to understand the investment risks of investment companies, and therefore would not significantly improve the ability of investors to efficiently allocate capital. Consequently, the reporting changes would not significantly promote capital formation.

c. Costs

As discussed above, we expect the adoption of N-CEN and rescission of Form N-SAR would result in reduced costs to funds in the form of lower expenses related to filing

Form N-CEN relative to Form N-SAR. ETFs and closed-end funds, however, may have higher expenses in filing reports on Form N-CEN relative to other investment companies, as they will generally be required to provide more information. There could, however, be costs as a result of the change in the disclosure of census information. For example, the Commission would receive census information on an annual instead of semi-annual basis, and therefore the information would be more dated than if the information was reported to the Commission on a semi-annual basis.[726] As discussed above, we believe that the costs related to reducing the frequency of the information received on Form N-SAR is not significant as this information is unlikely to change frequently. Also, some of the information from Form N-SAR would not be included in Form N-CEN.[727] However, we have attempted to mitigate the potential cost relating to the loss of information by eliminating only that information which is either available elsewhere, not frequently used by Commission staff, or provides little benefit.

Form N-CEN could impose costs on investors and other potential users of the information to obtain the information from a new or additional source, including the information that would not be included on Form N-CEN but would be available through other filings. The information that would not be included on Form N-CEN and that

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[726] However, as discussed *supra* note 378, this cost is mitigated, in part, by the fact that certain items that the Commission staff has deemed necessary on a more frequent basis would be included instead in reports on proposed Form N-PORT. In addition, the static nature of the information that would be reported on Form N-CEN increases the likelihood that the information remains current.

[727] *See* discussion *supra* Part II.E.5.

would not be available elsewhere would impose costs on investors and other potential users from a loss of information to the extent that the information is found to be useful.[728]

F. Alternatives to the Reporting Requirements

The Commission has explored ways to modernize and improve the utility and the quality of the information that funds provide to the Commission and to investors. Commission staff examined how information reported to the Commission could be improved to assist the Commission in its rulemaking, inspection, examination, policymaking, and risk-monitoring functions, and how technology could be used to facilitate those ends. Commission staff also examined enhancements that would benefit investors and other potential users of this information, including updating the reporting obligations of funds to keep pace with the changes in the fund industry.

In formulating our proposal, we have considered many alternatives to the individual elements contained in our proposal, and those alternatives are outlined above in the sections discussing each of the five parts of our proposal, and we have requested comment on these alternatives.[729] The following discussion addresses significant alternatives to our proposal, which involve broader issues than the more granular

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[728] Some of the information that would no longer be requested, such as loads paid to captive or unaffiliated brokers, has been found by interested third-parties, including researchers, to be important in their analysis of the fund industry. *See, e.g.,* Susan E. K. Christoffersen, Richard Evans, and David K. Musto, *What do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives*, The Journal of Finance, Vol. 68(1), 201-235 (2013). We are proposing to eliminate certain items from Form N-SAR that are either infrequently used by the Commission, provide minimal benefits, or costly for funds to provide. We request comment on the items required by Form N-SAR that would be eliminated by Form N-CEN. *See* discussion *supra* Part II.E.5.

[729] *See generally supra* Parts II and II.G.5.

alternatives to the individual elements contained in each part of our proposal, as discussed above.

We considered the frequency at which Commission staff believed it to be important to receive information from investment companies. A possible alternative to the monthly reporting of portfolio investment information in Form N-PORT is a quarterly reporting of the information, with the quarterly reports containing information for each month in the quarter. The quarterly reporting of portfolio investment information could decrease the ongoing burden of the proposal on investment companies. We do not believe, however, that the quarterly reporting of portfolio investment information would be as useful for Commission staff to oversee investment companies on an ongoing basis given the increase in alternative strategies and the use of derivatives, as this information, even if broken out into monthly data, would result in the Commission receiving the information with a longer time lag. For example, a longer time lag for the Commission to receive portfolio investment information could reduce its effectiveness to analyze the effect of a market or other event on the fund industry.

Likewise, a possible alternative to the annual reporting of census information in Form N-CEN is a semiannual reporting of the information similar to Form N-SAR. However, as we discussed above, the census-type nature of the information that we would collect from funds in Form N-CEN should not change frequently. Requiring management companies to report census information semi-annually would therefore place a burden on funds without a commensurate increase in the value of the information received by the Commission.

We also considered alternatives to extend or shorten the filing period of Form N-PORT from thirty days and Form N-CEN from sixty days. While a shorter filing period would provide more timely information to the Commission, it would also place a burden on funds that need time to collect, verify, and report the required information to the Commission. Conversely, a longer filing period would give funds more time to report the information and would decrease the potential costs to front-running or copycatting by other investors, but would decrease the utility of the information for the Commission. We therefore believe that the thirty-day filing period for Form N-PORT and the sixty-day filing period for Form N-CEN would appropriately balance the staff's need for timely information against the appropriate amount of time for funds to collect, verify, and report information to the Commission.

Other significant alternatives relate to the public dissemination of information reported on Form N-PORT. Alternatives to the proposal include making more of the portfolio and other information reported on the form either non-public or public, including making all or none of the information reported on Form N-PORT each month publicly available, and increasing or decreasing the lag from the date funds would file this information to when the information would be publicly released. Making more of the portfolio and other information reported on the form non-public or increasing the time-lag to release the information would reduce the amount of information investors have access to when making investment decisions. However, as discussed above, making more of the portfolio and other information reported on the form public or decreasing the time-lag could increase the risk of front-running, predatory trading, and copycatting/reverse engineering of trading strategies by other investors.[730] We believe the current proposal strikes an appropriate balance of providing more usable information to investors and other third-parties while mitigating the risk of potential investor harm that could occur from more frequent disclosure of portfolio information.

Other alternatives relate to the information that the Commission could require when determining the specific items to include and exclude on From N-PORT and Form N-CEN. The Commission considered what information it believes to be important for the Commission's oversight activities and to the public, and the costs to investment companies to provide the information. In particular, the Commission considered the benefits and costs of the information already disclosed in Form N-CSR, Form N-Q, and Form N-SAR, and that could be required on Form N-PORT and Form N-CEN. Commission staff believes that the benefits of the information currently disclosed by investment companies that would be reported on Form N-PORT and Form N-CEN, especially in a structured format, justify the costs to investment companies to report the information in these forms.

The Commission also considered the information that would be required on Form N-PORT as compared to the information on Form N-CEN. Commission staff considered the benefits to having the information more frequently updated as well as the cost to funds to report the information. Although the costs to report information on a more frequent basis imposes additional costs on funds, Commission staff believes the information that would be reported more frequently on Form N-PORT, relative to the

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[730] *See* Part IV.C.c

annual reporting on Form N-CEN, is necessary for the Commission's oversight activities and could be important to other interested third-parties.

The Commission also considered the benefits and costs of the new information that would be required on Form N-PORT and Form N-CEN. The new information that would be required includes contractual terms for debt securities and derivatives, a description of reference instruments, if any, and information describing securities lending and repurchase and reverse repurchase agreements. A reasonable alternative would be to not require some of the new information, and another reasonable alternative would be to require information in addition to what is currently proposed.

As discussed, the Commission would require information which provides staff an ability to identify investment risks and engage in further outreach as necessary, and not requiring the information would substantially reduce the ability of the Commission to oversee the fund industry. In addition, the information would be important to investors to differentiate investment companies. Although the new information that would be reported on Form N-PORT and Form N-CEN could increase the initial and ongoing reporting costs for investment companies, and increase the likelihood of front-running or copycatting by other investors, Commission staff believes that the information is important to fully describe a fund's investments.

The Commission is also proposing to require risk-sensitivity measures at the portfolio and position level on Form N-PORT. These measures would aid Commission staff to efficiently understand the risk exposures of investment companies, especially those funds that invest in debt securities and derivatives. The portfolio risk-sensitivity measures, DV01 and SDV01, and the position level risk-sensitivity measure, delta, would improve the ability of Commission staff to efficiently approximate the risk exposures of reporting funds.

A reasonable alternative is to require additional portfolio and position level risk-sensitivity measures that would provide Commission staff a more precise approximation of the risk exposures of reporting funds for larger changes in the value of the reference instrument. For example, Form N-PORT could require at the portfolio level measures that describe the sensitivity of a reporting fund to a 50 or 100 basis point change in interest rates and credit spreads, and a measure of convexity; and Form N-PORT at the position level could require gamma.[731] These measures could improve the ability of Commission staff to monitor the fund industry when large changes in prices and rates occur. The Commission could also require other risk measures including vega. While potentially valuable, requiring these additional risk-sensitivity measures could increase the burden on funds, and the additional precision might not significantly improve the ability of Commission staff to monitor the fund industry in most market environments. Another reasonable alternative is to not require any risk-sensitivity measures, or limit the requirement to certain derivatives such as those traded over-the-counter. Although the burden to investment companies to provide the information would be less if fewer or no risk-sensitivity measures were required by the Commission, staff believes that the benefits from requiring the measures, including the ability to efficiently identify and size specific investment risks, justify the costs to investment companies to provide the measures.

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[731] Other risk-sensitivity measures that the Commission could request include portfolio-level duration measures at the position level, or additional position level risk sensitivity measures such as vega.

The Commission is proposing a tiered compliance for filing reports on Form N-PORT—funds that together with other investment companies in the same group of related investment companies with assets over $1 billion would have eighteen months to file reports, and smaller groups of related investment companies with assets less than $1 billion would have thirty months to file reports. An alternative would be to not allow for tiered compliance and require all investment companies to begin filing reports on Form N-PORT within eighteen months. We believe it is appropriate to tier the compliance period to improve the ability of smaller fund complexes to make the system and internal process changes necessary to prepare reports on Form N-PORT. Although the Commission, investors, and other interested parties would potentially not have access to structured portfolio investment information for the smaller fund complexes until thirty months after the effective date, information similar to the proposed requirements concerning disclosures of derivatives that would be required on reports on proposed Form N-PORT would be available elsewhere, such in the fund's financial statements as a result of amendments to Regulation S-X. Although another alternative would be to tier the compliance period for our proposed amendments to Regulation S-X, we believe that it is less likely that smaller fund complexes would benefit from additional time to modify systems to adhere to the amendments to Regulation S-X because the proposed amendments are largely consistent with current disclosure practices and would therefore be unnecessary. Likewise, we could propose a tiered compliance period for reports on proposed Form N-CEN. However, as discussed above, we believe that it is less likely that smaller fund complexes would need additional time to comply with the requirements to file Form N-CEN because the requirements are similar to the current requirements to file Form N-SAR, and we expect that filers will prefer the updated, more efficient filing format of Form N-CEN. Commission staff also considered requiring funds to continue to report Form N-Q, and to amend Form N-SAR instead of replacing it with Form N-CEN. Commission staff believes, however, that the new reporting requirements for portfolio investment information, including the amendments to the certification requirements of Form N-CSR, would cause Form N-Q to become redundant if not outdated, and therefore impose costs on funds to file reports that would result in little benefit. Although requiring that certifying officers state that they have disclosed in the report any change in the registrant's internal control over financial reporting that occurred during the most recent fiscal half-year would increase the burden of filing Form N-CSR, these certifications are necessary to ensure that the information reported continues to be accurate. The Commission also believes that the technology associated with Form N-SAR required the introduction of a new form in order to increase the benefits from the changes made to the reporting of census information. One effect of the amendments to Regulation S-X would be to provide investors with more transparency in a fund's investments. For example, as discussed above, we are proposing to require funds, under certain circumstances, to disclose the components of a custom index underlying swaps or option contracts. As an alternative, we could require funds to only disclose a brief description of the index or require a different threshold for identifying the components of the swap or options contract, such as a custom basket that represents a larger portion of the fund's assets under management. Although these alternatives would attenuate the information disclosed and reduce the potential costs to funds and index providers, these alternatives would result in less transparency for investors into the assets underlying a swap or options contract and any related risks associated with these investments.

The accessibility of information about a fund's investments would also increase as a result of the new option for transmission of shareholder reports and other portfolio investment information. In general, the requirements of proposed rule 30e-3 are designed to allow funds to take advantage of the cost efficiencies from the advancements in technology and to more closely align the transmission format to investor preferences, while at the same time ensuring that shareholders would have an opportunity to view reports in their desired form and have an opportunity to view portfolio investment information in a central and more familiar location. One alternative would be to require different notice and consent procedures, and another alternative would be for funds to report different portfolio investment information on their websites. We believe that the requirements of rule 30e-3, as proposed, provide investors an ability to receive shareholder reports in their desired format and become aware of the availability of portfolio investment information, while at the same time providing funds an opportunity to take advantage of advancements in technology and reduce burdens.

Lastly, the Commission is proposing that investment companies file Form N-PORT and Form N-CEN in an XML structured format. One alternative is to not structure the information. As discussed, the ability of Commission staff investors, third-party information providers, and other potential users to utilize the information is dependent on the efficiency in which the information investment companies provide can be compiled and aggregated. Commission staff believes that the affected parties to this proposal would experience substantially less benefit from the reporting of investment company information if the information is not structured. In addition, based on the Commission's understanding of current practices, it is likely that investment companies and third party service providers have systems in place to accommodate the use of XML. Therefore, requiring information in a format such as XML should impose minimal costs. The proposal would require funds to file certain attachments to their reports on Form N-PORT and Form N-CEN, and these attachments would not be required in a structured format. Commission staff believes that only marginal benefits would result from requiring funds to file these attachments in a structured, XML format due to the narrative format of the information provided.

The technology used to structure the data could affect the benefits and costs associated with the proposed rules, and we have therefore considered alternative formats for structuring the data, such as XBRL. Sending a data file from a sender to a recipient requires many conditions to be satisfied, and one of crucial importance to regulatory data collection is the need for validation. XML provides for a built-in validation framework, and is supported in all modern programming languages. Other data formats can achieve validation but through custom software. The nature of the information we are collecting also lends itself to an XML format due to the non-complex requirements to structure the information, and does not necessitate the need for a more robust framework such as XBRL.

G. Request for Comments

Throughout this release, we have discussed the anticipated benefits and costs of the proposed rules and their potential impact on efficiency, competition, and capital formation. While the Commission does not have comprehensive information on all aspects of asset management industry reporting, the Commission is using the data currently available in considering the effects of the proposals. The Commission requests comment on all aspects of this initial economic analysis, including on whether the analysis has: (1) identified all benefits and costs, including all effects on efficiency, competition, and capital formation; (2) given due consideration to each benefit and cost, including each effect on efficiency, competition, and capital formation; and (3) identified and considered reasonable alternatives to the proposed new rules and rule amendments. We request and encourage any interested person to submit comments regarding the proposed rules, our analysis of the potential effects of the rules and other matters that may have an effect on the proposed rules. The Commission requests that commenters identify sources of data and information as well as provide data and information to assist the Commission in analyzing the economic consequences of the proposed rules. We are also interested in comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked. We urge commenters to be as specific as possible.

Comments on the following questions are of particular interest.

- To what extent would the monthly public reporting or the quarterly public reporting of monthly portfolio investment information aid in the ability of other investors to front-run, predatory trade, or copycat/reverse engineer the investment strategy of reporting funds? To what extent would the monthly public reporting or the quarterly public reporting of monthly portfolio investment information reduce the incentives of fund companies to develop new or alternative strategies, and what would be the effect on fund competition? How would investors benefit from the public reporting of portfolio investment information in the first and second month of each fiscal quarter as compared to the public reporting of the third month only? Would investors benefit from the quarterly public reporting of monthly portfolio investment information? Why?

- To what extent would the additional information required on Form N-PORT, especially with respect to the contractual terms for debt securities and derivatives, including information describing reference instruments, if any, and to securities lending and repurchase and reverse repurchase result in additional front-running, predatory trading, or copycatting/reverse engineering by other investors? Does this raise any confidentiality or other concerns?
- What are the benefits, costs, and other economic effects from funds providing portfolio investment information in a structured XML format? In particular, what are the effects of structured portfolio investment information on the ability of other investors to front-run, predatory trade, or copycat/reverse engineer the investment strategy of reporting funds? How would the effect of structured portfolio investment information differ between funds that engage in alternative strategies or utilize derivatives as part of its investment strategy and those funds that do not? To what extent would portfolio investment information that is structured reduce the incentives of fund companies to develop new or alternative strategies, and what would be the effect on fund competition? Also, would the public reporting of portfolio investment information in an XML format result in a decrease in the costs to investors from obtaining the information?
- What are the operational benefits and costs to investment companies to file Form N-PORT and Form N-CEN in a structured format? What are the costs to funds

from adapting systems to the new filing requirements? To what extent would the fund industry benefit from a standard format to report information?

- Is there additional information that Form N-PORT and Form N-CEN, as proposed, could require that would aid in the ability of the Commission to oversee the fund industry or that could be beneficial to other potential users? Are any of the proposed information requirements duplicative or unnecessary? What are the benefits and costs of reporting this additional information? Is there information that Form N-PORT and Form N-CEN, as proposed, would require that does not aid in the ability of the Commission to oversee the fund industry and would not benefit other potential users? What are the benefits and costs of not reporting this information?
- What are the costs, benefits, and other economic effects from investment companies reporting risk-sensitivity measures on Form N-PORT? What is the current availability of the measures to investment companies, in particular for more complex or exotic derivatives? Are there competitive or other economic effects from the reporting of risk-sensitivity measures? Would the public reporting of the risk-sensitivity measures disclose information relating to proprietary risk management practices of investment companies?
- To what extent would the proposal affect the ability of investors to understand the investment risks of investment companies as a result of the proposal and to efficiently allocate capital? Would investors be more likely to allocate additional capital to investment companies? What would be the effect on fund competition for investor capital?

- Under what circumstances and to what extent would funds choose to rely on proposed rule 30e-3 by making shareholder reports publicly accessible on a website and satisfying the other conditions of the rule? Would allowing funds that choose to rely on the proposed rule to transmit shareholder reports to their investors "by default" result in more investors viewing shareholder reports in a format that the investors prefer, or would the need for each investor who wishes to receive a printed report to affirmatively "opt-out" of electronic delivery reduce the number of shareholders that receive reports in the format that they prefer? Why or why not? What is the likelihood that investors would mistakenly opt-out and consent to website posting? Lastly, to what extent do investors compare portfolio investment information between fiscal quarters, and would investors benefit from the requirement that a fund's shareholder reports as well as its complete portfolio holdings from its most recent first and third fiscal quarters be publicly accessible on a website?
- What are the costs, benefits, and other economic effects to other market participants including third-party information providers, index providers, and swap dealers? For instance, what would be the economic effects of structured data on the cost to service providers to offer aggregated information to investors? Are there other market participants that would be affected by the proposal that are not discussed above? What are the benefits and costs to these other market participants?
- What are the benefits and costs of providing an additional twelve months for smaller entities to comply with the requirements to file Form N-PORT? Are there

potential costs from smaller fund complexes potentially not providing structured portfolio investment information during the additional twelve months? Are the potential costs, if any, from a loss of disclosed portfolio investment information from small fund complexes mitigated by the amendments to Regulation S-X? Are there other alternatives to the current compliance dates that would be more beneficial or that would be less costly, including with respect to other parts of the proposal? Which alternatives and why?

- What are the costs associated with rescinding N-Q and replacing Form N-SAR? How reliant are investors, third-party information providers, and other interested parties on the data reported on these forms? What are the costs to investors, third-party information providers, and other interested parties to obtain the information from alternative sources? What are the benefits from the amendments to certification requirements of Form N-CSR? What are the costs?
- Are there alternatives to the proposal that the Commission did not consider that would result in a more robust disclosure regime for investment companies? What are the costs associated with those alternatives? Similarly, are there alternatives to the proposal that would result in the same benefits but that would be less costly? Which alternatives and why?

V. PAPERWORK REDUCTION ACT

Proposed new forms, Form N-CEN and Form N-PORT, and proposed new rule 30e-3 contain "collections of information" within the meaning of the Paperwork

Reduction Act of 1995 ("PRA").[732] In addition, the proposed amendments to Articles 6 and 12 of Regulation S-X would impact the collections of information under rules 30e-1 and 30e-2 of the Investment Company Act,[733] and the proposed amendments to Forms N-1A, N-2, N-3, N-4 and N-6 under the Investment Company Act and Securities Act would impact the collections of information under those forms. Furthermore, the proposals would rescind Forms N-Q and N-SAR, thus eliminating the collections of information associated with those forms.

The titles for the existing collections of information are: "Form N-Q – Quarterly Schedule of Portfolio Holdings of Registered Management Investment Company" (OMB Control No. 3235-0578);[734] "Form N-SAR under the Investment Company Act of 1940, Semi-Annual Report for Registered Investment Companies" (OMB Control No. 3235-0330); Rule 30e-1 under the Investment Company Act of 1940, Reports to Stockholders of Management Companies" (OMB Control No. 3235-0025); "Rule 30e-2 pursuant to Section 30(e) of the Investment Company Act of 1940. Reports to Shareholders of Unit Investment Trusts" (OMB Control No. 3235-0494); "Form N-CSR under the Securities Exchange Act of 1934 and under the Investment Company Act of 1940, Certified

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[732] 44 U.S.C. 3501 through 3521.

[733] The paperwork burden from Regulation S-X is imposed by the rules and forms that relate to Regulation S-X and, thus, is reflected in the analysis of those rules and forms. To avoid a PRA inventory reflecting duplicative burdens and for administrative convenience, we have previously assigned a one-hour burden to Regulation S-X.

[734] Currently, there is a collection of information associated with rule 30b1-5 under the Investment Company Act. *See* rule 30b1-5, 'Quarterly Report' Originally submitted and approved as Proposed Rule 30b1-4 under the Investment Company Act of 1940, 'Quarterly Report'" (OMB Control No. 3235-0577). Rule 30b1-5 is the rule that requires certain funds to file Form N-Q. Among other things, today's proposals would rescind Form N-Q and require certain funds to file proposed Form N-PORT pursuant to proposed rule 30b1-9. If proposed rule 30b1-9 is adopted, we anticipate discontinuing the information collection for rule 30b1-5.

Shareholder Report of Registered Management Investment Companies" (OMB Control No. 3235-0570); "Form N-1A under the Securities Act of 1933 and under the Investment Company Act of 1940, Registration Statement of Open-End Management Investment Companies" (OMB Control No. 3235-0307); "Form N-2 under the Investment Company Act of 1940 and Securities Act of 1933, Registration Statement of Closed-End Management Investment Companies" (OMB Control No. 3235-0026); "Form N-3 Under the Securities Act of 1933 and Under the Investment Company Act of 1940, Registration Statement of Separate Accounts Organized as Management Investment Companies" (OMB Control No. 3235-0316); "Form N-4 (17 CFR 239.17b) Under the Securities Act of 1933 and (17 CFR 274.11c) Under the Investment Company Act of 1940, Registration Statement of Separate Accounts Organized as Unit Investment Trusts" (OMB Control No. 3235-0318); and "Form N-6 (17 CFR 239.17c) Under the Securities Act of 1933 and (17 CFR 274.11d) Under the Investment Company Act of 1940, Registration Statement of Separate Accounts Organized as Unit Investment Trusts that Offer Variable Life Insurance Policies" (OMB Control No. 3235-0503). We are also submitting new collections of information for proposed new forms, Form N-CEN and Form N-PORT and proposed new rule 30e-3 under the Investment Company Act. The titles for these new collections of information would be: "Form N-CEN Under the Investment Company Act, Annual Report for Registered Investment Companies;" "Form N-PORT Under the Investment Company Act, Monthly Portfolio Investments Report;" "Rule 30e-3 Under the Investment Company Act, Website Transmission of Shareholder Reports." The Commission is submitting these collections of information to the OMB for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

The Commission is proposing new forms, Form N-CEN and Form N-PORT, new rule 30e-3, and amendments to Regulation S-X and the relevant registration forms, as well as the rescission of Forms N-Q and Form N-SAR as part of a set of reporting and disclosure reforms. These reforms are designed to harness the benefits of advanced technology and to modernize the fund reporting regime in order to help investors and other market participants better assess different fund products and to assist the Commission in carrying out our regulatory functions. We discuss below the collection of information burdens associated with these reforms.

A. Portfolio Reporting

1. Form N-PORT

Under our proposal, certain funds would be required to file an electronic monthly report on proposed Form N-PORT within thirty days after the end of each month. Proposed Form N-PORT is intended to improve transparency of information about funds' portfolio holdings and facilitate oversight of funds. The information required by proposed Form N-PORT would be data-tagged in XML format. The respondents to proposed Form N-PORT would be management investment companies (other than money market funds and small business investment companies) and UITs that operate as ETFs. Compliance with proposed Form N-PORT would be mandatory for all such funds. Responses to the reporting requirements would be kept confidential for reports filed with respect to the first two months of each quarter; the third month of the quarter would not be kept confidential, but made public sixty days after the quarter end.

We estimate that 10,710 funds[735] would be required to file, on a monthly basis, a complete report on proposed Form N-PORT reporting certain information regarding the fund and its portfolio holdings. Based on our experience with other interactive data filings, we estimate that funds would prepare and file their reports on proposed Form N-PORT by either (1) licensing a software solution and preparing and filing the reports in house, or (2) retaining a service provider to provide data aggregation, validation and/or filing services as part of the preparation and filing of reports on proposed Form N-PORT on behalf of the fund. We estimate that 35% of funds (3,749 funds) would license a software solution and file reports on proposed Form N-PORT in house.[736] We further estimate that each fund that files reports on proposed Form N-PORT in house would require an average of approximately 44 burden hours to compile (including review of the information), tag, and electronically file a report on proposed Form N-PORT for the first time[737] and an average of approximately 14 burden hours for subsequent filings.[738]

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735 This estimate includes 8,731 mutual funds (excluding money market funds), 1,411 ETFs and 568 closed-end funds and is based on ICI statistics as of December 31, 2014 *available at* http://www.ici.org/research/stats.

736 *See* Money Market Fund Reform 2014 Release, *supra* note 13, at 47945 (adopting amendments to Form N-MFP and noting that approximately 35% of money market funds that report information on Form N-MFP license a software solution from a third party that is used to assist the funds to prepare and file the required information).

737 We anticipate that these funds would use the same software that was used to generate reports on Form N-Q and that the software vendor offering the Form N-Q software would likely offer an update to that software to handle reports on Form N-PORT. Accordingly, we estimate the burden associated with information that is currently filed on Form N-Q and that would also be filed on Form N-PORT to generally be the same – 10.5 hours per filing. With respect to new data that would be required by Form N-PORT that was not required by Form N-Q, we generally estimate that it would initially take up to 10 hours to connect the software to the new data points. However, because we understand risk metrics data may be located on a different system than portfolio holdings data and because current reporting requirements do not require funds to have a process in place for these two systems to work together, with respect to the new risk metrics data that would be required by Form N-PORT, we estimate that it would initially take up to 15 hours to connect the risk metrics data to the software and

Therefore, we estimate the per fund average annual hour burden associated with proposed Form N-PORT for 3,749 fund filers is 198 hours for the first year[739] and 168 hours for each subsequent year.[740] Amortized over three years, the average aggregate annual hour burden would be 178 hours per fund.[741]

We estimate that 65% of funds (6,962 funds) would retain the services of a third party to provide data aggregation, validation and/or filing services as part of the preparation and filing of reports on proposed Form N-PORT on the fund's behalf.[742] Because reports on Form N-PORT would be filed in a structured format and more frequently than current portfolio holdings reports (*i.e.,* Form N-CSR and Form N-Q), we

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that, once connected, it would take 5 hours to program the risk metrics software to output the required data to the Form N-PORT software. Additionally, we added another 3.5 hours to our estimated initial burden to account for the increased amount of information that would be required to be reported on Form N-PORT, but that is not currently required by Form N-Q. *See infra* note 738 (discussing the additional 30% burden added to the current Form N-Q estimate). We also note that funds that are part of a larger fund complex may realize certain economies of scale when preparing and filing reports on proposed Form N-PORT. For purposes of our analysis, we do not account for such economies of scale.

738 We anticipate that most of the burden associated with licensing a software solution, as discussed above, will be a one-time burden. Accordingly, we estimate approximately 14 hours per fund for subsequent filings. This estimate is based on the 10.5 hours currently estimated for filings on Form N-Q, plus 30% to account for the amount of additional information that would be required to be filed on Form N-PORT. Additionally, because we believe that the required information is generally maintained by funds pursuant to other regulatory requirements or in the ordinary course of business, for the purposes of our analysis, we have not ascribed any time to collecting the required information. *See also supra* note 737 (noting that our estimates do not account for economies of scale).

739 The estimate is based on the following calculation: (1 filing x 44 hours) + (11 filings x 14 hours) = 198 burden hours in the first year.

740 This estimate is based on the following calculation: 12 filings x 14 hours = 168 burden hours in each subsequent year.

741 The estimate is based on the following calculation: (198 + (168 x 2)) / 3 = 178.

742 *See* Money Market Fund Reform 2014 Release, *supra* note 13, at 47945 (adopting amendments to Form N-MFP and noting that approximately 65% of money market funds that report information on Form N-MFP retain the services of a third party to provide data aggregation and validation services as part of the preparation and filing of reports on Form N-MFP).

anticipate that funds and their third-party service providers will move to automate the aggregation and validation process to the extent they do not already use an automated process for portfolio holdings reports. For these funds, we estimate that each fund would require an average of approximately 60 burden hours to compile and review the information with the service provider prior to electronically filing the report for the first time[743] and an average of approximately 9 burden hours for subsequent filings.[744] Therefore, we estimate the per fund average annual hour burden associated with proposed Form N-PORT for 6,962 funds would be 159 hours for the first year[745] and 108 hours for each subsequent year.[746] Amortized over three years, the average aggregate annual hour

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[743] In order to be able to automate the process of communicating data to a third-party service provider so that it can be reported on Form N-PORT, we estimate that it will initially take a fund 60 hours to either procure software and integrate it into its systems or, alternatively, to write its own software. For those funds that already have an automated portfolio reporting process in place, we estimate that they would initially incur the same burden as those funds that license a software solution and file reports on proposed Form N-PORT in house. For these latter funds, however, we are using the higher burden hours estimated for using a third party service provider in order to be conservative in our estimates because we lack data on the number of funds that currently have an automated portfolio reporting process in place. *See supra* note 737 (discussing the burdens associated with licensing a software solution and filing reports on proposed Form N-PORT in house); *see also supra* note 737 (noting that our estimates do not account for economies of scale).

[744] We anticipate that most of the burden associated with third-party aggregation and validation will be the result of creating an automated process, as discussed above, and thus will be a one-time burden. Accordingly, we estimate approximately 9 hours per fund for subsequent filings. This estimate is based on the 10.5 hours currently estimated for filings on Form N-Q, plus 30% to account for the amount of additional information that would be required to be filed on Form N-PORT, and subtracting 5 hours in recognition of the use of a third-party service provider to assist in the preparation and filing of reports on the form. Additionally, because we believe that the required information is generally maintained by funds pursuant to other regulatory requirements or in the ordinary course of business, for the purposes of our analysis, we have not ascribed any time to collecting the required information. *See also supra* note 737 (noting that our estimates do not account for economies of scale).

[745] The estimate is based on the following calculation: (1 filing x 60 hours) + (11 filings x 9 hours) = 159 burden hours per year.

[746] The estimate is based on the following calculation: 12 filings x 9 hours = 108.

burden would be 125 hours per fund.[747] In sum, we estimate that filing reports on proposed Form N-PORT would impose an average total annual hour burden of 1,537,572 on applicable funds.[748]

In addition to the costs associated with the hour burdens discussed above, funds would also incur other external costs in connection with reports on proposed Form N-PORT. Based on our experience with other interactive data filings, we estimate that funds that would file reports on proposed Form N-PORT in house would license a third-party software solution to assist in filing their reports at an average cost of $4,805 per fund per year.[749] In addition, we estimate that funds that would use a service provider to prepare and file reports on proposed Form N-PORT would pay an average fee of $11,440 per fund per year for the services of that third-party provider.[750] In sum, we estimate that all applicable funds would incur on average, in the aggregate, external annual costs of $97,674,221.[751]

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747 The estimate is based on the following calculation: (159 + (108 x 2)) / 3 = 125.

748 The estimate is based on the following calculation: (3,749 x 178 hours) + (6,962 x 125 hours) = 1,537,572.

749 We estimate that money market funds that file reports on Form N-MFP in house license a third-party software solution for approximately $3,696 per fund per year. Due to the increased volume and complexity of the information that would be filed in reports pursuant to proposed Form N-PORT, we have increased our external cost estimate for funds filing in house on proposed Form N-PORT by 30% (or $1,109).

750 We estimate that money market funds that file reports on Form N-MFP through a third-party service provider pay approximately $8,800 per fund per year. Due to the increased volume and complexity of the information that would be filed in reports pursuant to proposed Form N-PORT, we have increased our estimate for funds filing through a third-party service provider on proposed Form N-PORT by 30% (or $2,640).

751 This estimate is based on the following calculation: (3,749 funds that would file reports on proposed Form N-PORT in house x $4,809 per fund, per year) + (6,962 funds that would file reports on proposed Form N-PORT using a third-party service provider x $11,440 per fund, per year) = $97,674,221.

2. Rescission of Form N-Q

Our proposed reforms would rescind Form N-Q in order to eliminate unnecessarily duplicative reporting requirements. The proposed rescission of Form N-Q would affect all management investment companies required to file reports on the form.

We currently estimate that each fund requires an average of approximately 21 hours per year to prepare and file two reports on Form N-Q annually, for a total estimated annual burden of 219,513 hours.[752] Accordingly, we estimate that, in the aggregate, our proposed rescission would eliminate the 219,513 annual burden hours associated with filing Form N-Q. Additionally, we currently estimate that there are no external costs associated with the certification requirement or with preparation of reports on Form N-Q in general.

B. Census Reporting

1. Form N-CEN

As proposed, amended rule 30a-1 would require all funds to file reports on proposed Form N-CEN with the Commission on an annual basis.[753] Similar to current Form N-SAR, proposed Form N-CEN would require reporting with the Commission of certain census-type information. However, unlike Form N-SAR, which requires semi-annual reporting for all management investment companies, proposed Form N-CEN would require annual reporting.[754] Proposed Form N-CEN would be a collection of information under the PRA, and is designed to facilitate the Commission's oversight of

[752] Management investment companies are required to file a quarterly report on Form N-Q after the close of the first and third quarters of each fiscal year.

[753] For purposes of the PRA analysis, the burdens associated with amended rule 30a-1, as proposed, are included in the collection of information estimates of Form N-CEN.

[754] UITs are only required to file Form N-SAR on an annual basis. *See* rule 30a-1.

funds and its ability to monitor trends and risks. This new collection of information would be mandatory for all funds, and responses would not be kept confidential.

The staff estimates that the Commission would receive an average of 3,146 reports per year, based on the number of existing Form N-SAR filers.[755] We estimate that management investment companies would each spend as much as 13.35 hours annually, preparing and filing reports on proposed Form N-CEN.[756] The Commission further estimates that UITs, including separate account UITs, would each spend as much as 9.11 hours annually, preparing and filing reports on proposed Form N-CEN, since a UIT would be required to respond to fewer items.[757]

As discussed below, we currently estimate that management investment companies spend as much as 15.35 hours preparing and filing each report on Form N-SAR. We have generally sought with proposed Form N-CEN, where appropriate, to simplify and decrease the census-type reporting burdens placed on registrants by current Form N-SAR. For example, proposed Form N-CEN would reduce the number of attachments that may need to be filed with the reports and largely eliminate financial statement-type information from the reports. Additionally, we believe that reports in XML on proposed Form N-CEN will be less burdensome to produce than the reports on Form N-SAR currently required to be filed using outdated technology. Accordingly, for management investment companies we believe the estimated hour burden for filing

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[755] This estimate is based on 2,419 management companies and 727 UITs filing reports on Form N-SAR as of December 31, 2014.

[756] Our estimate includes the hourly burden associated with registering/maintaining LEIs for the registrant/funds, which would be required to be included in reports on Form N-CEN.

[757] *See id.*

reports on proposed Form N-CEN should be a reduced burden from the hour burden associated with Form N-SAR.[758] As such, we estimate that the annual hour burden for management companies will be 13.35 per report on proposed Form N-CEN, down from 15.35 hours per report for Form N-SAR.

UITs may, however, experience an increase in the hour burden associated with census-type reporting if proposed Form N-CEN is adopted because UITs would be required to respond to more items in the form than they are currently required to respond to under Form N-SAR. For example, UITs would be required to provide certain background information and attachments in their reports on proposed Form N-CEN, which they are not currently required to provide in their reports on Form N-SAR. As a result, we have increased the annual hour burden for UITs from 7.11 hours in the currently approved collection for Form N-SAR to 9.11 hours for proposed Form N-CEN.

The Commission also believes that, in the first year reports on the form are filed, funds may require additional time to prepare and file reports. We estimate that, for the first year, funds would require 20 additional hours.[759] Accordingly, we estimate that management investment companies would require 33.35 annual burden hours in the first

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[758] We note that reports on Form N-CEN would be filed annually, rather than semi-annually as in the case of reports on Form N-SAR. Thus, while we estimate that the burden associated with each report on Form N-CEN for management companies would be two hours less than the burden associated with each report on Form N-SAR, we estimate that the annual Form N-CEN burden for management companies would actually be 17.35 hours less than that associated with Form N-SAR. This estimate is based on the following calculation: (15.35 Form N-SAR burden hours x 2 reports) – 13.35 Form N-CEN burden hours = 17.35 hours.

[759] This additional time may be attributable to, among other things, reviewing and collecting new or revised data pursuant to the Form N-CEN requirements or changing the software currently used to generate reports on Form N-SAR in order to output similar data in a different format.

year[760] and 13.35 annual burden hours in each subsequent year for preparing and filing reports on proposed Form N-CEN. Additionally, we estimate that UITs would require 29.11 annual burden hours in the first year[761] and 9.11 annual burden hours in each subsequent year for preparing and filing reports on proposed Form N-CEN.

We estimate that the average annual hour burden per response for proposed Form N-CEN for the first year would be 32.37 hours[762] and 12.37 hours in subsequent years.[763] Amortizing the burden over three years, we estimate that the average annual hour burden per fund per year would be 19.04[764] and the total average annual hour burden would be 59,900.[765]

With respect to the initial filing of a report on Form N-CEN, we estimate an external cost of $220 per fund and, with respect to subsequent filings, we estimate an annual external cost of $120 per fund.[766] We estimate the amortized annual external cost per fund would be $153.[767] We currently estimate that no external cost burden is associated with Form N-SAR. External costs include the cost of goods and services, which with respect to reports on Form N-CEN, would include the costs of registering and

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[760] This estimate is based on the following calculation: 13.35 hours for filings + 20 additional hours for the first filing = 33.35 hours.

[761] This estimate is based on the following calculation: 9.11 hours for filings + 20 additional hours for the first filing = 29.11 hours.

[762] This estimate is based on the following calculation: ((2,419 management investment companies x 33.35 hours) + (727 UITs x 29.11 hours)) / 3,146 total funds = 32.37 hours.

[763] This estimate is based on the following calculation: ((2,419 management investment companies x 13.35 hours) + (727 UITs x 9.11 hours)) / 3,146 = 12.37 hours.

[764] This estimate is based on the following calculation: (32.37 + (12.37 x 2)) / 3 = 19.04.

[765] This estimate is based on the following calculation: 3,146 x 19.04 = 59,900.

[766] *See supra* note 46 (discussing the costs associated with registering and maintaining an LEI).

[767] This estimate is based on the following calculation: $220 + (2 years x $120) / 3 = $153.

maintaining an LEI for the registrant/funds.[768] In sum, we estimate that all applicable funds would incur, in the aggregate, external annual costs of $1,748,637.[769]

2. Rescission of Form N-SAR

Our proposed reforms would rescind Form N-SAR in order to eliminate unnecessarily duplicative reporting requirements. The proposed rescission would affect all management investment companies and UITs.

We currently estimate that the weighted average annual hour burden per response for Form N-SAR is 14.25 hours,[770] with a total annual hour burden for all respondents of approximately 82,223 hours. Accordingly, we estimate that, in the aggregate, our proposed rescission would eliminate the 82,223 annual burden hours associated with filing Form N-SAR. Additionally, we currently estimate that there are no external costs associated with preparation of reports on Form N-SAR.

C. Amendments to Regulation S-X

1. Rule 30e-1

Section 30(e) of the Investment Company Act requires every registered investment company to transmit to its stockholders, at least semiannually, reports containing such information and financial statements or their equivalent, as of a reasonably current date, as the Commission may prescribe by rules and regulations.[771]

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[768] *See* Items 2.d. and 25.c. of Form N-CEN (requiring LEI for the registrant and each management company).

[769] This estimate is based on the following calculation: $153 x 11,429 funds = $1,748,637; *see infra* note 799 (explaining the calculation of 11,429 funds).

[770] This weighted estimate accounts for management companies filing reports on Form N-SAR twice a year and UITs filing reports on Form N-SAR once a year.

[771] Section 30(e).

Rule 30e-1 generally requires management investment companies to transmit to their shareholders, at least semi-annually, reports containing the information that is required to be included in such reports by the fund's registration statement form under the Investment Company Act.[772] Pursuant to this rule and Forms N-1A and N-2, management investment companies are required to include the financial statements required by Regulation S-X in their shareholder reports.[773]

Rule 30e-1 also permits, under certain conditions, delivery of a single shareholder report to investors who share an address ("householding").[774] Specifically, rule 30e-1 permits householding of annual and semi-annual reports by management companies to satisfy the transmission requirements of rule 30e-1 if, in addition to the other conditions set forth in the rule, the management company has obtained from each applicable investor written or implied consent to the householding of shareholder reports at such address. The rule requires management companies that wish to household shareholder reports with implied consent to send a notice to each applicable investor stating, among other things, that the investors in the household will receive one report in the future unless the investors provide contrary instructions. In addition, at least once a year, management companies relying on the householding provision must explain to investors who have provided written or implied consent how they can revoke their consent.

Compliance with the disclosure requirements of rule 30e-1 is mandatory. Responses to the disclosure requirements are not be kept confidential.

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772 Rule 30e-1.

773 *See* Item 27 of Form N-1A and Item 24 of Form N-2.

774 *See* rule 30e-1(f).

Based on staff conversations with fund representatives, we currently estimate that it takes approximately 84 hours per fund to comply with the collection of information associated with rule 30e-1, including the householding requirements. This time is spent, for example, preparing, reviewing, and certifying the reports. The current total estimated annual hour burden of responding to rule 30e-1 is approximately 903,000 hours.[775]

As discussed above, we are proposing certain amendments to Articles 6 and 12 of Regulation S-X. As outlined in Part II.C. above, the amendments would: (1) require new, standardized disclosures regarding fund holdings in open futures contracts, open forward foreign currency contracts, and open swap contracts, and additional disclosures regarding fund holdings of written and purchased options; (2) update the disclosures for other investments, as well as reorganize the order in which some investments are presented; (3) amend the rules regarding the general form and content of fund financial statements; and (iv) require a new disclosure in the notes to the financial statements relating to a fund's securities lending activities.[776]

We estimate that that there are 11,230 management companies that would have to comply with these amendments.[777] In addition, we estimate that these amendments would likely increase the time spent preparing, reviewing and certifying reports, if adopted. The extent to which a fund's burden would increase as a result of the proposed

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775 This estimate is based on the following calculation: 84 hours per fund x 10,750 funds (the estimated number of portfolios the last time the rule's information collections were submitted for PRA renewal in 2012) = 903,000 hours.

776 Our amendments would also require prominent placement of disclosures regarding investments in derivatives in a fund's financial statements, rather than allowing such schedules to be placed in the notes to the financial statements. *See supra* Part II.C.

777 This estimate includes 9,259 mutual funds (including money market funds), 1,403 ETFs (1,411 ETFs – 8 UIT ETFs) and 568 closed-end funds and is based on internal SEC data as well as ICI statistics as of December 31, 2014 *available at* http://www.ici.org/research/stats.

amendments would depend on the extent to which the fund invests in the instruments covered by many of the amendments. We estimate that, on an annual basis, funds generally will incur an additional 9 burden hours in the first year[778] and an additional 3 burden hours for filings in subsequent years in order to comply with the proposed amendments.[779] Amortized over three years, the average annual hour burden associated with the amendments for Regulation S-X would be 5 hours per fund.[780] Accordingly, the estimated total annual average hour burden associated with the amendments would be 56,150.[781]

We estimate that the annual external cost burden of compliance with the information collection requirements of rule 30e-1, which is currently $31,061 per fund,

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[778] With respect to the amendments to Article 6 of Regulation S-X, we estimate that each fund would spend an average of five hours to initially comply with the amendments. For example, amendments to Article 6-07.1 would likely require funds to identify non-cash income and put a process in place to capture it in the financial statements. In addition, some funds would also likely move their schedules from financial statement notes to the financial statements themselves. With respect to the amendments requiring disclosure of the components of a custom basket/index, some funds voluntarily provide this disclosure now, but others do not; we recognize that funds would be affected by this requirement differently depending on their investments.

With respect to the amendments to article 12 of Regulation S-X, we estimate each fund would spend an average of four hours to initially comply with the amendments. For example, while accounting guidance already requires funds to identify the level of each security (such as Level 3 securities), we estimate there will be an increased burden in adding another note to the financial statements. This increased burden would vary depending on the information already reported by funds in their financial statements. Likewise, while many funds voluntarily identify illiquid securities in their schedule of investments, the funds that do not make this disclosure would bear an initial burden to comply with these amendments.

[779] With respect to the amendments to Article 6 of Regulation S-X, we estimate each fund would require two hours to comply with the requirements in each subsequent year. We likewise estimate that each fund would require one hour to comply with the requirements of the proposed amendments to Article 12 in each subsequent year.

[780] The estimate is based on the following calculation: (9 hours + (3 hours x 2)) / 3 = 5.

[781] The estimate is based on the following calculation: 5 hours x 11,230 management investment companies = 56,150.

will not change as a result of the proposed amendments to Regulation S-X.[782] We further estimate that the total annual external cost burden for rule 30e-1 would be $348,815,030.[783] External costs include, for example, the costs for funds to prepare, print, and mail the reports.

2. Rule 30e-2

Rule 30e-2 requires registered UITs that invest substantially all of their assets in shares of a management investment company to send their unitholders annual and semiannual reports containing financial information on the underlying company.[784] Specifically, rule 30e-2 requires that the report contain all the applicable information and financial statements or their equivalent, required by rule 30e-1 under the Investment Company Act to be included in reports of the underlying fund for the same fiscal period.[785] Rule 30e-2 also permits UITs to rely on the householding provision in rule 30e-1 to transmit a single shareholder report to investors who share an address.[786]

Compliance with the disclosure requirements of rule 30e-2 is mandatory. Responses to the disclosure requirements are not kept confidential.

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782 Because the proposed amendments would largely reorganize information currently reported by funds in their financial statements, either voluntarily or because it is required, we do not believe the external costs, such as printing and mailing costs, will increase as a result of the amendments.

783 This estimate is based on the following calculation: 11,230 funds x $31,061 = $348,815,030. The current total annual cost burden of rule 30e-1 is $333,905,750, which reflects the higher estimated number of funds subject to rule 30e-1 at the time of the last renewal for the rule. *See supra* note 775.

784 Rule 30e-2.

785 As discussed above, rule 30e-1 (together with Forms N-1A and N-2) essentially requires management investment companies to transmit to their shareholders, at least semi-annually, reports containing the financial statements required by Regulation S-X.

786 *See* rule 30e-2(b); *see also supra* note 774 and accompanying text.

The Commission currently estimates that the annual burden associated with rule 30e-2, including the householding requirements, is 121 hours per respondent. The Commission currently estimates that the total hour burden is approximately 91,960 hours.[787]

As discussed above, we are proposing certain amendments to Articles 6 and 12 of Regulation S-X that, if adopted, would likely increase the time spent preparing, reviewing and certifying reports.[788] The extent to which a UIT's burden increases as a result of the proposed amendments would depend on the extent to which an underlying fund invests in the instruments covered by many of the amendments. We estimate that there are 727 UITs that may be subject to the proposed amendments.[789] We also estimate that, on an annual basis, UITs generally will incur an additional 9 burden hours in the first year[790] and an additional 3 burden hours for filings in subsequent years in order to comply with the proposed amendments.[791] Amortized over three years, we estimate that the average annual hour burden associated with the proposed amendments would be 5

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[787] 760 UITs (the estimated number of UITs the last time the rule's information collections were submitted for PRA renewal in 2012) x 121 hours per UIT = 91,960.

[788] As discussed above, the amendments would: (1) require new, standardized disclosures regarding fund holdings in open futures contracts, open forward foreign currency contracts, and open swap contracts, and additional disclosures regarding fund holdings of written and purchased options; (2) update the disclosures for other investments, as well as reorganize the order in which some investments are presented; (3) amend the rules regarding the general form and content of fund financial statements; and (iv) require a new disclosure in the notes to the financial statements relating to a fund's securities lending activities. In addition, our amendments would also require prominent placement of disclosures regarding investments in derivatives in a fund's financial statements, rather than allowing such schedules to be placed in the notes to the financial statements.

[789] This estimate is based on the number of UITs that filed Form N-SAR with the Commission as of December 31, 2014.

[790] *See supra* note 778.

[791] *See supra* note 779.

hours per fund.[792] Accordingly, we estimate that the total average annual hour burden associated with the proposed amendments to Regulation S-X would be 3,635 hours.[793]

In addition, we estimate that the annual external cost burden of compliance with the information collection requirements of rule 30e-2, which are currently $20,000 per respondent, will not change as a result of the proposed amendments to Regulation S-X.[794] We further estimate that the total annual external cost burden for rule 30e-2 would be $14,540,000.[795] External costs include, for example, the costs for the funds to prepare, print, and mail the reports.

D. Option for Website Transmission of Shareholder Reports

We are also proposing new rule 30e-3, which would permit, but not require, a fund to transmit its reports to shareholders by posting them on its website, as long as the fund meets certain other conditions of the rule regarding (a) availability of the report and other materials, (b) shareholder consent, (c) notice to shareholders, and (d) delivery of materials upon request of the shareholder.[796] Reliance on the rule would be voluntary; however, compliance with the rule's conditions is mandatory for funds relying on the rule. Responses to the information collections would not be kept confidential.

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[792] The estimate is based on the following calculation: (9 hours + (3 hours x 2)) / 3 = 5.

[793] The estimate is based on the following calculation: 5 hours x 727 UITs = 3,635.

[794] *See supra* note 782.

[795] This estimate is based on the following calculation: 727 UITs x $20,000 = $14,540,000. The current total annual cost burden of rule 30e-2 is $15,200,000, which reflects the higher estimated number of UITs at the time of the last renewal for the rule. *See supra* note 787.

[796] *See* proposed rule 30e-3.

1. Availability of Report and Other Materials and Delivery Upon Request

Proposed rule 30e-3 would provide that a fund's annual or semiannual report to shareholders would be considered transmitted to a shareholder of record if certain conditions set forth in the rule are satisfied. Among these conditions are the requirements that (i) the fund's shareholder report, any previous shareholder report transmitted to shareholders of record within the last 244 days, and in the case of a fund that is not an SBIC, the fund's complete portfolio holdings as of the close of its most recent first and third fiscal quarters, be publicly accessible, free of charge, at a specified website address,[797] and (ii) the fund (or a financial intermediary through which shares of the fund may be purchased or sold) must send a paper copy of any of the materials discussed in (i) above to a shareholder upon request.[798]

We estimate that 11,957 funds could rely on proposed new rule 30e-3.[799] Of these funds, we estimate that 90% of all funds (or 10,761 funds) would rely on proposed rule 30e-3.[800] Of this 10,761, we estimate 9,634 are funds relying on the summary prospectus

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797 Proposed rule 30e-3(b)(1)(i)-(iii).

798 Proposed rule 30e-3(e).

799 This estimate includes 9,259 mutual funds (including money market funds), 1,403 ETFs (1,411 ETFs – 8 UIT ETFs), 568 closed-end funds, and 727 UITs (including UIT ETFs) based on ICI statistics, Form N-SAR filings, and internal SEC data as of December 31, 2014. *See* ICI statistics *available at* http://www.ici.org/research/stats.

800 Open-end funds relying on the summary prospectus rule, rule 498 under the Securities Act, are required to post their annual and semi-annual reports online. *See* rule 498(e)(1). In 2014, 9,634 funds filed a summary prospectus, which amounts to 90% of all open-end funds (9,634 / (9,259 mutual funds + 1,403 ETFs (not including UITs))). Because these funds are already posting their shareholder reports online, we estimate that they will rely on proposed rule 30e-3 to transmit their reports. Based on the percentage of funds that rely on the summary prospectus rule, which, like proposed rule 30e-3, requires posting of documents online while also reducing printing and mailing costs for funds, we estimate that 90% of closed-end funds and UITs (or 1,166 funds ((568 closed-end funds + 727 UITs) x 90%) will rely on proposed

rule (rule 498 under the Securities Act) and, thus, currently posting annual and semiannual shareholder reports on their websites. Accordingly, with respect to these funds, we estimate that annual compliance with the posting requirements of proposed rule 30e-3 will require a half hour burden per fund.[801]

Of the remaining funds estimated to rely on proposed rule 30e-3, we further estimate that approximately 90% of those funds[802] (or 1,014 funds) already have a website.[803] With respect to these funds, we estimate that the posting requirements of proposed rule 30e-3 will require a one and half hour burden per fund to post the required documents online, both in the first year and annually thereafter. For the remaining 10% of funds (or 113 funds) that we estimate will rely on the proposed rule but that do not have a website,[804] we estimate initial compliance with the posting requirements will require approximately 24 hours per fund of internal fund staff time to develop a webpage

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rule 30e-3. Accordingly, we estimate that 90% of all funds ((9,634 open-end funds + 1,166 other funds) / 11,957 funds) would also rely on proposed rule 30e-3.

801 Because each of these funds is already required to have a website and to post its annual and semiannual shareholder reports on this website, we estimate that proposed rule 30e-3 will only result in each of these funds incurring a half hour burden per year to post their first and third quarter portfolio holdings on their websites, including in the first year of compliance with the rule.

802 *See* Money Market Fund Reform 2010 Release, *supra* note 13, at 10092 (estimating that 20% of money market funds would have to develop a website in connection with new website posting requirements). Because five years have passed since we estimated 80% of money market funds had websites, and given the increased use of the Internet, we believe it is appropriate to estimate that 90% of funds currently have websites.

803 This estimate is based on the following calculation: (10,761 funds – 9,634 open-end funds relying on the summary prospectus rule) x 90% = 1,014 funds.

804 This estimate is based on the following calculation: (10,761 funds – 9,634 open-end funds relying on the summary prospectus rule) x 10% = 113 funds.

and post the required documents on the webpage.[805] In addition, we estimate that each of these funds would spend approximately four hours of professional time to maintain and update a webpage with the required information on a quarterly basis.[806]

Accordingly, we estimate that the posting requirements will result in an average annual hour burden of 0.84 hours per fund in the first year of compliance[807] and 0.76 hours per fund for each of the next two years.[808] Amortized over three years, the average annual hour burden would be 0.79 hours per fund.[809] In sum, we estimate that the posting requirements of proposed rule 30e-3 would impose an average total annual hour burden of 8,447 hours on applicable funds.[810]

In addition, with respect to those funds that would rely on proposed rule 30e-3 but that do not currently have a website, we estimate that the posting requirements of the

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805 *See* Money Market Fund Reform 2010 Release, *supra* note 13, at 10092 (estimating 24 hours of internal staff time to develop a webpage). Funds that are part of a larger fund complex may realize certain economies of scale in connection with creating a website. For purposes of our analysis, we do not account for such economies of scale.

806 *See id.* (estimating 4 hours of professional time to maintain and update a webpage with the required money market fund information on a monthly basis). Funds that are part of a larger fund complex may realize certain economies of scale in connection with maintaining and updating a website. For purposes of our analysis, we do not account for such economies of scale.

807 This estimate is based on the following calculations: 9,634 open-end funds relying on the summary prospectus rule x .5 hours = 4,817 hours; 1,014 funds with a website but not relying on the summary prospectus rule x 1.5 hours = 1,521 hours; 113 funds without a website x 24 hours in the first year = 2,712 hours; 4,817 hours + 1,521 hours + 2,712 hours = 9,050; 9,050 / 10,761 = 0.84 hours.

808 This estimate is based on the following calculations: 9,634 open-end funds relying on the summary prospectus rule x .5 hours = 4,817 hours; 1,014 funds with a website but not relying on the summary prospectus rule x 1.5 hours = 1,521 hours; 113 funds without a website x (4 hours x 4 quarters) = 1,808 hours; 4,817 + 1,521 + 1,808 = 8,146; 8,146 / 10,761= 0.76 hours.

809 The estimate is based on the following calculation: (0.84 + (0.76 x 2)) / 3 = 0.79 hours.

810 This estimate is based on the following calculations: 9,050 hours for the first year + (8,146 hours x the 2 following years) = 25,342; 25,342 / 3 = 8,447.

proposed rule will result in an external cost burden of $2000 per fund in the first year to develop a website,[811] but no cost burden in subsequent years.[812] We further estimate that the amortized annual external cost burden associated with developing a website would be $667.[813] In the aggregate, we estimate that the annual total external cost burden with respect to these funds would be $75,371.[814] With respect to those funds that currently have websites, we estimate that the posting requirements of the proposed rule will not result in any external costs.[815] The external cost burden is the cost of goods and services purchased in connection with complying with the rule, which, with respect to the posting requirements, would include costs associated with development of a website.

Furthermore, we also estimate that funds may incur external costs in connection with the requirement to provide a complete shareholder report upon request of a shareholder. We estimate that the annual costs associated with printing and mailing these

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811 *See, e.g., How Much Should a Web Design Cost, Budgeting for a Professional Design for a Small Business Website, available at* http://webdesign.about.com/od/beforeyoustartawebsite/a/how-much-should-a-web-design-cost.htm (suggesting that a fairly basic website would cost $1250-$1500); *What Does a Website Cost? Website Development Costs, available at* http://www.atilus.com/what-does-a-website-cost-web-site-development-costs/ (suggesting a basis website can be created for $2000-$5000). We believe that a website developed for purposes of proposed rule 30e-3 could be fairly basic considering the website would only need to accommodate posting of the required documents.

812 We believe the collection of information burden in subsequent years will be handled internally and have, therefore, accounted for this burden in our estimate of the hourly burden for subsequent years. *See supra* note 806.

813 This estimate is based on the following calculation: $2000 / 3 = $667.

814 This estimate is based on the following calculation: 113 funds x $667 = $75,371.

815 Because these funds maintain their websites for reasons other than compliance with proposed rule 30e-3, we do not attribute any costs related to such maintenance to proposed rule 30e-3.

reports would be $500 per fund.[816] Accordingly, we estimate that the aggregate annual external costs associated with printing and mailing shareholder reports upon request would be $5,380,500.[817] Together with the external costs for those funds that would rely on proposed rule 30e-3 but that do not currently have a website, we estimate that the posting and shareholder request requirements of the proposed rule will result in an annual external cost burden of $5,455,871.[818]

2. Shareholder Consent and Notice

Proposed rule 30e-3 would permit electronic transmission of a shareholder report to a particular shareholder only if the shareholder has either previously consented to this method of transmission or has been determined to have provided implied consent under certain conditions specified in the rule.[819] One of the conditions for implied consent requires that the fund transmit to the shareholder an Initial Statement, at least 60 days

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816 As noted above, we estimate the external costs associated with rules 30e-1 and 30e-2 (the rules relating to shareholder reports) to be $31,061 and $20,000, respectively. These costs account for preparation and transmission of complete shareholder reports twice a year in paper to shareholders. We estimate that one-third of these external costs are attributed to printing and mailing shareholder reports. Additionally, we estimate that 5% of shareholders may request paper copies of shareholder reports transmitted via website pursuant to proposed rule 30e-3. In this regard, we note that shareholders preferring paper copies of shareholder reports will also have the ability to return the postage-paid, pre-addressed reply card that all shareholders will receive with their Initial Statement to indicate that they want to opt-out of website transmission. *See* Part II.D.3.b. above (discussing the Initial Statement). Accordingly, we believe that only a small percentage of shareholders whose shareholder reports are transmitted via website will request paper copies. In order to be conservative in our estimates, we have multiplied 5% by $10,000, which is approximately one-third of the external costs associated with management companies' shareholder reports ($31,061 / 3 = $10,354), which are higher than the external costs associated with UITs' shareholder reports. Thus, we estimate that the external costs associated with providing complete shareholder reports upon request would be $500 (5% x $10,000).

817 This estimate is based on the following calculation: $500 x 10,761 funds = $5,380,500.

818 This estimate is based on the following calculation: $5,380,500 + $75,371 = $5,455,871.

819 *See* proposed rule 30e-3(c).

before it begins to rely on the rule, notifying the shareholder of the fund's intent to make future shareholder reports available on the fund's website until the shareholder revokes consent. Additionally, proposed rule 30e-3 would require funds relying on the rule with respect to a shareholder who has consented to electronic transmission to send a Notice containing certain information to the shareholder within 60 days of the close of the fiscal period to which the report relates.[820] The proposed rule would also require funds to file a form of the Notice with the Commission not later than 10 days after the Notice is sent to shareholders.[821]

As discussed in Part V.D.1. above, we estimate that 90% of all eligible funds (or 10,761 funds) will choose to rely on proposed rule 30e-3.[822] For those funds relying on the rule, we estimate that it will take each fund one and a half hours to prepare the Initial Statement in the first year of compliance with the rule.[823] We further estimate that each fund will incur a half hour burden in subsequent years to the extent the fund has shareholders that have not previously consented to website transmission of the fund's shareholder reports.[824] We also estimate that each fund will incur two hours to prepare

820 *See* proposed rule 30e-3(d).

821 *See* proposed rule 30e-3(d)(7).

822 *See supra* note 800 and accompanying text.

823 *See* Internet Availability of Proxy Materials, Exchange Act Release No. 55146 (Jan. 22, 2007) [72 FR 4148, 4161 (Jan. 29, 2007)] ("Proxy Notice Release") (estimating the annual burden for an issuer or other soliciting person to prepare a notice of Internet availability of proxy materials ("proxy notice") to be approximately one and half hours). We estimate that the length and breadth of the Initial Statement would be similar to that of a proxy notice.

824 Based our initial hour burden estimate for the Initial Statement, and given that a fund will only have to provide the Initial Statement in subsequent years to those shareholders who have not previously consented, we believe the subsequent hour burden will be minimal. Accordingly, we have estimated a half hour burden per fund in subsequent years.

and file the first Notice in the first year[825] and an hour for each subsequent notice.[826] Additionally, with respect to both the Initial Statement and the Notice, we estimate that 75% of the annual hour burden would be incurred by the fund and that 25% of the burden would be incurred by outside counsel retained by the fund.[827]

Accordingly, we estimate that the Initial Statement will result in an average hourly burden per fund of 1.3 hours in the first year[828] and 0.38 hours in each subsequent year.[829] Amortized over three years, the average annual hour burden associated with the Initial Statement would be 0.69 hours per fund.[830] In addition, we estimate that the Notice will result in an average annual hour burden of 2.3 hours per fund in the first year [831] and 1.5 hours per fund in each subsequent year.[832] Amortized over three years, the

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825 *See supra* note 823. We estimate that the length and breadth of the Notice would be similar to that of a proxy notice. However, under proposed rule 30e-3, a Notice would also have to be separately filed with the Commission. Accordingly, we have increased the initial estimated hour burden for the Notice to two hours versus the hour and half estimated hour burden for the proxy notice. In addition, a fund relying on the proposed rule would have to prepare and send a notice to relevant shareholders, and file the notice with the Commission, twice a year – once for the annual shareholder report and once for the semiannual shareholder report. In the first year of compliance with the rule, we estimate that the fund would need two hours to prepare and file the first notice and one hour to prepare and file the second notice, for a total of three hours in the first year of compliance.

826 Based our initial hour burden estimate for the Notice, and given that a fund will likely use its original Notice as a template for subsequent notices but will also have to file each Notice with the Commission, we believe one hour burden per fund per subsequent filing is an appropriate estimate. As noted above, a fund would have to prepare and file a Notice twice a year. As such, we estimate the hour burden for each fund in subsequent years would be two hours.

827 *See* Proxy Notice Release, *supra* note 823 (estimating 75% of the proxy notice burden would be prepared by the issuer and that 25% of the burden would be prepared by outside counsel retained by the issuer).

828 The estimate is based on the following calculation: 1.5 hours x 75% = 1.3 hours.

829 The estimate is based on the following calculation: 0.5 hours x 75% = 0.38 hours.

830 The estimate is based on the following calculation: (1.3 hours + (2 years x 0.38 hours))/ 3 years = 0.69 hours.

831 The estimate is based on the following calculation: (2 hours + 1 hour) x 75% = 2.3 hours.

average annual hour burden associated with the Notice would be 1.8 hours per fund.[833] In sum, we estimate that the shareholder consent and Notice requirements of proposed rule 30e-3 would impose an average total annual hour burden of 8,932 hours on applicable funds.[834]

In addition, we estimate that funds will incur external costs if they rely on proposed rule 30e-3. The external cost burden is the cost of goods and services purchased in connection with complying with the rule, which, with respect to the Initial Statement and Notice, we estimate would include the costs associated with outside counsel and printing and mailing costs.

We estimate outside counsel retained by the fund will incur 25% of the hourly burden associated with each of the Initial Statement and Notice at a rate of $380 per hour.[835] Accordingly, we estimate that outside counsel costs associated with the Initial Statement will result in an average cost burden per fund of $144 in the first year,[836] $49 in subsequent years,[837] and amortized over three years, $81.[838] Additionally, we estimate

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[832] The estimate is based on the following calculation: (1 hour + 1 hour) x 75% = 1.5 hours.

[833] The estimate is based on the following calculation: (2.3 hours + (2 years x 1.5 hours)) / 3 years = 1.8 hours.

[834] This estimate is based on the following calculations: (0.69 hours for the Initial Statement x 10,761 funds) + (1.8 hours for the Notice x 10,761 funds) = 26,795; 26,795 hours / 3 years = 8,932.

[835] This estimate is based on the rate for attorneys in SIFMA's Management and Professional Earnings in the Securities Industry 2013, modified by Commission staff to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

[836] The estimate is based on the following calculation: 1.5 hours associated with x 25% = 0.38 hours; 0.38 hours x $380 = $144.

[837] The estimate is based on the following calculation: 0.5 hours x 25% = 0.13 hours; 0.13 hours x $380 = $49.

that outside counsel costs associated with the Notice will result in an average cost burden per fund of $285 in the first year,[839] $190 in subsequent years, [840] and amortized over three years, $222.[841] In sum, we estimate that the outside counsel costs related to the shareholder consent and Notice requirements of proposed rule 30e-3 would impose an annual average total cost burden of $3,260,583 on applicable funds.[842]

We also estimate that, in the first year, each fund will incur approximately $1000 in printing and mailing costs related to each of the first Initial Statement and Notice.[843] In subsequent years, we estimate each fund will incur $333 in printing and mailing costs

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838 The estimate is based on the following calculation: ($144 + (2 years x $49)) / 3 = $81.

839 The estimate is based on the following calculation: (2 hours + 1 hour) x 25% = 0.75 hours; 0.75 hours x $380 = $285.

840 The estimate is based on the following calculation: (1 hour + 1 hour) x 25% = 0.5 hours; 0.5 hours x $380 = $190.

841 The estimate is based on the following calculation: ($285 + (2 years x $190)) / 3 = $222.

842 This estimate is based on the following calculations: ($81 for the Initial Statement x 10,761 funds) + ($222 for the Notice x 10,761) = $3,260,583.

843 As noted above, we estimate the external costs associated with rules 30e-1 and 30e-2 (the rules relating to shareholder reports) to be $31,061 and $20,000, respectively. These costs account for preparation and transmission of complete shareholder reports twice a year in paper to shareholders. We estimate that one-third of these external costs are attributed to printing and mailing shareholder reports. We estimate that the Initial Statement and Notice would require significantly less be spent on printing and mailing costs given the significantly smaller size of the documents. Accordingly, we estimate that each of the Initial Statement and Notice would require 10% of the printing and mailing costs associated with complete shareholder reports. We also estimate that there would be no other external costs attributable to the Initial Statement or Notice. In order to be conservative in our estimates, we have multiplied 10% by $10,000, which is approximately one-third of the external costs associated with management companies' shareholder reports ($31,061 / 3 = $10,354), which are higher than the external costs associated with UITs' shareholder reports. Thus, we estimate that the initial printing and mailing costs associated with each of the Initial Statement and Notice would be $1000 (10% x $10,000). Additionally, however, with respect to the Notice, we note that a fund would send two Notices a year - one for each shareholder report. Accordingly, we estimate that the printing and mailing costs associated with the Notice would be $2000 ($100 x 2 Notices) in the first year.

related to the Initial Statement[844] and $1000 with respect to each Notice.[845] Amortized over three years, we estimate that the Initial Statement will result in $555 annual cost burden per fund[846] and the Notice will result in a $2000 annual cost burden per fund.[847] In sum, we estimate that the printing and mailing costs related to the shareholder consent and Notice requirements of proposed rule 30e-3 would impose an average annual total cost burden of $27,494,355 on applicable funds.[848] Accordingly, together with the costs associated with outside counsel, we estimate that the shareholder consent and Notice requirements of the proposed rule would impose an average annual total cost burden of $30,754,938.[849]

In total, proposed rule 30e-3 would impose an average total annual hour burden of 17,379 hours on applicable funds[850] and a total annual external cost burden of $36,210,809 on applicable funds.[851]

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844 Given that funds will only have to send the Initial Statement to shareholders who have not yet consented (*e.g.,* new shareholders), we estimate that the external cost burden in subsequent years would only be one-third the cost of the first Initial Statement ($1000 / 3 = $333).

845 We do not believe the external costs associated with printing and mailing the Notice will be different in subsequent years because proposed rule 30e-3 specifies the information to be included in the Notice, which must be sent each time a shareholder report is transmitted. As noted above, funds would send two Notices a year - one for each shareholder report. Accordingly, we estimate that the printing and mailing costs associated with the Notice would be $2000 ($1000 x 2 Notices) in each subsequent year.

846 This estimate is based on the following calculation: ($1000 + (2 years x $333)) / 3 = $555.

847 This estimate is based on the following calculation: ($2000 per year x 3 years) / 3 = $2000.

848 This estimate is based on the following calculations: ($555 for the Initial Statement x 10,761 funds) + ($2000 for the Notice x 10,761) = $27,494,355.

849 This estimate is based on the following calculations: $3,260,583+ $27,494,355 = $30,754,938.

850 This estimate is based on the following calculation: 8,447 hours for the posting requirements + 8,932 hours for the written shareholder consent statement and Notice requirements = 17,379 hours.

3. Impact on Information Collections for Rules 30e-1 and 30e-2

As discussed in Sections V.C.1. and 2. above, rule 30e-1 under the Investment Company Act requires management companies to transmit semi-annual reports to their shareholders and rule 30e-2 under the Investment Company Act requires certain UITs to similarly transmit semi-annual reports to their unitholders.[852] Also as discussed above, we currently estimate, with respect to rule 30e-1, that each fund incurs an annual hourly burden of 84 hours[853] and an annual external cost burden of $31,061 per fund.[854] Additionally, with respect to rule 30e-2, we currently estimate that each UIT respondent incurs an annual hourly burden of 121 hours per fund[855] and an annual external cost burden of $20,000 per fund.[856]

As discussed above, we estimate that 90% of all funds will rely on proposed rule 30e-3. In addition, we estimate that a fund's hourly burden associated with rule 30e-1 or rule 30e-2 will not change as result of proposed rule 30e-3. However, we estimate that, for those funds that rely on proposed rule 30e-3, the fund's external cost burden would decrease. In this regard, we estimate that for 90% of funds relying on rule 30e-3, their

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[851] This estimate is based on the following calculation: $5,455,871 + $30,754,938 = $36,210,809.

[852] *See supra* notes 784 and 785 and accompanying text.

[853] As discussed in Part V.C.1., the current estimated total annual hourly burden for all funds is 903,000 hours. *See supra* note 775.

[854] As discussed in Part V.C.1., the current total estimated annual cost burden for all funds is $333,905,750. *See supra* note 783.

[855] As discussed in Part V.C.2., the current estimated total annual hourly burden for all UIT respondents is 91,960 hours. *See supra* note 787.

[856] As discussed in Part V.C.2., the current total estimated annual cost burden for all UIT respondents is $15,200,000. *See supra* note 795.

annual cost burden related to rule 30e-1 would decrease from $31,061 to $20,707.[857] Additionally, we estimate that for the 90% of funds relying on rule 30e-3, their annual cost burden related to rule 30e-2 would decrease from $20,000 to $13,333.[858] Accordingly, if proposed rule 30e-3 is adopted, we estimate that for 90% of management companies the total annual external cost burden for rule 30e-1 would be $209,285,649[859] and the total annual external cost burden for all management companies under rule 30e-1 would be $244,167,152.[860] Additionally, if proposed rule 30e-3 is adopted, we estimate that for 90% of UITs the total annual external cost burden for rule 30e-2 would be $8,719,782[861] and the total annual external cost burden for all UITs under rule 30e-2 would be $10,179,782.[862]

E. Amendments to Certification Requirements of Form N-CSR

In connection with the rescission of Form N-Q, we are proposing to amend Form N-CSR, the reporting form used by management companies to file certified shareholder

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857 As discussed above, we estimate that one-third of the external costs currently attributed to rule 30e-1 relate to printing and mailing costs, which would not be applicable to management companies relying on proposed rule 30e-3. Accordingly, our estimate is based on the following calculation: $31,061 / 3 = $10,354; $31,061 - $10,354 = $20,707.

858 As discussed above, we estimate that one-third of the external costs currently attributed to rule 30e-2 relate to printing and mailing costs, which would not be applicable to UITs relying on proposed rule 30e-3. Accordingly, our estimate is based on the following calculation: $20,000 / 3 = $6,667; $20,000 - $6,667 = $13,333.

859 This estimate is based on the following calculation: 11,230 funds x 90% = 10,107; 10,107 funds x $20,707 = $209,285,649. *See also* note 777 (estimating the number of management companies subject to rule 30e-1 as 11,230).

860 This estimate is based on the following calculation: 11,230 funds – 10,107 funds = 1,123 funds; 1,123 funds x $31,061 = $34,881,503; $209,285,649 + $34,881,503 = $244,167,152.

861 This estimate is based on the following calculation: 727 UITs x 90% = 654; 654 UITs x $13,333 = $8,719,782; *see also* note 789 (estimating the number of UITs subject to rule 30e-2 as 727).

862 This estimate is based on the following calculation: 727 UITs – 654 UITs = 73 UITs; 73 UITs x $20,000 = $1,460,000; $8,719,782 + $1,460,000 = $10,179,782.

reports under the Investment Company Act and the Exchange Act. Form N-Q currently requires principal executive and financial officers of the fund to make certifications for the first and third fiscal quarters relating to (1) the accuracy of information reported to the Commission, and (2) disclosure controls and procedures and internal control over financial reporting.[863] Rescission of Form N-Q would eliminate these certifications.

Form N-CSR requires similar certification with respect to the fund's second and fourth fiscal quarters. As a result of the proposed rescission of Form N-Q, we are proposing to amend the form of certification in Form N-CSR to require each certifying officer to state that he or she has disclosed in the report any change in the registrant's internal control over financial reporting that occurred during the most recent fiscal half-year, rather than the registrant's most recent fiscal quarter as currently required by the form.[864] Lengthening the look-back of this certification to six months, so that the certifications on Form N-CSR for the semi-annual and annual reports would cover the first and second fiscal quarters and third and fourth fiscal quarters, respectively, would fill the gap in certification coverage that would otherwise occur once Form N-Q is rescinded.

Compliance with the amended certification requirements would be mandatory and responses would not be kept confidential.

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[863] *See supra* note 178 and accompanying text.

[864] Proposed Item 11(b) of Form N–CSR; proposed paragraph 5(b) of certification exhibit of Item 11(a)(2) of Form N–CSR.

We currently estimate that the annual burden associated with Form N-CSR is 14.42 hours per fund[865] and that the current total annual time burden for Form N-CSR is 177,799 hours.[866] We note that the amount and content of the information contained in the reports filed on Form N-CSR would not change as the result of the proposed amendments and the funds likely already have policies and procedures in place to assist officers in their certifications of this information. Accordingly, we estimate that the proposed amendments to Form N-CSR would not change the annual hour burden associated with Form N-CSR and, thus, we continue to estimate the annual hour burden associated with Form N-CSR to be 14.42 hours per fund. With respect to the total annual hour burden, however, we estimate 161,937 hours.[867] This decrease in the current total annual hour burden is a result of the decrease in the number of funds estimated to file Form N-CSR.

In addition, we currently estimate that the annual cost of outside services associated with Form N-CSR is approximately $129 per fund.[868] External costs include the cost of goods and services purchased to prepare and update filings on Form N-CSR. We do not believe that these costs will change as a result of the proposed amendments to

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[865] This estimate accounts for two filings per year. In addition, we note that our current estimate does not separately account for the certifications on Form N-CSR.

[866] This estimate is based on the following calculation: 14.42 hours x 12,330 funds (the estimated number of funds the last time the rule's information collections were submitted for PRA renewal in 2013)).

[867] This estimate is based on the following calculation: 11,230 funds x 14.42 hours = 161,937. *See supra* note 777 (calculating the estimate for 11,230 funds).

[868] The external costs associated with Form N-CSR do not include the external costs associated with the shareholder report. The external costs associated with the shareholder report are accounted for under the collections of information related to rules 30e-1 and 30e-2 under the Investment Company Act.

Form N-CSR and, thus, continue to estimate an external cost burden of $129 per fund to file Form N-CSR. We further estimate that the total annual external cost burden for Form N-CSR would be $2,897,340.[869]

F. Amendments to Registration Statement Forms

We are also proposing to amend Forms N-1A, N-2, N-3, N-4, and N-6 to exempt funds from those forms' respective books and records disclosures if the information is provided in a fund's most recent report on Form N-CEN.[870] The books and records disclosures required by these registration statement forms are not provided in a structured format. We believe that having this information in a structured format would increase our efficiency in preparing for exams as well as our ability to identify current industry trends and practices and, therefore, are proposing it be reported on proposed Form N-CEN.

Currently, we estimate the following total hour burden for each of the relevant forms: (i) Form N-1A – 1,579,974 hours; (ii) Form N-2 – 86,533 hours; (iii) Form N-3 – 2,173 hours; (iv) Form N-4 – 256,835 hours; and (v) Form N-6 – 34,349 hours. We estimate the total hour burden, as discussed above, for each respective form will not change as result of the proposed amendments. Additionally, we do not believe the total cost burden for any of the relevant forms would change as a result of the proposed

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869 This estimate is based on the following calculation: 11,230 funds x $129 = $1,448,670; $1,448,670 x 2 times per year = $2,897,340. The current total annual cost burden of Form N-CSR is $3,189,771, which reflects the higher estimated number of filers for Form N-CSR at the time of the last renewal for the form. *See supra* n.866.

870 *See supra* notes 397-399 and accompanying text. As discussed in Part II.F. above, we are also proposing technical and conforming amendments to certain registration forms. We do not believe these changes will result in any change to the burden and cost estimates currently applicable to those forms.

amendments and, therefore, we continue to estimate the following total cost burden for each of the respective forms: (i) Form N-1A – $124,820,197; (ii) Form N-2 – $5,488,048; (iii) Form N-3 – $139,300; (iv) Form N-4 – $26,609,241; and (v) Form N-6 – $3,820,447.

G. Request for Comments

We request comment on whether our estimates for burden hours and any external costs as described above are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The agency has submitted the proposed collection of information to OMB for approval. Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549 1090, with reference to File No. S7-08-15. OMB is required to make a decision concerning the collections of information between

30 and 60 days after publication of this release; therefore, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days after publication of this release. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-08-15, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE., Washington, DC 20549-2736.

VI. INITIAL REGULATORY FLEXIBILITY ANALYSIS

This Initial Regulatory Flexibility Analysis ("IRFA") has been prepared in accordance with section 3 of the Regulatory Flexibility Act ("RFA").[871] It relates to proposed new Form N-PORT and amendments to the Form N-CSR certification requirement, amendments to Regulation S-X, the proposed rule governing electronic transmission of shareholder reports, the rescission of Forms N-Q and N-SAR, and proposed amendments to Forms N-1A, N-2, N-3, N-4, and N-6.

A. Reasons for and Objectives of the Proposed Actions

The Commission collects certain information about the funds that it regulates. The Commission is proposing new rules, rule amendments, and new forms and form amendments that would improve the quality of information that funds report to the Commission, benefitting the Commission's risk monitoring and oversight, examination, and enforcement programs.

We believe that our proposals would improve the information that funds report to their shareholders and the Commission. In addition, the proposed new forms would require reports be filed in a structured data format (XML) to allow for easier collection

[871] 5 U.S.C. 603.

and analysis of data by Commission staff and the public. This is the format used by Form N-MFP, Form 13F, and Form D, which greatly improves the ability of Commission staff and other potential users to aggregate and analyze the data reported.

The Commission's objective is to gain more timely and useful information about funds' operations and portfolio holdings. The Commission also believes that its risk monitoring and oversight, examination, and enforcement programs would be improved by requiring enhanced information from funds.

B. Legal Basis

The Commission is proposing the rules and forms contained in this document under the authority set forth in the Securities Act, particularly, section 19 thereof [15 U.S.C. *77a et seq.*], the Trust Indenture Act, particularly, section 319 thereof [15 U.S.C. 77aaa *et seq.*], the Exchange Act, particularly, sections 10, 13, 15, 23, and 35A thereof [15 U.S.C. 78a *et seq.*], the Investment Company Act, particularly, sections 8, 30, and 38 thereof [15 U.S.C. 80a *et seq.*], and 44 U.S.C. 3506, 3507.

C. Small Entities Subject to the Rule

An investment company is a small entity if, together with other investment companies in the same group of related investment companies, it has net assets of $50 million or less as of the end of its most recent fiscal year.[872] Commission staff estimates that, as of December 2014, approximately 146 registered investment companies, including 133 open and closed-end funds (including one SBIC) and 13 UITs. The Commission staff further estimates that, as of December 2014, approximately 28 BDCs are small entities.

[872] 17 CFR 270.0-10(a).

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would create, amend, or eliminate current reporting requirements for small entities.

1. Form N-PORT

Funds currently report portfolio holdings information quarterly on Form N-Q (first and third fiscal quarters) and Form N-CSR (second and fourth fiscal quarters). The Commission is proposing to adopt new Form N-PORT on which funds, other than MMFs, UITs, and SBICs, would be required to report portfolio holdings information and information related to liquidity, derivatives, securities lending, purchases and redemptions, and counterparty exposure each month. Funds would be required to file Form N-PORT within 30 days after the end of the monthly period using a structured format. Only information reported for the third month of each quarter would be available to the public and such information would not be made public until 60 days after the end of the third month of the fund's fiscal quarter. For smaller funds and fund groups (*i.e.*, funds that together with other investment companies in the same "group of related investment companies" have net assets of less than $1 billion as of the end of the most recent fiscal year), which would include small entities, we expect to provide for an extra 12 months (or 30 months after the effective date) to comply with the new Form N-PORT reporting requirements.

Based on our experience with other interactive data filings, we estimate that funds would prepare and file their reports on proposed Form N-PORT by either (1) licensing a software solution and preparing and filing the reports in house, or (2) retaining a service provider to provide data aggregation and validation services as part of the preparation and filing of reports on proposed Form N-PORT on behalf of the fund. We estimate that approximately 132 open and closed-end funds (other than money market funds and SBICs), are small entities that would be required to file, on a monthly basis, a complete report on proposed Form N-PORT reporting certain information regarding the fund and its portfolio holdings. As discussed above, we estimate, for funds that choose to license a software solution to file reports on Form N-PORT, that completing, reviewing, and filing Form N-PORT would cost $55,970 for each fund, including small entities, in its first year of reporting and $46,745 per year for each subsequent year.[873] We further estimate, for funds that choose to retain a third-party service provider to provide data aggregation and validation services as part of the preparation and filing of reports on Form N-PORT, that completing, reviewing, and filing Form N-PORT would cost $54,821 for each fund, including small entities, in its first year of reporting, and $38,746 per year for each subsequent year.[874]

2. Rescission of Form N-Q

Our proposal would rescind Form N-Q in order to eliminate unnecessarily duplicative reporting requirements. The proposed rescission of Form N-Q would affect all management investment companies required to file reports on the form. We expect that approximately 132 open and closed-end funds are small entities that would be affected by the recession of Form N-Q.

[873] *See supra* notes 658-659 and accompanying text.

[874] *See supra* notes 660-661 and accompanying text.

As discussed above, we estimate that the rescission of Form N-Q would save $6,762 per year for each fund, including small entities.[875]

3. Form N-CEN

Funds currently report census type information relating to the fund's organization, service providers, fees and expenses, portfolio strategies and investments, portfolio transactions, and share transactions on Form N-SAR. Funds file this form semi-annually with the Commission, except for UITs, which must file such reports annually.[876] The utility of the information reported on Form N-SAR has been limited for two reasons. First, the data items funds are required to report on Form N-SAR have not been updated to reflect current Commission staff needs. Second, the technology by which funds file reports on Form N-SAR has not been updated and limits the Commission staff's ability to extract and analyze reported data.

Because of these limitations, the Commission is proposing to replace Form N-SAR with new Form N-CEN. This new form would streamline and updated the required data items to reflect current Commission staff needs. The Commission is also proposing that funds file reports on Form N-CEN in a structured (XML) format, which would allow for easier data analysis and use in the Commission's rulemaking, inspection, and risk monitoring functions and reduce burdens on filers. Finally, the Commission is proposing that funds file reports on Form N-CEN annually, opposed to semi-annually,

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[875] The estimated cost is based upon the following calculations: ($6,762= 21 hours/fund x $322/hour compensation for professionals commonly used in preparation of Form N-Q filings.) *See supra* Part V.A.2.

[876] *See* rule 30b1-1 and rule 30a-1.

which is currently required for Form N-SAR (except UITs, which currently must file reports annually).

We estimate that that approximately 146 registered investment companies, including 133 open and closed-end funds (including one SBIC) and 13 UITs, are small entities that would be required to file a complete report on Form N-CEN. Although UITs are required to complete fewer items on Form N-CEN than other registered investment companies, the burden on UITs would increase because UITs would be required to respond to more items in Form N-CEN than they are currently required to respond to under Form N-SAR.

As discussed above, the SEC estimates that completing, reviewing, and filing Form N-CEN would cost $10,622 for each fund,[877] including small entities, in its first year of reporting, and $4,252 per year for each subsequent year.[878] We further estimate that completing, reviewing, and filing Form N-CEN would cost $9,272 for each UIT,[879] including small entities, in its first year of reporting, and $2,902 per year for each subsequent year.[880]

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877 *See supra* notes 723 and 725 and accompanying text. The estimated costs is based upon the following calculations: ($10,622 = (13.35 hours/fund ongoing costs + 20 hours/fund initial costs) x $318.50/hour compensation for professionals commonly used in preparation of Form N-CEN filings)

878 *See supra* note 724 and accompanying text. The estimated costs is based upon the following calculations: ($4,252 = 13.35 hours/fund ongoing costs x $318.50/hour compensation for professionals commonly used in preparation of Form N-CEN filings)

879 *See supra* notes 723 and 725 and accompanying text. The estimated costs is based upon the following calculations: ($9,272 = (9.11 hours/UIT ongoing costs + 20 hours/UIT initial costs) x $318.50/hour compensation for professionals commonly used in preparation of Form N-CEN filings)

880 *See supra* note 724 and accompanying text. The estimated costs is based upon the following calculations: ($2,902 = 9.11 hours/UIT ongoing costs x $318.50/hour compensation for professionals commonly used in preparation of Form N-CEN filings)

4. Rescission of Form N-SAR

Our proposal would rescind Form N-SAR in order to eliminate unnecessarily duplicative reporting requirements. We estimate that that approximately 146 registered investment companies that are small entities, including 133 open and closed-end funds (including one SBIC) and 13 UITs would be affected by the rescission of Form N-SAR.

We estimate that rescinding Form N-SAR would save $9,778 per year for each fund, including small entities.[881] We further estimate that rescinding Form N-SAR would save $2,265 per year for each UIT, including small entities.[882]

5. Regulation S-X Amendments

The Commission is also proposing to amend Regulation S-X to require new, standardized disclosures regarding fund holdings in open futures contracts, open forward foreign currency contracts, and open swap contracts, and additional disclosures regarding fund holdings of written and purchased options, update the disclosures for other investments with conforming amendments, and amend the rules regarding the form and content of fund financial statements. We believe that the amendments we are proposing today are generally consistent with how many funds are currently reporting investments (including derivatives), and other information according to current industry practices. The Commission believes investors would benefit from our proposed amendments

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881 The estimated savings is based upon the following calculations: ($9,778= 15.35 hours/fund x $318.50/hour compensation for professionals commonly used in preparation of Form N-SAR filings x 2 filings/year.) *See supra* notes 724-725 and accompanying text (using a weighted average annual hour burden per response for Form N-SAR of 14.25 hours).

882 The estimated savings is based upon the following calculations: ($2,265= 7.11 hours/UIT x $318.50/hour compensation for professionals commonly used in preparation of Form N-SAR filings.) *See supra* notes 724-725 and accompanying text (using a weighted average annual hour burden per response for Form N-SAR of 14.25 hours).

because increased disclosure and standardization of fund holdings would improve comparability among funds including transparency for investors regarding a fund's use of derivatives and the liquidity of certain investments. The Commission also believes that greater clarity would benefit the industry, while any additional burdens would be reduced since similar disclosures would be proposed to be required on Form N-PORT.

We expect that approximately 146 registered investment companies, including 133 open and closed-end funds (including one SBIC) and 13 UITs and, approximately 28 BDCs, are small entities that would be affected by the amendments to Regulation S-X. As discussed above, we estimate that amending Regulation S-X would cost $2,417 for each fund, including small entities, in its first year of reporting, and $806 per year for each subsequent year.[883] As discussed above, we further estimate that amending Regulation S-X would cost $2,417 for each UIT, including small entities, in its first year of reporting, and $806 per year for each subsequent year.[884]

6. Website Transmission of Shareholder Reports

The Commission is proposing new rule 30e-3 under the Investment Company Act, which would, if adopted, permit, but not require, a fund to satisfy requirements under the Act and rules thereunder to transmit reports to shareholders if the fund makes the reports and certain other materials accessible on its website and periodically notifies investors of the materials' availability.[885] Proposed rule 30e-3 would provide that a fund's annual or semiannual report to shareholders would be considered "transmitted" to

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[883] *See supra* notes 694-699 and accompanying text.

[884] *See supra* notes 698-701 and accompanying text.

[885] *See supra* Part II.D.

a shareholder of record if certain conditions set forth in the rule are satisfied.[886] Funds that do not maintain websites or that otherwise wish to transmit shareholder reports in paper or pursuant the Commission's existing electronic delivery guidance would continue to be able to satisfy their transmission requirements by those transmission methods.

We expect that approximately 146 registered investment companies, including 133 open and closed-end funds (including one SBIC) and 13 UITs, are small entities that would rely on the website reporting rules. As discussed above, the SEC estimates that our proposed website reporting would save $4,792 for each fund, including small entities, in its first year of reporting, and $6,122 per year for each subsequent year.[887]

7. Amendments to Form N-CSR

Form N-Q and Form N-CSR currently require a quarterly SOX certification relating to the accuracy of information reported to the Commission and disclosure controls and procedures and internal control over financial reporting. To facilitate the elimination of Form N-Q, we are proposing to expand the SOX certification for Form N-CSR to six months to maintain coverage for the entire fiscal year. We expect that approximately 146 registered investment companies, including 133 open and closed-end funds (including one SBIC) and 13 UITs, are small entities that would be affected by the amendments to Form N-CSR. As discussed above, the, the Commission does not believe that the costs associated with reporting on Form N-CSR for will change for funds, including small entities, as a result of the proposed amendments to Form N-CSR.[888]

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[886] Proposed rule 30e-3(a).

[887] *See supra* notes 715, 717, and 718 and accompanying text.

[888] *See supra* Part V.E.

8. Amendments to Registration Statement Forms

We are also proposing to amend Forms N-1A, N-2, N-3, N-4, and N-6 to exempt funds from those forms' respective books and records disclosures if the information is provided in a fund's most recent report on Form N-CEN.[889] The books and records disclosures required by these registration statement forms are not provided in a structured format. We believe that having this information in a structured format would increase our efficiency in preparing for exams as well as our ability to identify current industry trends and practices and, therefore, are proposing it be reported on proposed Form N-CEN. We are also proposing amendments that would restrict funds that would rely on proposed rule 30e-3 from providing a Summary Schedule in their shareholder reports in lieu of a complete schedule, and certain technical and conforming amendments to Forms N-1A, N-2 and N-3 to refer to the availability of portfolio holdings schedules attached to reports on Form N-PORT and posted on fund websites rather than on reports on Form N-Q.

We expect that approximately 146 registered investment companies, including 133 open and closed-end funds (including one SBIC) and 13 UITs, and approximately 28 BDCs, are small entities that would be required to file registration statements. As discussed above, the SEC estimates that our proposed amendments would not change for funds, including small entities, as a result of our proposed amendments to Forms N-1A, N-2, N-3, N-4, and N-6.[890]

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[889] *See supra* notes 397-399 and accompanying text.

[890] *See supra* Part V.F.

E. Duplicative, Overlapping, or Conflicting Federal Rules

Funds currently report portfolio holdings information for the first and third fiscal quarters on Form N-Q and for the second and fourth fiscal quarters on Form N-CSR. As a result of our proposal to create new Form N-PORT, on which funds will report portfolio holdings information monthly, the Commission is proposing to eliminate Form N-Q, which will reduce duplication of portfolio holdings information for the first and third fiscal quarters. We acknowledge that Form N-CSR, Form N-PORT, Regulation S-X, and web reporting would require reporting of some duplicative information, including information currently reported on the fund's registration statements and annual reports. However, we believe that both the nature and structure of the reporting are sufficiently different to justify overlapping information requirements on the fund's website or on respective Commission forms.[891]

Funds currently report census information on Form N-SAR. As part of our proposed amendments, the Commission is proposing to replace Form N-SAR with new Form N-CEN. In addition, we are proposing that reports on Form N-CEN be filed annually, as opposed to semi-annually, which is generally required for Form N-SAR. Again, we acknowledge that Form N-CEN would require reporting of some duplicative information, including information currently reported on the fund's registration statements and annual reports. Like Form N-PORT and Form N-CSR, we believe that both the nature and structure of the reporting are sufficiently different to justify overlapping information requirements.

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[891] For example, the purpose of Form N-PORT is to provide structured portfolio holdings data for Commission staff and other to analyze, while the purpose of web reporting is to provide shareholders with investor-friendly portfolio disclosures on a quarterly basis.

Finally, in order to reduce duplicative information in Form N-CEN and fund registration statements, we are proposing to amend Forms N-1A, N-2, N-3, N-4, and N-6 to exempt funds from those forms' respective books and records disclosures if the information is provided in a fund's most recent report on Form N-CEN.

F. Significant Alternatives

The RFA directs the Commission to consider significant alternatives that would accomplish our stated objective, while minimizing any significant economic impact on small entities. The Commission considered the following alternatives for small entities in relation our proposed amendments: (i) establishing different reporting requirements or frequency to account for resources available to small entities; (ii) using performance rather than design standards; and (iii) exempting small entities from all or part of the proposal.

Small entities currently follow the same requirements that large entities do when filing reports on Form N-SAR, Form N-CSR, and Form N-Q. The Commission believes that establishing different reporting requirements or frequency for small entities would not be consistent with the Commission's goal of industry oversight and investor protection. However, as discussed above, we are proposing a delayed compliance period for small entities that would file reports on Form N-PORT.

G. General Request for Comment

The Commission requests comments regarding this IRFA. We request comments on the number of small entities that may be affected by our proposed rules and guidelines, and whether the proposed rules and guidelines would have any effects not considered in this analysis. We request that commenters describe the nature of any effects on small entities subject to the rules, and provide empirical data to support the nature and extent of such effects. We also request comment on the proposed compliance burdens and the effect these burdens would have on smaller entities.

VII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[892] the Commission must advise OMB whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in:

- An annual effect on the economy of $100 million or more;
- A major increase in costs or prices for consumers or individual industries; or
- Significant adverse effects on competition, investment, or innovation.

We request comment on whether our proposal would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- The potential effect on the U.S. economy on an annual basis;
- Any potential increase in costs or prices for consumers or individual industries; and
- Any potential effect on competition, investment, or innovation.

Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VIII. STATUTORY AUTHORITY AND TEXT OF PROPOSED AMENDMENTS

We are proposing the rules and forms contained in this document under the authority set forth in the Securities Act, particularly, section 19 thereof [15 U.S.C. *77a et*

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[892] Public Law 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C., and as a note to 5 U.S.C. 601).

seq.], the Trust Indenture Act, particularly, section 319 thereof [15 U.S.C. 77aaa *et seq.*], the Exchange Act, particularly, sections 10, 13, 15, 23, and 35A thereof [15 U.S.C. 78a *et seq.*], the Investment Company Act, particularly, sections 8, 30, and 38 thereof [15 U.S.C. 80a *et seq.*], and 44 U.S.C. 3506, 3507.

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Organization and functions (Government agencies).

17 CFR Part 210

Accounting, Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 230 and 239

Investment companies, Reporting and recordkeeping requirements, Securities.

17 CFR Part 232

Administrative practice and procedure, Reporting and recordkeeping requirements, Securities.

17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

17 CFR Parts 270 and 274

Investment companies, Reporting and recordkeeping requirements, Securities.

TEXT OF PROPOSED RULE AND FORM AMENDMENTS

For reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows:

PART 200 — ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

Subpart N — Commission Information Collection Requirements Under the Paperwork Reduction Act: OMB Control Numbers

1. The authority citation for Part 200 Subpart N continues to read as follows:

Authority: 44 U.S.C. 3506; 44 U.S.C. 3507.

2. Section 200.800 is amended in paragraph (b) by removing the entry for "Form N-SAR" and adding in its place an entry "Form N-CEN" and adding an entry in numerical order by part and section number for "Form N-PORT", to read as follows:

§200.800 OMB control numbers assigned pursuant to the Paperwork Reduction Act.

* * * * *

(b) * * *

Information collection requirement	17 CFR part or section where identified and described	Current OMB control No.
	* * * * * * *	
Form N-CEN	274.101	[OMB control number TBD]
	* * * * * * *	
Form N-PORT	274.150	[OMB control number TBD]
	* * * * * * *	

PART 210 — FORM AND CONTENT OF AND REQUIREMENTS FOR FINANCIAL STATEMENTS, SECURITIES ACT OF 1933, SECURITIES EXCHANGE ACT OF 1934, INVESTMENT COMPANY ACT OF 1940, INVESTMENT ADVISERS ACT OF 1940, AND ENERGY POLICY AND CONSERVATION ACT OF 1975

3. The authority citation for part 210 continues to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77nn(25), 77nn(26), 78c, 78j-1, 78*l*, 78m, 78n, 78o(d), 78q, 78u-5, 78w, 78*ll*, 78mm, 80a-8, 80a-20, 80a-29, 80a-30, 80a-31, 80a-37(a), 80b-3, 80b-11, 7202 and 7262, unless otherwise noted.

4. Revise §210.6-01 and the undesignated heading preceding it to read as follows:

REGISTERED INVESTMENT COMPANIES AND BUSINESS DEVELOPMENT COMPANIES

§210.6-01 Application of §§210.6-01 to 210.6-10.

Sections 210.6-01 to 210.6-10 shall be applicable to financial statements filed for registered investment companies and business development companies.

5. Revise §210.6-03 to read as follows:

§210.6-03 Special rules of general application to registered investment companies and business development companies.

The financial statements filed for persons to which §§210.6-01 to 210.6-10 are applicable shall be prepared in accordance with the following special rules in addition to the general rules in §§210.1-01 to 210.4-10 (Articles 1, 2, 3, and 4). Where the requirements of a special rule differ from those prescribed in a general rule, the requirements of the special rule shall be met.

(a) *Content of financial statements.* The financial statements shall be prepared in accordance with the requirements of this part (Regulation S-X) notwithstanding any provision of the articles of incorporation, trust indenture or other governing legal instruments specifying certain accounting procedures inconsistent with those required in §§210.6-01 to 210.6-10.

(b) *Audited financial statements.* Where, under Article 3 of this part, financial statements are required to be audited, the independent accountant shall have been selected and ratified in accordance with section 32 of the Investment Company Act of 1940 (15 U.S.C. 80a-31).

(c) *Consolidated and combined statements.* (1) Consolidated and combined statements filed for registered investment companies and business development companies shall be prepared in accordance with §§210.3A-01 to 210.3A-04 (Article 3A) except that:

(i) Statements of the registrant may be consolidated only with the statements of subsidiaries which are investment companies;

(ii) A consolidated statement of the registrant and any of its investment company subsidiaries shall not be filed unless accompanied by a consolidating statement which sets forth the individual statements of each significant subsidiary included in the consolidated statement: *Provided, however,* That a consolidating statement need not be filed if all included subsidiaries are totally held; and

(iii) Consolidated or combined statements filed for subsidiaries not consolidated with the registrant shall not include any investment companies unless accompanied by consolidating or combining statements which set forth the individual statements of each included investment company which is a significant subsidiary.

(2) If consolidating or combining statements are filed, the amounts included under each caption in which financial data pertaining to affiliates is required to be furnished shall be subdivided to show separately the amounts:

(i) Eliminated in consolidation; and

(ii) Not eliminated in consolidation.

(d) *Valuation of investments.* The balance sheets of registered investment companies and business development companies, other than issuers of face-amount certificates, shall reflect all investments at value, with the aggregate cost of each category of investment reported under §§210.6-04.1, 6-04.2, 6-04.3 and 6-04.9 or the aggregate cost of each category of investment reported under §210.6-05.1 shown parenthetically. State in a note the methods used in determining value of investments. As required by section 28(b) of the Investment Company Act of 1940 (15 U.S.C. 80a-28(b)), *qualified* assets of face-amount certificate companies shall be valued in accordance with certain provisions of the Code of the District of Columbia. For guidance as to valuation of securities, see §§404.03 to 404.05 of the Codification of Financial Reporting Policies.

(e) *Qualified assets.* State in a note the nature of any investments and other assets maintained or required to be maintained, by applicable legal instruments, in respect of outstanding face-amount certificates. If the nature of the qualifying assets and amount thereof are not subject to the provisions of section 28 of the Investment Company Act of 1940 (15 U.S.C. 80a-28), a statement to that effect shall be made.

(f) *Restricted securities.* State in a note unless disclosed elsewhere the following information as to investment securities which cannot be offered for public sale without first being registered under the Securities Act of 1933 (restricted securities):

(1) The policy of the person with regard to acquisition of restricted securities.

(2) The policy of the person with regard to valuation of restricted securities. Specific comments shall be given as to the valuation of an investment in one or more issues of securities of a company or group of affiliated companies if any part of such investment is restricted and the aggregate value of the investment in all issues of such company or affiliated group exceeds five percent of the value of total assets. (As used in this paragraph, the term *affiliated* shall have the meaning given in §210.6-02(a).)

(3) A description of the person's rights with regard to demanding registration of any restricted securities held at the date of the latest balance sheet.

(g) *Income recognition.* Dividends shall be included in income on the ex-dividend date; interest shall be accrued on a daily basis. Dividends declared on short positions existing on the record date shall be recorded on the ex-dividend date and included as an expense of the period.

(h) *Federal income taxes.* The company's status as a *regulated investment company* as defined in subtitle A, chapter 1, subchapter M of the Internal Revenue Code, as amended, shall be stated in a note referred to in the appropriate statements. Such note shall also indicate briefly the principal assumptions on which the company relied in making or not making provisions for income taxes. However, a company which retains realized capital gains and designates such gains as a distribution to shareholders in accordance with section 852(b)(3)(D) of the Internal Revenue Code shall, on the last day of its taxable year (and not earlier), make provision for taxes on such undistributed capital gains realized during such year.

(i) *Issuance and repurchase by a registered investment company or business development company of its own securities.* Disclose for each class of the company's securities:

(1) The number of shares, units, or principal amount of bonds sold during the period of report, the amount received therefor, and, in the case of shares sold by closed-end management investment companies, the difference, if any, between the amount received and the net asset value or preference in involuntary liquidation (whichever is appropriate) of securities of the same class prior to such sale; and

(2) The number of shares, units, or principal amount of bonds repurchased during the period of report and the cost thereof. Closed-end management investment companies shall furnish the following additional information as to securities repurchased during the period of report:

(i) As to bonds and preferred shares, the aggregate difference between cost and the face amount or preference in involuntary liquidation and, if applicable net assets taken at value as of the date of repurchase were less than such face amount or preference, the aggregate difference between cost and such net asset value;

(ii) As to common shares, the weighted average discount per share, expressed as a percentage, between cost of repurchase and the net asset value applicable to such shares at the date of repurchases.

Note to paragraphs (h)(2)(i) and (ii): The information required by paragraphs (h)(2)(i) and (ii) of this section may be based on reasonable estimates if it is impracticable to determine the exact amounts involved.

(j) *Series companies.* (1) The information required by this part shall, in the case of a person which in essence is comprised of more than one separate investment company, be given as if each class or series of such investment company were a separate investment company; this shall not prevent the inclusion, at the option of such person, of information applicable to other classes or series of such person on a comparative basis, except as to footnotes which need not be comparative.

(2) If the particular class or series for which information is provided may be affected by other classes or series of such investment company, such as by the offset of realized gains in one series with realized losses in another, or through contingent liabilities, such situation shall be disclosed.

(k) *Certificate reserves.* (1) For companies issuing face-amount certificates subsequent to December 31, 1940 under the provisions of section 28 of the Investment Company Act of 1940 (15 U.S.C. 80a-28), balance sheets shall reflect reserves for outstanding certificates computed in accordance with the provisions of section 28(a) of the Act.

(2) For other companies, balance sheets shall reflect reserves for outstanding certificates determined as follows:

(i) For certificates of the installment type, such amount which, together with the lesser of future payments by certificate holders as and when accumulated at a rate not to exceed 3½ per centum per annum (or such other rate as may be appropriate under the circumstances of a particular case) compounded annually, shall provide the minimum maturity or face amount of the certificate when due.

(ii) For certificates of the fully-paid type, such amount which, as and when accumulated at a rate not to exceed $3\frac{1}{2}$ per centum per annum (or such other rate as may be appropriate under the circumstances of a particular case) compounded annually, shall provide the amount or amounts payable when due.

(iii) Such amount or accrual therefor, as shall have been credited to the account of any certificate holder in the form of any credit, or any dividend, or any interest in addition to the minimum maturity or face amount specified in the certificate, plus any accumulations on any amount so credited or accrued at rates required under the terms of the certificate.

(iv) An amount equal to all advance payments made by certificate holders, plus any accumulations thereon at rates required under the terms of the certificate.

(v) Amounts for other appropriate contingency reserves, for death and disability benefits or for reinstatement rights on any certificate providing for such benefits or rights.

(l) *Inapplicable captions.* Attention is directed to the provisions of §§210.4-02 and 210.4-03 which permit the omission of separate captions in financial statements as to which the items and conditions are not present, or the amounts involved not significant. However, amounts involving directors, officers, and affiliates shall nevertheless be separately set forth except as otherwise specifically permitted under a particular caption.

(m) *Securities Lending.* State in a note unless disclosed elsewhere the following information regarding securities lending activities and cash collateral management:

(1) The gross income from securities lending activities, including income from cash collateral reinvestment;

(2) The dollar amount of all fees and/or compensation paid by the registrant for securities lending activities and related services, including borrower rebates and cash collateral management services;

(3) The net income from securities lending activities;

(4) The terms governing the compensation of the securities lending agent, including any revenue sharing split, with the related percentage split between the registrant and the securities lending agent, and/or any fee-for-service, and a description of services included;

(5) The details of any other fees paid directly or indirectly, including any fees paid directly by the registrant for cash collateral management and any management fee deducted from a pooled investment vehicle in which cash collateral is invested; and

(6) The monthly average of the value of portfolio securities on loan.

6. Revise §210.6-04 to read as follows:

§210.6-04 Balance sheets.

This section is applicable to balance sheets filed by registered investment companies and business development companies except for persons who substitute a statement of net assets in accordance with the requirements specified in §210.6-05, and issuers of face-amount certificates which are subject to the special provisions of §210.6-06. Balance sheets filed under this rule shall comply with the following provisions:

ASSETS

1. *Investments in securities of unaffiliated issuers.*

2. *Investments in and advances to affiliates.* State separately investments in and advances to: (a) Controlled companies and (b) other affiliates.

3. *Other investments.* State separately amounts of assets related to (a) variation margin receivable on futures contracts, (b) forward foreign currency contracts; (c) swap contracts; and (d) investments—other than those presented in §§210.12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B, and 12-13C.

4. *Cash.* Include under this caption cash on hand and demand deposits. Provide in a note to the financial statements the information required under §210.5-02.1 regarding restrictions and compensating balances.

5. *Receivables.* (a) State separately amounts receivable from (1) sales of investments; (2) subscriptions to capital shares; (3) dividends and interest; (4) directors and officers; and (5) others.

(b) If the aggregate amount of notes receivable exceeds 10 percent of the aggregate amount of receivables, the above information shall be set forth separately, in the balance sheet or in a note thereto, for accounts receivable and notes receivable.

6. *Deposits for securities sold short and other investments.* State separately amounts held by others in connection with: (a) Short sales; (b) open option contracts (c) futures contracts, (d) forward foreign currency contracts; (e) swap contracts; and (f) investments—other than those presented in §§210.12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B, and 12-13C.

7. *Other assets.* State separately (a) prepaid and deferred expenses; (b) pension and other special funds; (c) organization expenses; and (d) any other significant item not properly classified in another asset caption.

8. *Total assets.*

LIABILITIES

9. *Other investments.* State separately amounts of liabilities related to: (a) Securities sold short; (b) open option contracts written; (c) variation margin payable on futures contracts, (d) forward foreign currency contracts; (e) swap contracts; and (f) investments—other than those presented in §§210.12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B, and 12-13C.

10. *Accounts payable and accrued liabilities.* State separately amounts payable for: (a) other purchases of securities; (b) capital shares redeemed; (c) dividends or other distributions on capital shares; and (d) others. State separately the amount of any other liabilities which are material.

11. *Deposits for securities loaned.* State the value of securities loaned and indicate the nature of the collateral received as security for the loan, including the amount of any cash received.

12. *Other liabilities.* State separately (a) amounts payable for investment advisory, management and service fees; and (b) the total amount payable to: (1) Officers and directors; (2) controlled companies; and (3) other affiliates, excluding any amounts owing to noncontrolled affiliates which arose in the ordinary course of business and which are subject to usual trade terms.

13. *Notes payable, bonds and similar debt.* (a) State separately amounts payable to: (1) Banks or other financial institutions for borrowings; (2) controlled companies; (3) other affiliates; and (4) others, showing for each category amounts payable within one year and amounts payable after one year.

(b) Provide in a note the information required under §210.5-02.19(b) regarding unused lines of credit for short-term financing and §210.5-02.22(b) regarding unused commitments for long-term financing arrangements.

14. *Total liabilities.*

15. *Commitments and contingent liabilities.*

NET ASSETS

16. *Units of capital.* (a) Disclose the title of each class of capital shares or other capital units, the number authorized, the number outstanding, and the dollar amount thereof.

(b) Unit investment trusts, including those which are issuers of periodic payment plan certificates, also shall state in a note to the financial statements: (1) The total cost to the investors of each class of units or shares; (2) the adjustment for market depreciation or appreciation; (3) other deductions from the total cost to the investors for fees, loads and other charges, including an explanation of such deductions; and (4) the net amount applicable to the investors.

17. *Accumulated undistributed income (loss).* Disclose:

(a) The accumulated undistributed investment income-net,

(b) accumulated undistributed net realized gains (losses) on investment transactions, and (c) net unrealized appreciation (depreciation) in value of investments at the balance sheet date.

18. *Other elements of capital.* Disclose any other elements of capital or residual interests appropriate to the capital structure of the reporting entity.

19. *Net assets applicable to outstanding units of capital.* State the net asset value per share.

7. Revise §210.6-05 to read as follows:

§210.6-05 Statements of net assets.

In lieu of the balance sheet otherwise required by §210.6-04, persons may substitute a statement of net assets if at least 95 percent of the amount of the person's total assets are represented by investments in securities of unaffiliated issuers. If presented in such instances, a statement of net assets shall consist of the following:

STATEMENTS OF NET ASSETS

1. A schedule of investments in securities of unaffiliated issuers as prescribed in §210.12-12.

2. The excess (or deficiency) of other assets over (under) total liabilities stated in one amount, except that any amounts due from or to officers, directors, controlled persons, or other affiliates, excluding any amounts owing to noncontrolled affiliates which arose in the ordinary course of business and which are subject to usual trade terms, shall be stated separately.

3. Disclosure shall be provided in the notes to the financial statements for any item required under §210.6-04.3 and §§210.6-04.9 to 210.6-04.13.

4. The balance of the amounts captioned as *net assets.* The number of outstanding shares and net asset value per share shall be shown parenthetically.

5. The information required by (i) §210.6-04.16, (ii) §210.6-04.17 and (iii) §210.6-04.18 shall be furnished in a note to the financial statements.

8. Revise §210.6-07 to read as follows:

§210.6-07 Statements of operations.

Statements of operations filed by registered investment companies and business development companies, other than issuers of face-amount certificates subject to the special provisions of §210.6-08, shall comply with the following provisions:

STATEMENTS OF OPERATIONS

1. *Investment income.* State separately income from: (a) cash dividends; (b) non-cash dividends; (c) interest on securities excluding payment in kind interest; (d) payment in kind interest on securities; and (e) other income. If income from investments in or indebtedness of affiliates is included hereunder, such income shall be segregated under an appropriate caption subdivided to show separately income from: (1) Controlled companies; and (2) other affiliates. If non-cash dividends or payment in kind interest are included in income, the bases of recognition and measurement used in respect to such amounts shall be disclosed. Any other category of income which exceeds five percent of the total shown under this caption shall be stated separately.

2. *Expenses.* (a) State separately the total amount of investment advisory, management and service fees, and expenses in connection with research, selection, supervision, and custody of investments. Amounts of expenses incurred from transactions with affiliated persons shall be disclosed together with the identity of and related amount applicable to each such person accounting for five percent or more of the total expenses shown under this caption together with a description of the nature of the affiliation. Expenses incurred within the person's own organization in connection with research, selection and supervision of investments shall be stated separately. Reductions or

reimbursements of management or service fees shall be shown as a negative amount or as a reduction of total expenses shown under this caption.

(b) State separately any other expense item the amount of which exceeds five percent of the total expenses shown under this caption.

(c) A note to the financial statements shall include information concerning management and service fees, the rate of fee, and the base and method of computation. State separately the amount and a description of any fee reductions or reimbursements representing: (1) Expense limitation agreements or commitments; and (2) offsets received from broker-dealers showing separately for each amount received or due from (i) unaffiliated persons; and (ii) affiliated persons. If no management or service fees were incurred for a period, state the reason therefor.

(d) If any expenses were paid otherwise than in cash, state the details in a note.

(e) State in a note to the financial statements the amount of brokerage commissions (including dealer markups) paid to affiliated broker-dealers in connection with purchase and sale of investment securities. Open-end management companies shall state in a note the net amounts of sales charges deducted from the proceeds of sale of capital shares which were retained by any affiliated principal underwriter or other affiliated broker-dealer.

(f) State separately all amounts paid in accordance with a plan adopted under 17 CFR 270.12b-1 of this chapter. Reimbursement to the fund of expenses incurred under such plan (12b-1 expense reimbursement) shall be shown as a negative amount and deducted from current 12b-1 expenses. If 12b-1 expense reimbursements exceed current

12b-1 costs, such excess shall be shown as a negative amount used in the calculation of total expenses under this caption.

(g)(1) *Brokerage/Service Arrangements.* If a broker-dealer or an affiliate of the broker-dealer has, in connection with directing the person's brokerage transactions to the broker-dealer, provided, agreed to provide, paid for, or agreed to pay for, in whole or in part, services provided to the person (other than brokerage and research services as those terms are used in section 28(e) of the Securities Exchange Act of 1934 [15 U.S.C. 78bb(e)]), include in the expense items set forth under this caption the amount that would have been incurred by the person for the services had it paid for the services directly in an arms-length transaction.

(2) *Expense Offset Arrangements.* If the person has entered into an agreement with any other person pursuant to which such other person reduces, or pays a third party which reduces, by a specified or reasonably ascertainable amount, its fees for services provided to the person in exchange for use of the person's assets, include in the expense items set forth under this caption the amount of fees that would have been incurred by the person if the person had not entered into the agreement.

(3) *Financial Statement Presentation.* Show the total amount by which expenses are increased pursuant to paragraphs (1) and (2) of this paragraph (2)(g) as a corresponding reduction in total expenses under this caption. In a note to the financial statements, state separately the total amounts by which expenses are increased pursuant to paragraphs (1) and (2) of this paragraph (2)(g), and list each category of expense that is increased by an amount equal to at least 5 percent of total expenses. If applicable, the note should state that the person could have employed the assets used by another person

to produce income if it had not entered into an arrangement described in paragraph (2)(g)(2) of this section.

3. *Interest and amortization of debt discount and expense.* Provide in the body of the statements or in the footnotes, the average dollar amount of borrowings and the average interest rate.

4. *Investment income before income tax expense.*

5. *Income tax expense.* Include under this caption only taxes based on income.

6. *Investment income-net.*

7. *Realized and unrealized gain (loss) on investments-net.* (a) State separately the net realized gain or loss from: (1) Transactions in investment securities of unaffiliated issuers, (2) transactions in investment securities of affiliated issuers, (3) expiration or closing of option contracts written, (4) closed short positions in securities, (5) expiration or closing of futures contracts, (6) settlement of forward foreign currency contracts, (7) expiration or closing of swap contracts, and (8) transactions in other investments held during the period.

(b) Distributions of realized gains by other investment companies shall be shown separately under this caption.

(c) State separately the amount of the net increase or decrease during the period in the unrealized appreciation or depreciation in the value of: (1) investment securities of unaffiliated issuers, (2) investment securities of affiliated issuers, (3) option contracts written, (4) short positions in securities, (5) futures contracts, (6) forward foreign currency contracts, (7) swap contracts, and (8) other investments held at the end of the period.

(d) State separately any: (1) Federal income taxes and (2) other income taxes applicable to realized and unrealized gain (loss) on investments, distinguishing taxes payable currently from deferred income taxes.

8. *Net gain (loss) on investments.*

9. *Net increase (decrease) in net assets resulting from operations.*

9. Revise §210.6-10 to read as follows:

§210.6-10 What schedules are to be filed.

(a) The schedules shall be examined by an independent accountant if the related financial statements are so examined.

(b) *Management investment companies.* (1) Except as otherwise provided in the applicable form, the schedules specified in this paragraph shall be filed for management investment companies as of the dates of the most recent audited balance sheet and any subsequent unaudited statement being filed for each person or group.

Schedule I—Investments in securities of unaffiliated issuers. The schedule prescribed by §210.12-12 shall be filed in support of caption 1 of each balance sheet.

Schedule II—Investments in and advances to affiliates. The schedule prescribed by §210.12-14 shall be filed in support of caption 2 of each balance sheet.

Schedule III—Investments—securities sold short. The schedule prescribed by §210.12-12A shall be filed in support of caption 9(a) of each balance sheet.

Schedule IV—Open option contracts written. The schedule prescribed by §210.12-13 shall be filed in support of caption 9(b) of each balance sheet.

Schedule V—Open futures contracts. The schedule prescribed by §210.12-13A shall be filed in support of captions 3(a) and 9(c) of each balance sheet.

Schedule VI—Open forward foreign currency contracts. The schedule prescribed by §210.12-13B shall be filed in support of captions 3(b) and 9(d) of each balance sheet.

Schedule VII—Open swap contracts. The schedule prescribed by §210.12-13C shall be filed in support of captions 3(c) and 9(e) of each balance sheet.

Schedule VIII—Investments—other than those presented in §§210.12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B and 12-13C. The schedule prescribed by §210.12-13D shall be filed in support of captions 3(d) and 9(f) of each balance sheet.

(2) When permitted by the applicable form, the schedule specified in this paragraph may be filed for management investment companies as of the dates of the most recent audited balance sheet and any subsequent unaudited statement being filed for each person or group.

Schedule IX—Summary schedule of investments in securities of unaffiliated issuers. The schedule prescribed by §210.12-12B may be filed in support of caption 1 of each balance sheet.

(c) *Unit investment trusts.* Except as otherwise provided in the applicable form:

(1) Schedules I and II, specified below in this section, shall be filed for unit investment trusts as of the dates of the most recent audited balance sheet and any subsequent unaudited statement being filed for each person or group.

(2) Schedule III, specified below in this section, shall be filed for unit investment trusts for each period for which a statement of operations is required to be filed for each person or group.

Schedule I—Investment in securities. The schedule prescribed by §210.12-12 shall be filed in support of caption 1 of each balance sheet (§210.6-04).

Schedule II—Allocation of trust assets to series of trust shares. If the trust assets are specifically allocated to different series of trust shares, and if such allocation is not shown in the balance sheet in columnar form or by the filing of separate statements for each series of trust shares, a schedule shall be filed showing the amount of trust assets, indicated by each balance sheet filed, which is applicable to each series of trust shares.

Schedule III—Allocation of trust income and distributable funds to series of trust shares. If the trust income and distributable funds are specifically allocated to different series of trust shares and if such allocation is not shown in the statement of operations in columnar form or by the filing of separate statements for each series of trust shares, a schedule shall be submitted showing the amount of income and distributable funds, indicated by each statement of operations filed, which is applicable to each series of trust shares.

(d) *Face-amount certificate investment companies.* Except as otherwise provided in the applicable form:

(1) Schedules I, V and X, specified below, shall be filed for face-amount certificate investment companies as of the dates of the most recent audited balance sheet and any subsequent unaudited statement being filed for each person or group.

(2) All other schedules specified below in this section shall be filed for face-amount certificate investment companies for each period for which a statement of operations is filed, except as indicated for Schedules III and IV.

Schedule I—Investment in securities of unaffiliated issuers. The schedule prescribed by §210.12-21 shall be filed in support of caption 1 and, if applicable, caption

5(a) of each balance sheet. Separate schedules shall be furnished in support of each caption, if applicable.

Schedule II—Investments in and advances to affiliates and income thereon. The schedule prescribed by §210.12-22 shall be filed in support of captions 1 and 5(b) of each balance sheet and caption 1 of each statement of operations. Separate schedules shall be furnished in support of each caption, if applicable.

Schedule III—Mortgage loans on real estate and interest earned on mortgages. The schedule prescribed by §210.12-23 shall be filed in support of captions 1 and 5(c) of each balance sheet and caption 1 of each statement of operations, except that only the information required by column G and note 8 of the schedule need be furnished in support of statements of operations for years for which related balance sheets are not required.

Schedule IV—Real estate owned and rental income. The schedule prescribed by §210.12-24 shall be filed in support of captions 1 and 5(a) of each balance sheet and caption 1 of each statement of operations for rental income included therein, except that only the information required by columns H, I and J, and item "Rent from properties sold during the period" and note 4 of the schedule need be furnished in support of statements of operations for years for which related balance sheets are not required.

Schedule V—Qualified assets on deposit. The schedule prescribed by §210.12-27 shall be filed in support of the information required by caption 4 of §210.6-06 as to total amount of qualified assets on deposit.

Schedule VI—Certificate reserves. The schedule prescribed by §210.12-26 shall be filed in support of caption 7 of each balance sheet.

Schedule VII—Valuation and qualifying accounts. The schedule prescribed by §210.12-09 shall be filed in support of all other reserves included in the balance sheet.

10. Revise §210.12-12 to read as follows:

FOR MANAGEMENT INVESTMENT COMPANIES

§210.12-12 Investments in securities of unaffiliated issuers.

[For management investment companies only]

Col. A	Col. B	Col. C
Name of issuer and title of issue[1 2 3 4]	Balance held at close of period. Number of shares—principal amount of bonds and notes [7]	Value of each item at close of period. [5 6 8 9 10 11 12]

[1]Each issue shall be listed separately: *Provided,* however, that an amount not exceeding five percent of the total of Column C may be listed in one amount as "Miscellaneous securities," provided the securities so listed are not restricted, have been held for not more than one year prior to the date of the related balance sheet, and have not previously been reported by name to the shareholders of the person for which the schedule is filed or to any exchange, or set forth in any registration statement, application, or annual report or otherwise made available to the public. If any securities are listed as "Miscellaneous securities," briefly explain in a footnote what the term represents.

[2]Categorize the schedule by (i) the type of investment (such as common stocks, preferred stocks, convertible securities, fixed income securities, government securities, options purchased, warrants, loan participations and assignments, commercial paper, bankers' acceptances, certificates of deposit, short-term securities, repurchase agreements, other investment companies, and so forth); (ii) the related industry of the investment; and (iii) the related country, or geographic region of the investment. Short-term debt

instruments (*i.e.*, debt instruments whose maturities or expiration dates at the time of acquisition are one year or less) of the same issuer may be aggregated, in which case the range of interest rates and maturity dates shall be indicated. For issuers of periodic payment plan certificates and unit investment trusts, list separately: (i) Trust shares in trusts created or serviced by the depositor or sponsor of this trust; (ii) trust shares in other trusts; and (iii) securities of other investment companies. Restricted securities shall not be combined with unrestricted securities of the same issuer. Repurchase agreements shall be stated separately showing for each the name of the party or parties to the agreement, the date of the agreement, the total amount to be received upon repurchase, the repurchase date and description of securities subject to the repurchase agreements.

[3]For options purchased, all information required by §210.12-13 for options contracts written should be shown. Options on underlying investments where the underlying investment would otherwise be presented in accordance with §§210.12-12, 12-13A, 12-13B, 12-13C, or 12-13D should include the description of the underlying investment as would be required by §§210.12-12, 12-13A, 12-13B, 12-13C, or 12-13D as part of the description of the option.

[4]Indicate the interest rate or preferential dividend rate and maturity date, as applicable, for preferred stocks, convertible securities, fixed income securities, government securities, loan participations and assignments, commercial paper, bankers' acceptances, certificates of deposit, short-term securities, repurchase agreements, or other instruments with a stated rate of income. For variable rate securities, indicate a description of the reference rate and spread. For securities with payment in kind income, disclose the rate paid in kind.

[5]The subtotals for each category of investments, subdivided both by type of investment and industry, country, or geographic region, shall be shown together with their percentage value compared to net assets.

[6]Column C shall be totaled. The total of column C shall agree with the correlative amounts shown on the related balance sheet.

[7]Indicate by an appropriate symbol each issue of securities which is non-income producing. Evidences of indebtedness and preferred shares may be deemed to be income producing if, on the respective last interest payment date or date for the declaration of dividends prior to the date of the related balance sheet, there was only a partial payment of interest or a declaration of only a partial amount of the dividends payable; in such case, however, each such issue shall be indicated by an appropriate symbol referring to a note to the effect that, on the last interest or dividend date, only partial interest was paid or partial dividends declared. If, on such respective last interest or dividend date, no interest was paid or no cash or in kind dividends declared, the issue shall not be deemed to be income producing. Common shares shall not be deemed to be income producing unless, during the last year preceding the date of the related balance sheet, there was at least one dividend paid upon such common shares.

[8]Indicate by an appropriate symbol each issue of restricted securities. State the following in a footnote: (a) As to each such issue: (1) Acquisition date, (2) carrying value per unit of investment at date of related balance sheet, e.g., a percentage of current market value of unrestricted securities of the same issuer, etc., and (3) the cost of such securities; (b) as to each issue acquired during the year preceding the date of the related balance sheet, the carrying value per unit of investment of unrestricted securities of the

same issuer at: (1) The day the purchase price was agreed to; and (2) the day on which an enforceable right to acquire such securities was obtained; and (c) the aggregate value of all restricted securities and the percentage which the aggregate value bears to net assets.

[9]Indicate by an appropriate symbol each issue of securities whose fair value was determined using significant unobservable inputs.

[10]Indicate by an appropriate symbol each issue of illiquid securities.

[11]Indicate by an appropriate symbol each issue of securities held in connection with open put or call option contracts, loans for short sales, or where any portion of the issue is on loan.

[12]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of securities for Federal income tax purposes.

11. Revise §210.12-12A to read as follows:

§210.12-12A Investments—securities sold short.

[For management investment companies only]

Col. A	Col. B	Col. C
Name of issuer and title of issue[1 2 3]	Balance of short position at close of period. (number of shares)	Value of each open short position[4 5 6 7 8]

[1]Each issue shall be listed separately.

[2]Categorize the schedule as required by instruction 2 of §210.12-12.

[3] Indicate the interest rate or preferential dividend rate and maturity date, as applicable, as required by instruction 4 of §210.12-12.

[4]The subtotals for each category of investments, subdivided both by type of investment and industry, country, or geographic region, shall be shown together with their percentage value compared to net assets.

[5]Column C shall be totaled. The total of column C shall agree with the correlative amounts shown on the related balance sheet.

[6]Indicate by an appropriate symbol each issue of securities whose fair value was determined using significant unobservable inputs.

[7]Indicate by an appropriate symbol each issue of securities held in connection with open put or call option contracts.

[8]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of securities for Federal income tax purposes.

12. Revise §210.12-12B to read as follows:

§210.12-12B Summary schedule of investments in securities of unaffiliated issuers.

Column A	Column B	Column C	Column D
Name of issuer and title of issue[1] [3 4 5 6 7 8]	Balance held at close of period. Number of shares—principal amount of bonds and notes [10]	Value of each item at close of period[2 9] [11 12 13 14 15]	Percentage value compared to net assets.

[1]Categorize the schedule by (a) the type of investment (such as common stocks, preferred stocks, convertible securities, fixed income securities, government securities,

options purchased, warrants, loan participations and assignments, commercial paper, bankers' acceptances, certificates of deposit, short-term securities, repurchase agreements, other investment companies, and so forth); (b) the related industry of the investment; and (c) the related country or geographic region of the investment.

[2]The subtotals for each category of investments, subdivided both by type of investment and industry, country, or geographic region, shall be shown together with their percentage value compared to net assets.

[3]Indicate the interest rate or preferential dividend rate and maturity date, as applicable, for preferred stocks, convertible securities, fixed income securities, government securities, loan participations and assignments, commercial paper, bankers' acceptances, certificates of deposit, short-term securities, repurchase agreements, or other instruments with a stated rate of income. For variable rate securities, indicate a description of the reference rate and spread. For securities with payment in kind income, disclose the rate paid in kind.

[4]Except as provided in note 6, list separately the 50 largest issues and any other issue the value of which exceeded one percent of net asset value of the registrant as of the close of the period. For purposes of the list (including, in the case of short-term debt instruments, the first sentence of note 4), aggregate and treat as a single issue, respectively, (a) short-term debt instruments (*i.e.*, debt instruments whose maturities or expiration dates at the time of acquisition are one year or less) of the same issuer (indicating the range of interest rates and maturity dates); and (b) fully collateralized repurchase agreements (indicate in a footnote the range of dates of the repurchase agreements, the total purchase price of the securities, the total amount to be received

upon repurchase, the range of repurchase dates, and description of securities subject to the repurchase agreements). Restricted and unrestricted securities of the same issue should be aggregated for purposes of determining whether the issue is among the 50 largest issues, but should not be combined in the schedule. For purposes of determining whether the value of an issue exceeds one percent of net asset value, aggregate and treat as a single issue all securities of any one issuer, except that all fully collateralized repurchase agreements shall be aggregated and treated as a single issue. The U.S. Treasury and each agency, instrumentality, or corporation, including each government-sponsored entity, that issues U.S. government securities is a separate issuer.

[5]For options purchased, all information required by §210.12-13 for options contracts written should be shown. Options on underlying investments where the underlying investment would otherwise be presented in accordance with §§210.12-12, 12-13A, 12-13B, 12-13C, or 12-13D should include the description of the underlying investment as would be required by §§210.12-12, 12-13A, 12-13B, 12-13C, or 12-13D as part of the description of the option.

[6]If multiple securities of an issuer aggregate to greater than one percent of net asset value, list each issue of the issuer separately (including separate listing of restricted and unrestricted securities of the same issue) except that the following may be aggregated and listed as a single issue: (a) Fixed-income securities of the same issuer which are not among the 50 largest issues and whose value does not exceed one percent of net asset value of the registrant as of the close of the period (indicating the range of interest rates and maturity dates); and (b) U.S. government securities of a single agency, instrumentality, or corporation, which are not among the 50 largest issues and whose

value does not exceed one percent of net asset value of the registrant as of the close of the period (indicating the range of interest rates and maturity dates). For each category identified pursuant to note 1, group all issues that are neither separately listed nor included in a group of securities that is listed in the aggregate as a single issue in a sub-category labeled "Other securities," and provide the information for Columns C and D.

[7]Any securities that would be required to be listed separately or included in a group of securities that is listed in the aggregate as a single issue may be listed in one amount as "Miscellaneous securities," provided the securities so listed are eligible to be, and are, categorized as "Miscellaneous securities" in the registrant's Schedule of Investments in Securities of Unaffiliated Issuers required under §210.12-12. However, if any security that is included in "Miscellaneous securities" would otherwise be required to be included in a group of securities that is listed in the aggregate as a single issue, the remaining securities of that group must nonetheless be listed as required by notes 4 and 5 even if the remaining securities alone would not otherwise be required to be listed in this manner (e.g., because the combined value of the security listed in "Miscellaneous securities" and the remaining securities of the same issuer exceeds one percent of net asset value, but the value of the remaining securities alone does not exceed one percent of net asset value).

[8]If any securities are listed as "Miscellaneous securities" pursuant to note 6 or "Other securities" pursuant to note 5, briefly explain in a footnote what those terms represent.

[9]Total Column C. The total of column C should equal the total shown on the related balance sheet for investments in securities of unaffiliated issuers.

[10]Indicate by an appropriate symbol each issue of securities which is non-income producing. Evidences of indebtedness and preferred shares may be deemed to be income producing if, on the respective last interest payment date or date for the declaration of dividends prior to the date of the related balance sheet, there was only a partial payment of interest or a declaration of only a partial amount of the dividends payable; in such case, however, each such issue shall be indicated by an appropriate symbol referring to a note to the effect that, on the last interest or dividend date, only partial interest was paid or partial dividends declared. If, on such respective last interest or dividend date, no interest was paid or no cash or in kind dividends declared, the issue shall not be deemed to be income producing. Common shares shall not be deemed to be income producing unless, during the last year preceding the date of the related balance sheet, there was at least one dividend paid upon such common shares.

[11]Indicate by an appropriate symbol each issue of restricted securities. State the following in a footnote: (a) as to each such issue: (1) Acquisition date, (2) carrying value per unit of investment at date of related balance sheet, e.g., a percentage of current market value of unrestricted securities of the same issuer, etc., and (3) the cost of such securities; (b) as to each issue acquired during the year preceding the date of the related balance sheet, the carrying value per unit of investment of unrestricted securities of the same issuer at: (1) The day the purchase price was agreed to; and (2) the day on which an enforceable right to acquire such securities was obtained; and (c) the aggregate value of all restricted securities and the percentage which the aggregate value bears to net assets.

[12]Indicate by an appropriate symbol each issue of securities whose fair value was determined using significant unobservable inputs.

[13]Indicate by an appropriate symbol each issue of illiquid securities.

[14]Indicate by an appropriate symbol each issue of securities held in connection with open put or call option contracts, loans for short sales, or where any portion of the issue is on loan.

[15]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of securities for Federal income tax purposes.

13. Remove §210.12-12C.

14. Revise §210.12-13 to read as follows:

§210.12-13 Open option contracts written.

[For management investment companies only]

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F	Col. G
Description[1 2 3]	Counterparty[4]	Number of contracts[5]	Notional amount	Exercise price	Expiration date	Value[6 7 8 9 10]

[1]Information as to put options shall be shown separately from information as to call options.

[2]Options where descriptions, counterparties, exercise prices or expiration dates differ shall be listed separately.

[3]Options on underlying investments where the underlying investment would otherwise be presented in accordance with §§210.12-12, 12-13A, 12-13B, 12-13C, or 12-13D should include the description of the underlying investment as would be required by

§§210.12-12, 12-13A, 12-13B, 12-13C, or 12-13D as part of the description of the option.

If the underlying investment is an index or basket of investments, and the components are publicly available on a website as of the balance sheet date, identify the index or basket. If the underlying investment is an index or basket of investments, the components are not publicly available on a website as of the balance sheet date, and the notional amount of the option contract does not exceed one percent of the net asset value of the registrant as of the close of the period, identify the index or basket. If the underlying investment is an index or basket of investments, the components are not publicly available on a website as of the balance sheet date, and the notional amount of the option contract exceeds one percent of the net asset value of the registrant as of the close of the period, list separately each underlying investment in the index or basket. For each investment separately listed, include the description of the underlying investment as would be required by §§210.12-12, 12-13, 12-13A, 12-13B, or 12-13D as part of the description, the quantity held (e.g. the number of shares for common stocks, principal amount for fixed income securities), the value at the close of the period, and the percentage value when compared to the custom basket's net assets.

[4]Not required for exchange-traded options.

[5]If the number of shares subject to option is substituted for number of contracts, the column name shall reflect that change.

[6]Indicate by an appropriate symbol each investment which cannot be sold because of restrictions or conditions applicable to the investment.

[7]Indicate by an appropriate symbol each investment whose fair value was determined using significant unobservable inputs.

[8]Indicate by an appropriate symbol each illiquid investment.

[9]Column G shall be totaled and shall agree with the correlative amount shown on the related balance sheet.

[10]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all investments in which there is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all investments in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of investments for Federal income tax purposes.

15. Add §210.12-13A to read as follows:

§210.12-13A Open futures contracts.

[For management investment companies only]

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F
Description[1] [2]	Number of contracts	Expiration date	Notional amount	Value	Unrealized appreciation/depreciation [4] [5] [6] [7] [8]

[1]Information as to long purchases of futures contracts shall be shown separately from information as to futures contracts sold short.

[2]Futures contracts where descriptions or expiration dates differ shall be listed separately.

[3]Description should include the name of the reference asset or index.

[4]Indicate by an appropriate symbol each investment which cannot be sold because of restrictions or conditions applicable to the investment.

[5]Indicate by an appropriate symbol each investment whose fair value was determined using significant unobservable inputs.

[6]Indicate by an appropriate symbol each illiquid investment.

[7]Column F shall be totaled and shall be reconciled to the total variation margin receivable or payable on the related balance sheet.

[8]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all investments in which there is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all investments in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of investments for Federal income tax purposes.

16. Add §210.12-13B to read as follows:

§210.12-13B Open forward foreign currency contracts.

[For management investment companies only]

Col. A	Col. B	Col. C	Col. D	Col. E
Amount and description of currency to be purchased[1]	Amount and description of currency to be sold[1]	Counterparty	Settlement date	Unrealized appreciation/depreciation[2 3 4 5 6]

[1]Forward foreign currency contracts where description of currency purchased, description of currency sold, counterparty, or settlement dates differ shall be listed separately.

[2]Indicate by an appropriate symbol each investment which cannot be sold because of restrictions or conditions applicable to the investment.

[3]Indicate by an appropriate symbol each investment whose fair value was determined using significant unobservable inputs.

[4]Indicate by an appropriate symbol each illiquid investment.

[5]Column E shall be totaled and shall agree with the total of correlative amount(s) shown on the related balance sheet.

[6]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all investments in which there is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all investments in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of investments for Federal income tax purposes.

17. Add §210.12-13C to read as follows:

§210.12-13C Open swap contracts.

[For management investment companies only]

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F	Col. G	Col. H
Description and terms of payments to be received from another party[1 2 3]	Description and terms of payments to be paid to another party[1 2 3]	Counterparty[4]	Maturity date	Notional amount	Value	Upfront payments/ receipts	Unrealized appreciation/ depreciation[5 6 7 8 9]

[1]List each major category of swaps by descriptive title (e.g., credit default swaps, interest rate swaps, total return swaps). Credit default swaps where protection is sold shall be listed separately from credit default swaps where protection is purchased.

[2]Swaps where description, counterparty, or maturity dates differ shall be listed separately within each major category.

[3]Description should include information sufficient for a user of financial information to understand the terms of payments to be received and paid. (e.g. For a credit default swap, including, among other things, description of reference obligation(s) or index, financing rate to be paid or received, and payment frequency. For an interest rate swap, this may include, among other things, whether floating rate is paid or received, fixed interest rate, floating interest rate, and payment frequency. For a total return swap, this may include, among other things, description of reference asset(s) or index, financing rate, and payment frequency.)

If the reference instrument is an index or basket of investments, and the components are publicly available on a website as of the balance sheet date, identify the index or basket. If the reference instrument is an index or basket of investments, the components are not publicly available on a website as of the balance sheet date, and the notional amount of the swap contract does not exceed one percent of the net asset value of the registrant as of the close of the period, identify the index or basket. If the reference instrument is an index or basket of investments, the components are not publicly available on a website as of the balance sheet date, and the notional amount of the swap contract exceeds one percent of the net asset value of the registrant as of the close of the period, list separately each underlying investment. For each investment separately listed, include the description of the underlying investment as would be required by §§210.12-12, 12-13, 12-13A, 12-13B, or 12-13D as part of the description, the quantity held (e.g. the number of shares for common stocks, principal amount for fixed income securities), the value at the close of the period, and the percentage value when compared to the custom basket's net assets.

[4]Not required for exchange-traded swaps.

[5]Indicate by an appropriate symbol each investment which cannot be sold because of restrictions or conditions applicable to the investment.

[6]Indicate by an appropriate symbol each investment whose fair value was determined using significant unobservable inputs.

[7]Indicate by an appropriate symbol each illiquid investment.

[8]Columns F, G, and H shall be totaled and shall agree with the total of correlative amount(s) shown on the related balance sheet.

[9]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all investments in which there is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all investments in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of investments for Federal income tax purposes.

18. Add §210.12-13D to read as follows:

§210.12-13D Investments other than those presented in §§210.12-12, 12-12A, 12-12B, 12-13, 12-13A, 12-13B, and 12-13C.

[For management investment companies only]

Col. A	Col. B	Col. C
Description[1 2 3]	Balance held at close of period—quantity[4 5]	Value of each item at close of period[6 7 8 9 10 11]

[1]Each investment where any portion of the description differs shall be listed separately.

[2]Categorize the schedule by (i) the type of investment (such as real estate, commodities, and so forth); and, as applicable, (ii) the related industry of the investment and (iii) the related country, or geographic region of the investment.

[3]Description should include information sufficient for a user of financial information to understand the nature and terms of the investment, which may include, among other things, reference security, asset or index, currency, geographic location, payment terms, payment rates, call or put feature, exercise price, expiration date, and counterparty for non-exchange-traded investments.

[4]If practicable, indicate the quantity or measure in appropriate units.

[5]Indicate by an appropriate symbol each investment which is non-income producing.

[6]Indicate by an appropriate symbol each investment which cannot be sold because of restrictions or conditions applicable to the investment.

[7]Indicate by an appropriate symbol each investment whose fair value was determined using significant unobservable inputs.

[8]Indicate by an appropriate symbol each illiquid investment.

[9]Indicate by an appropriate symbol each investment subject to option. State in a footnote: (a) The quantity subject to option, (b) nature of option contract, (c) option price, and (d) dates within which options may be exercised.

[10]Column C shall be totaled and shall agree with the correlative amount shown on the related balance sheet.

[11]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all investments in which there

is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all investments in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of investments for Federal income tax purposes.

19. Revise §210.12-14 to read as follows:

§210.12-14 Investments in and advances to affiliates.

[For management investment companies only]

Col. A	Col. B	Col. C	Col. D	Col. E	Col. F
Name of issuer and title of issue or nature of indebtedness[1,2,3]	Number of shares—principal amount of bonds, notes and other indebtedness held at close of period	Net realized gain or loss for the period[4,6]	Net increase or decrease in unrealized appreciation or depreciation for the period[4,6]	Amount of dividends or interest[4,6] (1) Credited to income. (2) Other.	Value of each item at close of period[4,5,7,8,9,10,11]

[1](a) List each issue separately and group (1) Investments in majority-owned subsidiaries; (2) other controlled companies; and (3) other affiliates. (b) If during the period there has been any increase or decrease in the amount of investment in and advance to any affiliate, state in a footnote (or if there have been changes to numerous affiliates, in a supplementary schedule) (1) name of each issuer and title of issue or nature of indebtedness; (2) balance at beginning of period; (3) gross additions; (4) gross reductions; (5) balance at close of period as shown in Column E. Include in the footnote or schedule comparable information as to affiliates in which there was an investment at any time during the period even though there was no investment at the close of the period of report.

[2]Categorize the schedule as required by instruction 2 of §210.12-12.

[3]Indicate the interest rate or preferential dividend rate and maturity date, as applicable, as required by instruction 4 of §210.12-12.

[4]Columns C, D, E, and F shall be totaled. The totals of Column F shall agree with the correlative amount shown on the related balance sheet.

[5](a) Indicate by an appropriate symbol each issue of restricted securities. The information required by instruction 8 of §210.12-12 shall be given in a footnote. (b) Indicate by an appropriate symbol each issue of securities subject to option. The information required by §210.12-13 shall be given in a footnote.

[6](a) Include in Column E (1) as to each issue held at the close of the period, the dividends or interest included in caption 1 of the statement of operations. In addition, show as the final item in Column E (1) the aggregate of dividends and interest included in the statement of operations in respect of investments in affiliates not held at the close of the period. The total of this column shall agree with the correlative amount shown on the related statement of operations.

(b) Include in Column E (2) all other dividends and interest. Explain in an appropriate footnote the treatment accorded each item.

(c) Indicate by an appropriate symbol all non-cash dividends and interest and explain the circumstances in a footnote.

(d) Indicate by an appropriate symbol each issue of securities which is non-income producing. Evidences of indebtedness and preferred shares may be deemed to be income producing if, on the respective last interest payment date or date for the declaration of dividends prior to the date of the related balance sheet, there was only a partial payment of interest or a declaration of only a partial amount of the dividends payable; in such case, however, each such issue shall be indicated by an appropriate symbol referring to a note to the effect that, on the last interest or dividend date, only partial interest was paid or partial dividends declared. If, on such respective last interest or dividend date, no interest was paid or no cash or in kind dividends declared, the issue shall not be deemed to be income producing. Common shares shall not be deemed to be income producing unless, during the last year preceding the date of the related balance sheet, there was at least one dividend paid upon such common shares.

(e) Include in Column C (1) as to each issue held at the close of the period, the realized gain or loss included in caption 7 of the statement of operations. In addition, show as the final item in Column C (1) the aggregate of realized gain or loss included in the statement of operations in respect of investments in affiliates not held at the close of the period. The total of this column shall agree with the correlative amount shown on the related statement of operations.

(f) Include in Column D (1) as to each issue held at the close of the period, the net increase or decrease in unrealized appreciation or depreciation included in caption 7 of the statement of operations. In addition, show as the final item in Column D (1) the aggregate of increase or decrease in unrealized appreciation or depreciation included in the statement of operations in respect of investments in affiliates not held at the close of the period. The total of this column shall agree with the correlative amount shown on the related statement of operations.

[7]The subtotals for each category of investments, subdivided both by type of investment and industry, country, or geographic region, shall be shown together with their percentage value compared to net assets.

[8]Indicate by an appropriate symbol each issue of securities whose fair value was determined using significant unobservable inputs.

[9]Indicate by an appropriate symbol each issue of illiquid securities.

[10]Indicate by an appropriate symbol each issue of securities held in connection with open put or call option contracts, loans for short sales, or where any portion of the issue is on loan.

[11]State in a footnote the following amounts based on cost for Federal income tax purposes: (a) Aggregate gross unrealized appreciation for all securities in which there is an excess of value over tax cost, (b) the aggregate gross unrealized depreciation for all securities in which there is an excess of tax cost over value, (c) the net unrealized appreciation or depreciation, and (d) the aggregate cost of securities for Federal income tax purposes.

* * * * *

PART 230 — GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

20. The authority citation for part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77d note, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78*o*, 78*o*-7 note, 78t, 78w, 78*ll* (d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

21. Amend §230.498 by:

a. Adding to the end of paragraph (b)(1)(v)(A) "If a Fund relies on §270.30e-3 of this chapter to transmit a report, the legend must also include the Web site address required by §270.30e-3(d)(1)(iv) of this chapter if different from the Web site address required by this paragraph (b)(1)(v)(A)."; and

b. In paragraph (f)(2), adding the phrase "a Notice or Initial Statement under §270.30e-1 of this chapter," after "Statutory Prospectuses,".

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

22. 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), 78*l*, 78m, 78n, 78o(d), 78w(a), 78*ll*, 80a-6(c), 80a-8, 80a-29, 80a-30, 80a-37, and 7201 *et seq.*; and 18 U.S.C. 1350.

* * * * *

23. Amend §232.105 by removing paragraph (a) and redesignating paragraphs (b) and (c) as paragraphs (a) and (b).

24. Amend §232.301 by removing the fourth sentence "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)."

25. Amend §232.401 paragraph (d)(2)(iii) by removing the phrase ", N-CSR (§274.128 of this chapter) or N-Q (§274.130 of this chapter)" and adding in its place "or N-CSR (§274.128 of this chapter)".

PART 239 — FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

26. The authority citation for part 239 continues to read, in part, as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78o-7, 78o-7 note, 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-

9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, 80a-37, and Pub. L. 111-203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

*   *   *   *   *

27. Amend Form N-14 (referenced in §239.23) Item 14, subpart 1(ii) by removing the phrase "the following schedules in support of the most recent balance sheet: (A) columns C and D of Schedule III [17 CFR 210.12-14]; and (B) Schedule IV [17 CFR 210.12-03];" and adding in its place "columns C and D of Schedule III [17 CFR 210.12-14] in support of the most recent balance sheet".

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

28. The authority citation for part 240 continues to read, in part, as follows:

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

*   *   *   *   *

29. Amend §240.10A-1 paragraph (a)(4)(i) by removing the phrase "Form N-SAR" and adding in its place "Form N-CEN".

30. Amend §240.12b-25 by:

a. In the section heading, removing the phrase "Form N-SAR" and adding in its place "Form N-CEN";

b. In paragraph (a), removing the phrase "Form N-SAR" and adding in its place "Form N-CEN"; and

c. In paragraph (b)(2)(ii), removing the phrase "N-SAR," and adding in its place "N-CEN,".

31. Amend §240.13a-10 paragraph (h) by removing the phrase "Rule 30b1-1 (§270.30b1-1 of this chapter)" and adding in its place "§270.30a-1 of this chapter".

32. Amend §240.13a-11 paragraph (b) by removing the phrase "§270.30b1-1" and adding in its place "§270.30a-1".

33. Amend §240.13a-13 paragraph (b)(1) by removing the phrase "§270.30b1-1" and adding in its place "§270.30a-1 of this chapter".

34. Amend §240.13a-16 paragraph (a)(1) by removing the phrase "Rule 30b1-1 (17 CFR 270.30b1-1)" and adding in its place "17 CFR 270.30a-1 of this chapter" .

35. Amend §240.14a-16 paragraph (f)(2)(iii) by adding the phrase "a Notice or Initial Statement under §270.30e-1 of this chapter," after "§230.498(b) of this chapter," in.

36. Amend §240.15d-10 paragraph (h) by removing the phrase "Rule 30b1-1 (§270.30b1-1 of this chapter)" and adding in its place "§270.30a-1 of this chapter".

37. Amend §240.15d-11 paragraph (h) by removing the phrase "§270.30b1-1" and adding in its place "§270.30a-1".

38. Amend §240.15d-13 paragraph (b)(1) by removing the phrase "§270.30b1-1" and adding in its place "§270.30a-1 of this chapter".

39. Amend §240.15d-16 paragraph (a)(1) by removing the phrase "Rule 30b1-1 [17 CFR 270.30b1-1]" and adding in its place "17 CFR 270.30a-1".

PART 249 — FORMS, SECURITIES EXCHANGE ACT OF 1934

40. The general authority citation for part 249 continues to read, and the sectional authority for §249.330 is revised to read as follows:

Authority: 15 U.S.C. 78a *et seq.* and 7201 *et seq.*; 12 U.S.C. 5461 *et seq.*; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

Section 249.330 is also issued under 15 USC 80a-29(a).

* * * * *

41. Amend §249.322 in the first sentence of paragraph (a) by removing the phrase "or a semi-annual, annual, or transition report on Form N-SAR (§§249.330; 274.101) or" and adding in its place "an annual report on Form N-CEN (§§249.330; 274.101), or a semi-annual or annual report on".

42. Section 249.330 is revised to read as follows:

§249.330 Form N-CEN, annual report of registered investment companies.

This form shall be used by registered unit investment trusts and small business investment companies for annual reports to be filed pursuant to §270.30a-1 of this chapter in satisfaction of the requirement of section 30(a) of the Investment Company Act of 1940 (15 USC 80a-29(a)) that every registered investment company must file annually with the Commission such information, documents, and reports as investment companies having securities registered on a national securities exchange are required to file annually pursuant to section 13(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78m(a)) and the rules and regulations thereunder.

Note: The text of Form N-CEN will not appear in the *Code of Federal Regulations*.

43. Section 249.332 is removed and reserved.

PART 270 — RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

44. The authority citation for part 270 continues to read, in part, as follows:

Authority: 15 U.S.C. 80a-1 *et seq*., 80a-34(d), 80a-37, 80a-39, and Pub. L. 111-203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

* * * * *

45. Amend §270.8b-16 paragraph (a) by removing the phrase "a semi-annual report on Form N-SAR, as prescribed by rule 30b1-1 (17 CFR 270.30b1-1)" and adding in its place "an annual report on Form N-CEN, as prescribed by 17 CFR 270.30a-1".

46. Amend §270.8b-33 by:

a. In the first sentence, removing the phrase ", Form N-CSR (§§249.331 and 274.128 of this chapter), or Form N-Q (§§249.332 and 274.130 of this chapter)" and adding in its place the phrase "or Form N-CSR (§§249.331 and 274.128 of this chapter)"; and

b. In the third sentence, removing the phrase "or Form N-Q".

47. Amend §270.10f-3 by removing and reserving paragraph (c)(9).

48. Revise §270.30a-1 to read as follows:

§270.30a-1 Annual report for registered investment companies.

Every registered investment company must file an annual report on Form N-CEN (§274.101 of this chapter) at least every twelve months and not more than sixty calendar days after the close of each fiscal year. A registered investment company that has filed a registration statement with the Commission registering its securities for the first time under the Securities Act of 1933 is relieved of this reporting obligation with respect to any reporting period or portion thereof prior to the date on which that registration statement becomes effective or is withdrawn.

49. Amend §270.30a-2 by:

a. In the section heading, removing the phrase "and Form N-Q"; and

b. In the first sentence of paragraph (a), removing the phrases "or Form N-Q (§§249.332 and 274.130 of this chapter)" and "or Item 3 of Form N-Q, as applicable,".

50. Amend §270.30a-3 by:

a. In paragraph (b), removing the phrase "and Form N-Q (§§249.332 and 274.130 of this chapter)".

b. In the first sentence of paragraph (c), removing the phrase "and Form N-Q (§§249.332 and 274.130 of this chapter)".

c. In the second sentence of paragraph (c), removing the phrase "and Form N-Q (§§249.332 and 274.130 of this chapter)".

51. Section 270.30a-4 is added to read as follows:

§270.30a-4 Annual report for wholly-owned registered management investment company subsidiary of registered management investment company.

Notwithstanding the provisions of §270.30a-1, a registered management investment company that is a wholly-owned subsidiary of a registered management investment company need not file an annual report on Form N-CEN if financial information with respect to that subsidiary is reported in the parent's annual report on Form N-CEN.

52. Section 270.30b1-1 is removed and reserved.

53. Section 270.30b1-2 is removed and reserved.

54. Section 270.30b1-3 is removed and reserved.

55. Section 270.30b1-5 is removed and reserved.

56. Section 270.30b1-9 is added to read as follows:

§270.30b1-9 Monthly report.

Each registered management investment company or exchange-traded fund organized as a unit investment trust, or series thereof, other than a registered open-end management investment company that is regulated as a money market fund under §270.2a-7 or a small business investment company registered on Form N-5 (§§239.24 and 274.5 of this chapter), must file a monthly report of portfolio holdings on Form N-PORT (§274.150 of this chapter), current as of the last business day, or last calendar day, of the month. A registered investment company that has filed a registration statement with the Commission registering its securities for the first time under the Securities Act of 1933 is relieved of this reporting obligation with respect to any reporting period or portion thereof prior to the date on which that registration statement becomes effective or is withdrawn. Reports on Form N-PORT must be filed with the Commission no later than 30 days after the end of each month.

57. Amend §270.30d-1 by:

a. In the first sentence, removing the phrase "and Form N-Q (§§249.332 and 274.130 of this chapter)"; and

b. In the second sentence, removing the phrase "Form N-SAR" and adding in its place "Form N-CEN".

58. Section 270.30e-3 is added to read as follows:

§270.30e-3 Internet availability of reports to shareholders.

(a) *Website Transmission.* A report required by §270.30e-1 or §270.30e-2 will be considered transmitted to a shareholder of record if all of the conditions set forth in paragraphs (b) through (e) of this section are satisfied.

(b) *Availability of Report to Shareholders and Other Materials.*

(1) The following materials are publicly accessible, free of charge, at the website address specified in the Notice from the date of the transmission in reliance on paragraph (a) of this section until the Fund next transmits a report required by §270.30e-1 or §270.30e-2:

(i) The Fund's current report required by §270.30e-1 or §270.30e-2.

(ii) Any report required by §270.30e-1 or §270.30e-2 transmitted to shareholders of record within the last 244 days.

(iii) In the case of a Fund that is a management company, other than a Fund that is regulated as a money market fund under §270.2a-7 or a small business investment company registered on Form N-5 (§§239.24 and 274.5 of this chapter), the Fund's complete portfolio holdings as of the close of the Fund's most recent first and third fiscal quarters, if any, after the date on which the Fund's registration statement became effective, presented in accordance with the schedules set forth in §§210.12-12 – 12-14 of Regulation S-X [17 CFR 210.12-12 – 12-14], which need not be audited.

(2) In the case of a Fund that is a management company, other than a Fund that is regulated as a money market fund under §270.2a-7 or a small business investment company registered on Form N-5 (§§239.24 and 274.5 of this chapter), the Fund's complete portfolio holdings as of the close of the next fiscal quarter, presented in accordance with the schedules set forth in §§210.12-12 – 12-14 of Regulation S-X [17

CFR 210.12-12 – 12-14], which need not be audited, are publicly accessible, free of charge, at the website address specified in the Notice from a date not more than 60 days after the close of the fiscal period until the Fund next transmits a report required by §270.30e-1 or §270.30e-2.

(3) The website address relied upon for compliance with this section may not be the address of the Commission's electronic filing system.

(4) The materials that are accessible in accordance with paragraphs (b)(1) through (b)(2) of this section must be presented on the website in a format, or formats, that are convenient for both reading online and printing on paper.

(5) Persons accessing the materials specified in paragraphs (b)(1) through (b)(2) of this section must be able to permanently retain, free of charge, an electronic version of such materials in a format, or formats, that meet the conditions of paragraph (b)(4) of this section.

(6) The conditions set forth in paragraphs (b)(1) through (b)(5) of this section shall be deemed to be met, notwithstanding the fact that the materials specified in paragraphs (b)(1) through (b)(2) of this section are not available for a time in the manner required by paragraphs (b)(1) through (b)(5) of this section, provided that:

(i) The Fund has reasonable procedures in place to ensure that the specified materials are available in the manner required by paragraphs (b)(1) through (b)(5) of this section; and

(ii) The Fund takes prompt action to ensure that the specified documents become available in the manner required by paragraphs (b)(1) through (b)(5) of this section, as soon as practicable following the earlier of the time at which it knows or reasonably should have known that the documents are not available in the manner required by paragraphs (b)(1) through (b)(5) of this section.

(c) *Consent.* The shareholder has previously consented to website transmission of shareholder reports or all of the following conditions are met:

(1) The Fund has transmitted a separate written statement ("Initial Statement") to the shareholder at least 60 days before the Fund begins to rely on this section concerning transmission of reports to that shareholder. The Initial Statement must be written using plain English principles pursuant to paragraph (e) of this section and:

(i) State that future shareholder reports will be accessible, free of charge, at a website;

(ii) Explain that the Fund will no longer mail printed copies of shareholder reports to the shareholder unless the shareholder notifies the Fund that he or she wishes to receive printed reports in the future;

(iii) Include a toll-free telephone number and be accompanied by a reply form that is pre-addressed with postage provided and that includes the information the Fund would need to identify the shareholder, and explain that the shareholder can use either of those two methods at any time to notify the Fund that he or she wishes to receive printed reports in the future;

(iv) State that the Fund will mail printed copies of future shareholder reports within 30 days after the Fund receives notice of the shareholder's preference; and

(v) Contain a prominent legend in bold-face type that states: "How to Continue Receiving Printed Copies of Shareholder Reports". This legend must appear on the envelope in which the Initial Statement is delivered. Alternatively, if the Initial

Statement is delivered separately from other communications to investors, this legend may appear either on the Initial Statement or on the envelope in which the Initial Statement is delivered.

(2) The Initial Statement may not be incorporated into, or combined with, another document.

(3) The Initial Statement must be sent separately from other types of shareholder communications and may not accompany any other document or materials; *provided, however*, that the Initial Statement may accompany the Fund's current Summary Prospectus, Statutory Prospectus, Statement of Additional Information, or Notice of Internet Availability of Proxy Materials under §240.14a-16 of this chapter.

(4) The Fund has not received the reply form or other notification indicating that the shareholder wishes to continue to receive a print copy of the report, within 60 days after the Fund sent the Initial Statement.

(d) *Notice.* The Fund must send a notice to shareholders ("Notice") meeting the following conditions of this paragraph (d) within 60 days after the close of the period for which the report to shareholders transmitted in reliance on paragraph (a) of this section is being made:

(1) The Notice must be written using plain English principles pursuant to paragraph (e) of this section and:

(i) Contain a prominent legend in bold-face type that states "[A]n Important Report[s] to Shareholders of [insert Fund name or fund complex name] [is/are] Now Available Online and In Print by Request";

(ii) State that each report to shareholders contains important information about their Fund, including its portfolio holdings, and is available on the Internet or, upon request, by mail, and that encourages the shareholder to access and review the report.

(iii) Include a website address that leads directly to each report the Fund is transmitting to the recipient shareholder in reliance on this section.

(iv) Include a website address where the report to shareholders and other materials specified in paragraphs (b)(1) through (b)(2) of this section are available. The website address must be specific enough to lead investors directly to the documents that are required to be accessible under paragraphs (b)(1) through (b)(2) of this section, rather than to the home page or section of the website other than on which the documents are posted. The website may be a central site with prominent links to each document.

(v) Provide instructions describing how a shareholder may request a paper copy of the shareholder report and other materials specified in paragraphs (b)(1) through (b)(2) of this section at no charge, and an indication that they will not otherwise receive a paper or email copy.

(vi) Include a toll-free telephone number and be accompanied by a reply form that is pre-addressed with postage provided and that includes the information the Fund would need to identify the shareholder, and explain that the shareholder can use either of those two methods at any time to notify the Fund that he or she wishes to receive printed reports in the future.

(2) The Notice may not be incorporated into, or combined with, another document.

(3) The Notice may contain only the information required by paragraph (d)(1) of this section.

(4) The Notice must be sent separately from other types of shareholder communications and may not accompany any other document or materials; *provided, however*, that the Notice may accompany the Fund's current Summary Prospectus, Statutory Prospectus, Statement of Additional Information, or Notice of Internet Availability of Proxy Materials under §240.14a-16 of this chapter.

(5) A Notice required by this paragraph (d) will be considered sent to a shareholder of record if the Fund satisfies the conditions set forth in §270.30e-1(f) with respect to that shareholder.

(6) The Fund must file a form of the Notice with the Commission not later than 10 business days after it is sent to shareholders.

(e) *Plain English Requirements.*

(1) To enhance the readability of the Initial Statement and the Notice, the Fund must use plain English principles in the organization, language, and design of those materials.

(2) The Fund must draft the language in the Initial Statement and the Notice so that, at a minimum, the materials substantially comply with each of the following plain English writing principles:

(i) Short sentences;

(ii) Definite, concrete, everyday words;

(iii) Active voice;

(iv) Tabular presentation or bullet lists for complex material, whenever possible;

(v) No legal jargon or highly technical business terms; and

(vi) No multiple negatives.

(f) *Delivery upon Request.* The Fund (or a financial intermediary through which shares of the Fund may be purchased or sold) must send, at no cost to the requestor and by U.S. first class mail or other reasonably prompt means, a paper copy of any of the materials specified in paragraph (b)(1) through (b)(2) of this section to any person requesting such a copy within three business days after receiving a request for a paper copy.

(g) A Fund may not rely on this section to transmit a copy of its currently effective Statutory Prospectus or Statement of Additional Information, or both, under the Securities Act as permitted by paragraph (d) of §270.30e-1.

(h) *Definitions.* For purposes of this section:

(1) *Fund* means a registered investment company and any series of the investment company.

(2) *Initial Statement* means the statement described in paragraph (c)(1) of this section.

(3) *Notice* means the notice described in paragraph (d) of this section.

(4) *Statement of Additional Information* means the statement of additional information required by Part B of the registration form applicable to the Fund.

(5) *Statutory Prospectus* means a prospectus that satisfies the requirements of section 10(a) of the Securities Act of 1933 (15 U.S.C. 77(j)(a)).

(6) *Summary Prospectus* means the summary prospectus described in paragraph (b) of §230.498 of this chapter.

PART 274 — FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

59. The general authority citation for part 274 continues to read as follows, and the sectional authorities for §§274.101 and 274.130 are removed:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78*l*, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, 80a-29, and Pub. L. 111-203, sec. 939A, 124 Stat. 1376 (2010), unless otherwise noted.

*   *   *   *   *

60. Form N-1A (referenced in 274.11A) is amended by:

a. In Item 16(f), Instruction 3(b), removing the phrase "or Form N-Q";

b. In Item 27(b)(1), Instruction 1, removing the phrase "Schedule VI" and adding in its place "Schedule IX", removing the phrase "[17 CFR 210.12-12C]" and adding in its place "17 CFR 210.12-12B]", and removing the phrase "(b)" and adding in its place "(b) the Fund is not relying upon rule 30e-3 [17 CFR 270.30e-3] to transmit reports to its shareholders; and (c)";

c. In Item 27(b)(1), Instruction 2, removing the phrase ""[17 CFR 210.12-12C]" and adding in its place "17 CFR 210.12-12B]";

d. In Item 27(d), revising paragraph (3) to read as follows "*Statement Regarding Availability of Quarterly Portfolio Schedule.* A statement that: (i) the Fund files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year as an exhibit to its reports on Form N-PORT; (ii) the Fund's Form N-PORT reports are available on the Commission's website at http://www.sec.gov; and (iii) if the Fund makes the information on Form N-PORT available to shareholders on its website or upon request, a description of how the information may be obtained from the Fund; *provided, however*, that a Fund that makes its complete schedule of portfolio holdings for the first and third quarters of the fiscal year available on its website in accordance with rule 30e-3 under the Act should only provide a statement that describes how the information may be obtained from the Fund."; and

e. In Item 33, adding after the paragraph a new instruction "*Instruction.* A fund may omit this information to the extent it is provided in its most recent report on Form N-CEN [17 CFR 274.101].".

61. Form N-2 (referenced in 274.11a-1) is amended by:

a. In Item 24, Instruction 6, revising paragraph (b) to read as follows "*Statement Regarding Availability of Quarterly Portfolio Schedule.* A statement that: (i) the Registrant files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year as an exhibit to its reports on Form N-PORT; (ii) the Registrant's Form N-PORT reports are available on the Commission's website at http://www.sec.gov; (iii) if the Registrant makes the information on Form N-PORT available to shareholders on its website or upon request, a description of how the information may be obtained from the Registrant; *provided, however*, that a Fund that makes its complete schedule of portfolio holdings for the first and third quarters of the fiscal year available on its website in accordance with rule 30e-3 under the Act should only provide a statement that describes how the information may be obtained from the Fund.";

b. In Item 24, Instruction 7, removing the phrase "Schedule VI" and adding in its place "Schedule IX", removing the phrase "[17 CFR 210.12-12C]" and adding in its place "17 CFR 210.12-12B]", and removing the phrase "(b)" and adding in its place "(b) the Registrant is not relying upon rule 30e-3 [17 CFR 270.30e-3] to transmit reports to its shareholders; and (c)"; and

c. In Item 32, adding after the paragraph a new instruction "*Instruction.* A fund may omit this information to the extent it is provided in its most recent report on Form N-CEN [17 CFR 274.101].".

62. Form N-3 (referenced in 274.11b) is amended by:

a. In Item 28(a), Instruction 6, revising paragraph (ii) to read as follows "*Statement Regarding Availability of Quarterly Portfolio Schedule.* A statement that: (i) the Fund files its complete schedule of portfolio holdings with the Commission for the first and third quarters of each fiscal year as an exhibit to its reports on Form N-PORT; (ii) the Fund's Form N-PORT reports are available on the Commission's website at http://www.sec.gov; and (iii) if the Fund makes the information on Form N-PORT available to contractowners on its website or upon request, a description of how the information may be obtained from the Fund; *provided, however*, that a Fund that makes its complete schedule of portfolio holdings for the first and third quarters of the fiscal year available on its website in accordance with rule 30e-3 under the Act should only provide a statement that describes how the information may be obtained from the Fund.";

b. In Item 28(a), Instruction 7(i), removing the phrase "Schedule VI" and adding in its place "Schedule IX", removing the phrase "[17 CFR 210.12-12C]" and adding in its place "17 CFR 210.12-12B]", and removing the phrase "(B)" and adding in its place "(B) the Registrant is not relying upon rule 30e-3 [17 CFR 270.30e-3] to transmit reports to its contractowners; and (C)";

c. In Item 28(a), Instruction 7(i), removing the phrase "[17 CFR 210.12-12C]" and adding in its place "17 CFR 210.12-12]"; and

d. In Item 36, adding after the paragraph a new instruction "*Instruction.* A fund may omit this information to the extent it is provided in its most recent report on Form N-CEN [17 CFR 274.101].".

63. Form N-4 (referenced in 274.11c) is amended by adding to the end of Item 30 a new instruction "*Instruction.* A fund may omit this information to the extent it is provided in its most recent report on Form N-CEN [17 CFR 274.101].".

64. Form N-6 (referenced in 274.11d) is amended by adding to the end of Item 31 a new instruction "*Instruction.* A fund may omit this information to the extent it is provided in its most recent report on Form N-CEN [17 CFR 274.101].".

65. Section 274.101 and its heading are revised to read as follows:

§274.101 Form N-CEN, annual report of registered investment companies.

This form shall be used by registered investment companies for annual reports to be filed pursuant to 17 CFR 270.30a-1.

Note: The text of Form N-CEN will not appear in the *Code of Federal Regulations*.

FORM N-CEN
ANNUAL REPORT FOR REGISTERED INVESTMENT COMPANIES

Form N-CEN is to be used by all registered investment companies, other than face amount certificate companies, to file annual reports with the Commission, not later than 60 days after the close of the fiscal year for which the report is being prepared, pursuant to rule 30a-1 under the Investment Company Act of 1940 ("Act") (17 CFR 270.30a-1). Face amount certificate companies should continue to file periodic reports pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 ("Exchange Act"). The Commission may use the information provided on Form N-CEN in its regulatory, enforcement, examination, disclosure review, inspection, and policymaking roles.

GENERAL INSTRUCTIONS

A. Rule as to Use of Form N-CEN

Form N-CEN is the reporting form that is to be used for annual reports filed pursuant to rule 30a-1 under the Act (17 CFR 270.30a-1) by registered investment companies, other than face amount certificate companies, under section 30(a) of the Act and, in the case of small business investment companies and registered unit investment trusts, under section 13 or 15(d) of the Exchange Act, if applicable.

Registrants must respond to all items in the relevant Parts of Form N-CEN, as listed below in this General Instruction A. If an item within a required Part is inapplicable, the Registrant should respond "N/A" to that item. Registrants are not, however, required to respond to items in Parts of Form N-CEN that they are not required by this General Instruction A to respond to.

Management investment companies: Management investment companies other than small business investment companies must complete Parts A, B, C, and G of this Form. Management investment companies that offer multiple series must complete Part C as to each series separately, even if some information is the same for two or more series. Closed-end management investment companies also must complete Part D of this Form. Small business investment companies must complete Parts A, B, D, and G of this Form. Management investment companies that are registered on Form N-3 also must complete certain items in Part F of this Form as directed by Item 7.c.i.

Exchange-traded funds or exchange-traded managed funds: Funds that are exchange-traded funds or exchange-traded managed funds, as defined by this Form, must complete Part E of this Form in addition to any other required Parts.

Unit investment trusts: Unit investment trusts must complete Parts A, B, F, and G of this Form.

B. Application of General Rules and Regulations

The General Rules and Regulations under the Act contain certain general requirements that are applicable to reporting on any form under the Act. These general requirements should be carefully read and observed in the preparation and filing of reports on this form, except that any provision in the form or in these instructions shall be controlling.

C. Filing of Report

All registered investment companies with shares outstanding (other than shares issued in connection with an initial investment to satisfy section 14(a) of the Investment Company Act) must file a report on Form N-CEN at least annually. If a Registrant changes its fiscal year, a report filed on Form N-CEN may cover a period shorter than 12 months, but in no event may a report filed on Form N-CEN cover a period longer than 12 months or a period that overlaps with a period covered by a previously filed report. For example, if in 2014 a Registrant with a September 30 fiscal year end changes its fiscal year end to December 31, the Registrant could file a report on this Form for the fiscal period ending September 30, 2014 and a report for the period ending December 31, 2014. A Registrant could not, however, only file a report for the fiscal period ending December 31, 2014 if its last report was filed for the fiscal period ending September 30, 2013. An extension of time of up to 15 days for filing the form may be obtained by following the procedures specified in rule 12b-25 under the Exchange Act (17 CFR 240.12b-25).

Reports must be filed electronically using the Commission's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system in accordance with Regulation S-T. Consult the EDGAR Filer Manual and Appendices for EDGAR filing instructions.

D. Paperwork Reduction Act Information

A registrant is required to disclose the information specified by Form N-CEN, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CEN unless the form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to the Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. 3507.

E. Signature and Filing of Report

If the report is filed in paper pursuant to a hardship exemption from electronic filing (see Item 201 *et seq.* of Regulation S-T (17 CFR 232.201 *et seq.*)), eight complete copies of the report shall be filed with the Commission. At least one complete copy of the report shall be filed with each exchange on which any class of securities of the registrant is registered. At least one complete copy of the report filed with the Commission and one such copy filed with each exchange must be manually signed. Copies not manually signed must bear typed or printed signatures.

A registrant may file an amendment to a previously filed report at any time, including an amendment to correct a mistake or error in a previously filed report. A registrant that files an amendment to a previously filed report must provide information in response to all required items of Form N-CEN, regardless of why the amendment is filed.

The report must be signed by the Registrant, and on behalf of the Registrant, by an authorized officer of the Registrant. The name of each person who signs the report shall be typed or printed beneath his or her signature. Attention is directed to rule 8b-11 under the Act (17 CFR 270.8b-11) concerning manual signatures and signatures pursuant to powers of attorney.

F. Definitions

Except as defined below or where the context clearly indicates the contrary, terms used in Form N-CEN have meanings as defined in the Act and the rules and regulations thereunder. Unless otherwise indicated, all references in the form or its instructions to statutory sections or to rules are sections of the Act and the rules and regulations thereunder.

In addition, the following definitions apply:

"Class" means a class of shares issued by a Multiple Class Fund that represents interest in the same portfolio of securities under rule 18f-3 under the Act (17 CFR 270.18f-3) or under an order exempting the Multiple Class Fund from sections 18(f), 18(g), and 18(i) of the Act (15 U.S.C. 80a-18(f), 18(g), and 18(i)).

"CRD number" means a central licensing and registration system number issued by the Financial Industry Regulatory Authority.

"Exchange-Traded Fund" means an open-end management investment company (or Series or Class thereof) or unit investment trust, the shares of which are listed and traded on a national securities exchange at market prices, and that has formed and operates under an exemptive order under the Act granted by the Commission or in reliance on an exemptive rule under the Act adopted by the Commission.

"Exchange-Traded Managed Fund" means an open-end management investment company (or Series or Class thereof) or unit investment trust, the shares of which are listed and traded on a national securities exchange at NAV-based prices, and that has formed and operates under an exemptive order under the Act granted by the Commission or in reliance on an exemptive rule under the Act adopted by the Commission.

"Fund" means the Registrant or a separate Series of the Registrant. When an item of Form N-CEN specifically applies to a Registrant or Series, those terms will be used.

"LEI" means, with respect to any company, the "legal entity identifier" as assigned or recognized by the Global LEI Regulatory Oversight Committee or the Global LEI Foundation. In the case of a financial institution, if a "legal entity identifier" has not been assigned, then provide the RSSD ID, if any, assigned by the National Information Center of the Board of Governors of the Federal Reserve System.

"Money Market Fund" means an open-end management investment company registered under the Act, or Series thereof, that is regulated as a money market fund pursuant to rule 2a-7 under the Act (17 CFR 270.2a-7).

"Multiple Class Fund" means a Fund that has more than one Class.

"PCAOB number" means the registration number issued to an independent public accountant registered with the Public Company Accounting Oversight Board.

"Registrant" means the investment company filing this report or on whose behalf the report is filed.

"SEC File number" means the number assigned to an entity by the Commission when that entity registered with the Commission in the capacity in which it is named in Form N-CEN.

"Series" means shares offered by a Registrant that represent undivided interests in a portfolio of investments and that are preferred over all other Series of shares for assets specifically allocated to that Series in accordance with rule 18f-2(a) (17 CFR 270.18f-2(a)).

FORM N-CEN
ANNUAL REPORT FOR REGISTERED INVESTMENT COMPANIES

Part A: General Information

Item 1. Reporting period covered.

a. Report for period ending: [month/day/year]

b. Does this report cover a period of less than 12 months? [Y/N]

Part B: Information About the Registrant

Instruction. If the response to an item in Part B differs between Series of the Registrant, provide a response for each Series, as applicable, and label the response with the name and Series identification number of the Series to which a response relates.

Item 2. Background information.

a. Full name of Registrant: ____

b. Investment Company Act file number (*e.g.*, 811-): ____

c. CIK: ____

d. LEI: ____

Item 3. Address and telephone number of Registrant.

a. Street: ____

b. City: ____

c. State, if applicable: ____

d. Foreign country, if applicable: ____

e. Zip code and zip code extension, or foreign postal code: ____

f. Telephone number (including country code if foreign): ____

g. Public website, if any: ____

Item 4. Location of books and records.

a. Name of person (*e.g.*, a custodian of records): ____

b. Street: ____

c. City: ____

d. State, if applicable

e. Foreign country, if applicable: ____

f. Zip code and zip code extension, or foreign postal code: ____

g. Telephone number (including country code if foreign): ____

h. Briefly describe the books and records kept at this location: ____

Instruction. Provide the requested information for each person maintaining physical possession of each account, book, or other document required to be maintained by section 31(a) of the Act (15 U.S.C. 80a-30(a)) and the rules under that section.

Item 5. Initial or final filings.

a. Is this the first filing on this form by the Registrant? [Y/N]

b. Is this the last filing on this form by the Registrant? [Y/N]

Instruction. Respond "yes" to Item 5(b) only if the Registrant has filed an application to deregister on Form N-8F or otherwise.

Item 6. Family of investment companies.

a. Is the Registrant part of a family of investment companies? [Y/N]

i. Full name of family of investment companies: ____

Instruction. "Family of investment companies" means, except for insurance company separate accounts, any two or more registered investment companies that (i) share the same investment adviser or principal underwriter; and (ii) hold themselves out to investors as related companies for purposes of investment and investor services. In responding to this item, all Registrants in the family of investment companies should report the name of the family of investment companies identically.

Insurance company separate accounts that may not hold themselves out to investors as related companies (products) for purposes of investment and investor services should consider themselves part of the same family if the operational or accounting or control systems under which these entities function are substantially similar.

Item 7. Organization. Indicate the classification of the Registrant by checking the applicable item below.

a. Open end management investment company registered under the Act on Form N-1A: ____

i. Total number of Series of the Registrant: ____

ii. If a Series of the Registrant was terminated during the reporting period, provide the following information:

1. Name of the Series: ____

2. Series identification number: ____

3. Date of termination (month/year): ____

b. Closed-end management investment company registered under the Act on Form N-2: ____

c. Separate account offering variable annuity contracts which is registered under the Act as a management investment company on Form N-3: ____

   i. Registrants that indicate they are a management investment company registered under the Act on Form N-3, should respond to Item 74 through Item 77 of this Form in addition to the items discussed in General Instruction A of this Form.

d. Separate account offering variable annuity contracts which is registered under the Act as a unit investment trust on Form N-4: ____

e. Small business investment company registered under the Act on Form N-5: ____

f. Separate account offering variable life insurance contracts which is registered under the Act as a unit investment trust on Form N-6: ____

g. Unit investment trust registered under the Act on Form N-8B-2: ____

Instruction. For Item 7.a.i, the Registrant should include all Series that have been established by the Registrant and have shares outstanding (other than shares issued in connection with an initial investment to satisfy section 14(a) of the Act).

Item 8. Securities Act registration. Is the Registrant the issuer of a class of securities registered under the Securities Act of 1933 ("Securities Act")? [Y/N]

Item 9. Directors. Provide for each director the information below (management investment companies only):

a. Full name: ____

b. Is the director an "interested person" of the Registrant as that term is defined in section 2(a)(19) of the Act (15 U.S.C. 80a-2(a)(19))? [Y/N]

c. Investment Company Act file number of any other registered investment company for which the director also serves as a director (*e.g.*, 811-): ____

Item 10. Chief compliance officer. Provide the information requested below about the person serving as chief compliance officer of the Registrant for purposes of rule 38a-1 (17 CFR 270.38a-1):

a. Full name: ____

b. CRD number, if any: ____

c. Street: ____

d. City: ____

e. State, if applicable: ____

f. Foreign country, if applicable: ____

g. Zip code and zip code extension, or foreign postal code: ____

h. Telephone number (including country code if foreign): ____

i. Has the chief compliance officer changed since the last filing? [Y/N]

j. If the chief compliance officer is compensated or employed by any person other than the Registrant, or an affiliated person of the Registrant, for providing chief compliance officer services, provide:

   i. Name of the person: ____

   ii. Person's Employer Identification Number: ____

Item 11. Matters for security holder vote. Were any matters submitted by the Registrant for its security holders' vote during the reporting period? [Y/N]

Item 12. Legal proceedings.

a. Have there been any material legal proceedings, other than routine litigation incidental to the business, to which the Registrant or any of its subsidiaries was a party or of which any of their property was the subject during the reporting period? [Y/N] If yes, include the attachment required by Item 79.a.i.

b. Has any proceeding previously reported been terminated? [Y/N] If yes, include the attachment required by Item 79.a.i.

Instruction. For purposes of this Item, the following proceedings should be described: (1) any bankruptcy, receivership or similar proceeding with respect to the Registrant or any of its significant subsidiaries; (2) any proceeding to which any director, officer or other affiliated person of the Registrant is a party adverse to the Registrant or any of its subsidiaries; and (3) any proceeding involving the revocation or suspension of the right of the Registrant to sell securities.

Item 13. Fidelity bond and insurance (management investment companies only).

a. Were any claims with respect to the Registrant filed under a fidelity bond (including, but not limited to, the fidelity insuring agreement of the bond) during the reporting period? [Y/N]

   i. If yes, enter the aggregate dollar amount of claims filed: ____

Item 14. Directors and officers/errors and omissions insurance (management investment companies only).

a. Are the Registrant's officers or directors covered in their capacities as officers or directors under any directors and officers/errors and omissions insurance policy owned by the Registrant or anyone else? [Y/N]

   i. If yes, were any claims filed under the policy during the reporting period with respect to the Registrant? [Y/N]

Item 15. Provision of financial support. Did an affiliated person, promoter, or principal underwriter of the Registrant, or an affiliated person of such a person, provide any form of financial support to the Registrant during the reporting period? [Y/N] If yes, include the attachment required by Item 79.a.ii, unless the Registrant is a Money Market Fund.

Instruction. For purposes of this Item, a provision of financial support includes any (1) capital contribution, (2) purchase of a security from a Money Market Fund in reliance on rule 17a-9 under the Act (17 CFR 270.17a-9), (3) purchase of any defaulted or devalued security at fair value, (4) execution of letter of credit or letter of indemnity, (5) capital support agreement (whether or not the Registrant ultimately received support), (6) performance guarantee, or (7) other similar action reasonably intended to increase or stabilize the value or liquidity of the Registrant's portfolio. Provision of financial support does not include any (1) routine waiver of fees or reimbursement of Registrant's expenses, (2) routine inter-fund lending, (3) routine inter-fund purchases of Registrant's shares, or (4) action that would qualify as financial support as defined above, that the board of directors has otherwise determined not to be reasonably intended to increase or stabilize the value or liquidity of the Registrant's portfolio.

Item 16. Exemptive orders.

a. During the reporting period, did the Registrant rely on any orders from the Commission granting an exemption from one or more provisions of the Act, Securities Act or Exchange Act? [Y/N]

   i. If yes, provide below the release number for each order: ____

Item 17. Principal underwriters.

a. Provide the information requested below about each principal underwriter:

   i. Full name: ____

   ii. SEC file number (e.g., 8-): ____

   iii. CRD number: ____

   iv. LEI, if any: ____

v. State, if applicable: ____

vi. Foreign country, if applicable: ____

vii. Is the principal underwriter an affiliated person of the Registrant, or its investment adviser(s) or depositor? [Y/N]

b. Have any principal underwriters been hired or terminated during the reporting period? [Y/N]

Item 18. Independent public accountant. Provide the following information about the independent public accountant:

a. Full name: ____

b. PCAOB number: ____

c. LEI, if any: ____

d. State, if applicable: ____

e. Foreign country, if applicable: ____

f. Has the independent public accountant changed since the last filing? [Y/N] If yes, include the attachment required by Item 79.a.iii.

Item 19. Report on internal control (management investment companies only). For the reporting period, did an independent public accountant's report on internal control find any material weaknesses? [Y/N]

Instruction. Small business investment companies are not required to respond to this item.

Item 20. Audit opinion. For the reporting period, did an independent public accountant issue an opinion other than an unqualified opinion with respect to its audit of the Registrant's financial statements? [Y/N]

Item 21. Change in valuation methods. Have there been material changes in the method of valuation (e.g., change from use of bid price to mid price for fixed income securities or change in trigger threshold for use of fair value factors on international equity securities) of the Registrant's assets during the reporting period? [Y/N] If yes, provide the following:

a. Date of change: ___

b. Explanation of the change: ____

c. Type of investments involved: ____

d. Statutory or regulatory basis, if any: ____

e. Fund(s) involved:

   i. Fund name: _____

   ii. Series identification number: ____

Instruction. Responses to this item need not include changes to valuation techniques used for individual securities (e.g., changing from market approach to income approach for a private equity security).

Item 22. Change in accounting principles and practices. Have there been any changes in accounting principles or practices, or any change in the method of applying any such accounting principles or practices, which will materially affect the financial statements filed or to be filed for the current year with the Commission and which has not been previously reported? [Y/N] If yes, include the attachment required by Item 79.a.v.

Item 23. Net asset value error corrections (open-end management investment companies only).

a. During the reporting period, did the Registrant make any payments to shareholders or reprocess shareholder accounts as a result of an error in calculating the Registrant's net asset value (or net asset value per share)? [Y/N]

Item 24. Rule 19a-1 notice (management investment companies only). During the reporting period, did the Registrant pay any dividend or make any distribution in the nature of a dividend payment, required to be accompanied by a written statement pursuant to section 19(a) of the Act (15 U.S.C. 80a-19(a)) and rule 19a-1 thereunder (17 CFR 270.19a-1)? [Y/N]

Part C: Additional Questions for Management Investment Companies

Item 25. Background information.

a. Full name of the Fund: ____

b. Series identification number, if any: ____

c. LEI: ____

d. Is this the first filing on this form by the Fund? [Y/N]

Item 26. Classes of open-end management investment companies.

a. How many Classes of shares of the Fund (if any) are authorized? ____

b. How many new Classes of shares of the Fund were added during the reporting period? ____

c. How many Classes of shares of the Fund were terminated during the reporting period? ___

d. For each Class with shares outstanding, provide the information requested below:

   i. Full name of Class: ____

   ii. Class identification number, if any: ____

   iii. Ticker symbol, if any: ____

Item 27. Type of fund. Indicate if the Fund is any one of the types listed below. Check all that apply.

a. Exchange-Traded Fund or Exchange-Traded Managed Fund or offers a Class that itself is an Exchange-Traded Fund or Exchange-Traded Managed Fund:

   i. Exchange-Traded Fund: ____

   ii. Exchange-Traded Managed Fund: ____

b. Index Fund: ____

   i. If the Fund is an index fund, provide the annualized difference between the Fund's total return during the reporting period and the index's return during the reporting period (*i.e.*, the Fund's total return less the index's return):

      1. Before Fund fees and expenses: ____

      2. After Fund fees and expenses (*i.e.*, net asset value): ____

   ii. If the Fund is an index fund, provide the annualized standard deviation of the daily difference between the Fund's total return and the index's return during the reporting period:

      1. Before Fund fees and expenses: ____

      2. After Fund fees and expenses (*i.e.*, net asset value): ____

c. Seeks to achieve performance results that are a multiple of a benchmark, the inverse of a benchmark, or a multiple of the inverse of a benchmark: ____

d. Interval Fund: ____

e. Fund of Funds: ____

f. Master-Feeder Fund: ____

   i. If the Registrant is a master fund, then provide the information requested below with respect to each feeder fund:

      1. Full name: ____

2. For registered feeder funds:

    a. Investment Company Act file number (*e.g.*, 811-): ____

    b. Series identification number, if any: ____

    c. LEI of feeder fund: ____

3. For unregistered feeder funds:

    a. SEC file number of the feeder fund's investment adviser (*e.g.*, 801-): ____

    b. LEI of feeder fund, if any: ___

ii. If the Registrant is a feeder fund, then provide the information requested below with respect to a master fund registered under the Act:

1. Full name: ____

2. Investment Company Act file number (*e.g.*, 811-): ____

3. SEC file number of the master fund's investment adviser (*e.g.*, 801-): ___

4. LEI: ___

g. Money Market Fund: ____

h. Target Date Fund: ___

i. Underlying fund to a variable annuity or variable life insurance contract: ____

Instructions.

1. "Fund of Funds" means a fund that acquires securities issued by any other investment company in excess of the amounts permitted under paragraph (A) of section 12(d)(1) of the Act (15 U.S.C. 80a-12(d)(1)(A)).

2. "Index Fund" means an investment company, including an Exchange-Traded Fund, that seeks to track the performance of a specified index.

3. "Interval Fund" means a closed-end management investment company that makes periodic repurchases of its shares pursuant to rule 23c-3 under the Act (17 CFR 270.23c-3).

4. "Master-Feeder Fund" means a two-tiered arrangement in which one or more funds (each a feeder fund) holds shares of a single Fund (the master fund) in accordance with section 12(d)(1)(E) of the Act (15 U.S.C. 80a-12(d)(1)(E)).

5. "Target Date Fund" means an investment company that has an investment objective or strategy of providing varying degrees of long-term appreciation and capital preservation through a mix of equity and fixed income exposures that changes over time based on an investor's age, target retirement date, or life expectancy.

Item 28. Diversification. Does the Fund seek to operate as a "non-diversified company" as such term is defined in section 5(b)(2) of the Act (15 U.S.C. 80a-5(b)(2))? [Y/N]

Item 29. Investments in certain foreign corporations.

a. Does the fund invest in a controlled foreign corporation for the purpose of investing in certain types of instruments such as, but not limited to, commodities? [Y/N]

b. If yes, provide the following information:

i. Full name of subsidiary: ___

ii. LEI of subsidiary, if any: ___

Instruction. "Controlled foreign corporation" has the meaning provided in section 957 of the Internal Revenue Code [26 U.S.C. 957].

Item 30. Securities lending.

a. Is the Fund authorized to engage in securities lending transactions? [Y/N]

b. Did the Fund lend any of its securities during the reporting period? [Y/N]

i. If yes, has any borrower of fund securities defaulted during the reporting period? [Y/N]

c. Provide the information requested below about each securities lending agent, if any, retained by the Fund:

i. Full name of securities lending agent: ____

ii. LEI, if any: ____

iii. Is the securities lending agent an affiliated person, or an affiliated person of an affiliated person, of the Fund? [Y/N]

iv. Does the securities lending agent or any other entity indemnify the fund against borrower default on loans administered by this agent? [Y/N]

v. If the entity providing the indemnification is not the securities lending agent, provide the following information:

1. Name of person providing indemnification: ____

2. LEI, if any, of person providing indemnification: ____

d. If a person providing cash collateral management services to the Fund in connection with the Fund's securities lending activities does not also serve as securities lending agent, provide the following information about each cash collateral manager:

   i. Full name of cash collateral manager: ____

   ii. LEI, if any: ____

   iii. Is the cash collateral manager an affiliated person, or an affiliated person of an affiliated person, of a securities lending agent retained by the Fund? [Y/N]

   iv. Is the cash collateral manager an affiliated person, or an affiliated person of an affiliated person, of the Fund? [Y/N]

e. Types of payments made to one or more securities lending agents and cash collateral managers (check all that apply):

   i. revenue sharing split: ____

   ii. non-revenue sharing split (other than administrative fee): ____

   iii. administrative fee: ____

   iv. cash collateral reinvestment fee: ____

   v. indemnification fee: ____

   vi. other: _____. If other, describe: ______.

Item 31. Reliance on certain rules. Did the Fund rely on any of the following rules under the Act during the reporting period? (check all that apply)

a. Rule 10f-3 (17 CFR 270.10f-3): ____

b. Rule 12d1-1 (17 CFR 270.12d1-1): ____

c. Rule 15a-4 (17 CFR 270.15a-4): ____

d. Rule 17a-6 (17 CFR 270.17a-6): ____

e. Rule 17a-7 (17 CFR 270.17a-7): ____

f. Rule 17a-8 (17 CFR 270.17a-8): ____

g. Rule 17e-1 (17 CFR 270.17e-1): ____

h. Rule 22d-1 (17 CFR 270.22d-1): ____

i. Rule 23c-1 (17 CFR 270.23c-1): ____

j. Rule 32a-4 (17 CFR 270.32a-4): ____

Item 32. Expense limitations.

a. Did the Fund have an expense limitation arrangement in place during the reporting period? [Y/N]

b. Were any expenses of the Fund reduced or waived pursuant to an expense limitation arrangement during the reporting period? [Y/N]

c. Are the fees waived subject to recoupment? [Y/N]

d. Were any expenses previously waived recouped during the period? [Y/N]

Instruction. Provide information concerning any direct or indirect limitations, waivers or reductions, on the level of expenses incurred by the fund during the reporting period. A limitation, for example, may be applied indirectly (such as when an adviser agrees to accept a reduced fee pursuant to a voluntary fee waiver) or it may apply only for a temporary period such as for a new fund in its start-up phase.

Item 33. Investment advisers.

a. Provide the following information about each investment adviser (other than a sub-adviser) of the Fund:

   i. Full name: ____

   ii. SEC file number (*e.g.*, 801-): ____

   iii. CRD number: _____

   iv. LEI, if any: _____

   v. State, if applicable: ____

   vi. Foreign country, if applicable: ____

   vii. Was the investment adviser hired during the reporting period? [Y/N]

      1. If the investment adviser was hired during the reporting period, indicate the investment adviser's start date: ____

b. If an investment adviser (other than a sub-adviser) to the Fund was terminated during the reporting period, provide the following with respect to each investment adviser:

   i. Full name: ____

   ii. SEC file number (*e.g.*, 801-): ____

   iii. CRD number: ____

   iv. LEI, if any: ____

   v. State, if applicable: ____

   vi. Foreign country, if applicable: ____

vii. Termination date: ____

c. For each sub-adviser to the Fund, provide the information requested:

i. Full name: ____

ii. SEC file number (e.g., 801-), if applicable: ____

iii. CRD number: _____

iv. LEI, if any: _____

v. State, if applicable: ____

vi. Foreign country, if applicable: ____

vii. Is the sub-adviser an affiliated person of the Fund's investment adviser(s)? [Y/N]

viii. Was the sub-adviser hired during the reporting period? [Y/N]

1. If the sub-adviser was hired during the reporting period, indicate the sub-adviser's start date: ____

d. If a sub-adviser was terminated during the reporting period, provide the following with respect to such sub-adviser:

i. Full name: ____

ii. SEC file number (*e.g.*, 801-): ____

iii. CRD number: ____

iv. LEI, if any: ____

v. State, if applicable: ____

vi. Foreign country, if applicable: ____

vii. Termination date: ____

Item 34. Transfer agents.

a. Provide the following information about each person providing transfer agency services to the Fund:

i. Full name: ____

ii. SEC file number (e.g., 84- or 85-): ____

iii. LEI, if any: ____

iv. State, if applicable: ____

v. Foreign country, if applicable: ____

vi. Is the transfer agent an affiliated person of the Fund or its investment adviser(s)? [Y/N]

b. Has a transfer agent been hired or terminated during the reporting period? [Y/N]

Item 35. Pricing services. Provide the following information about each person that provided pricing services to the Fund during the reporting period:

a. Full name: ____

b. LEI, if any, or provide and describe other identifying number: ____

c. State, if applicable: _____

d. Foreign country, if applicable: ____

e. Is the pricing service an affiliated person of the Fund or its investment adviser(s)? [Y/N]

f. Was the pricing service first retained by the Fund to provide pricing services during the current reporting period? [Y/N]

Item 36. Pricing services no longer retained. Provide the following information about each person that formerly provided pricing services to the Fund during the current or immediately prior reporting period that no longer provides such services to the Fund:

a. Full name: ____

b. LEI, if any, or provide and describe other identifying number: ____

c. State, if applicable: _____

d. Foreign country, if applicable: ____

e. Termination date: ____

Item 37. Custodians.

a. Provide the following information about each person that provided custodial services to the Fund during the reporting period:

i. Full name: ____

ii. LEI, if any: ____

iii. State, if applicable: ____

iv. Foreign country, if applicable: ____

v. Is the custodian an affiliated person of the Fund or its investment adviser(s)? [Y/N]

vi. Is the custodian a sub-custodian? [Y/N]

vii. With respect to the custodian, check below to indicate the type of custody:

1. Bank – section 17(f)(1) (15 U.S.C. 80a-17(f)(1)): ____
2. Member national securities exchange – rule 17f-1 (17 CFR 270.17f-1): ____
3. Self – rule 17f-2 (17 CFR 270.17f-2): ____
4. Securities depository – rule 17f-4 (17 CFR 270.17f-4): ____
5. Foreign custodian – rule 17f-5 (17 CFR 270.17f-5): ____
6. Futures commission merchants and commodity clearing organizations – rule 17f-6 (17 CFR 270.17f-6): ____
7. Foreign securities depository – rule 17f-7 (17 CFR 270.17f-7): ____
8. Insurance company sponsor – rule 26a-2 (17 CFR 270.26a-2): ____
9. Other: ____. If other, describe: ______.

b. Has a custodian been hired or terminated during the reporting period? [Y/N]

Item 38. Shareholder servicing agents.

a. Provide the following information about each shareholder servicing agent of the Fund:

i. Full name: ____

ii. LEI, if any, or provide and describe other identifying number: ____

iii. State, if applicable: _____

iv. Foreign country, if applicable: ____

v. Is the shareholder servicing agent an affiliated person of the Fund or its investment adviser(s)? [Y/N]

b. Has a shareholder servicing agent been hired or terminated during the reporting period? [Y/N]

Item 39. Third-party administrators.

a. Provide the following information about each third-party administrator of the Fund:

i. Full name: ____

ii. LEI, if any, or provide and describe other identifying number: ____

iii. State, if applicable: _____

iv. Foreign country, if applicable: ___

v. Is the third-party administrator an affiliated person of the Fund or its investment adviser(s)? [Y/N]

b. Has a third-party administrator been hired or terminated during the reporting period? [Y/N]

Item 40. Affiliated broker-dealers. Provide the following information about each affiliated broker-dealer:

a. Full name: ____

b. SEC file number: ____

c. CRD number: ____

d. LEI, if any: ____

e. State, if applicable: _____

f. Foreign country, if applicable: ____

g. Total commissions paid to the affiliated broker-dealer for the reporting period: ____

Item 41. Brokers.

a. For each of the ten brokers that received the largest dollar amount of brokerage commissions (excluding dealer concessions in underwritings) by virtue of direct or indirect participation in the Fund's portfolio transactions, provide the information below:

i. Full name of broker: ____

ii. SEC file number: ____

iii. CRD number: ____

iv. LEI, if any: ____

v. State, if applicable: _____

vi. Foreign country, if applicable: ____

vii. Gross commissions paid by the Fund for the reporting period: ____

b. Aggregate brokerage commissions paid by Fund during the reporting period: ____

Item 42. Principal transactions.

a. For each of the ten entities acting as principals with which the Fund did the largest dollar amount of principal transactions (include all short-term obligations, and U.S. government and tax-free securities) in both the secondary market and in underwritten offerings, provide the information below:

   i. Full name of dealer: ____

   ii. SEC file number: ____

   iii. CRD number: ____

   iv. LEI, if any: ____

   v. State, if applicable: _____

   vi. Foreign country, if applicable: ____

   vii. Total value of purchases and sales (excluding maturing securities) with Fund: ____

b. Aggregate value of principal purchase/sale transactions of Fund during the reporting period: ____

Instructions to Item 41 and Item 42.

To help Registrants distinguish between agency and principal transactions, and to promote consistent reporting of the information required by these items, the following criteria should be used:

1. If a security is purchased or sold in a transaction for which the confirmation specifies the amount of the commission to be paid by the Registrant, the transaction should be considered an agency transaction and included in determining the answers to Item 41.

2. If a security is purchased or sold in a transaction for which the confirmation specifies only the net amount to be paid or received by the Registrant and such net amount is equal to the market value of the security at the time of the transaction, the transaction should be considered a principal transaction and included in determining the amounts in Item 42.

3. If a security is purchased by the Registrant in an underwritten offering, the acquisition should be considered a principal transaction and included in answering Item 42 even though the Registrant has knowledge of the amount the underwriters are receiving from the issuer.

4. If a security is sold by the Registrant in a tender offer, the sale should be considered a principal transaction and included in answering Item 42 even though the Registrant has knowledge of the amount the offeror is paying to soliciting brokers or dealers.

5. If a security is purchased directly from the issuer (such as a bank CD), the purchase should be considered a principal transaction and included in answering Item 42.

6. The value of called or maturing securities should not be counted in either agency or principal transactions and should not be included in determining the amounts shown in Item 41 and Item 42. This means that the acquisition of a security may be included, but it is possible that its disposition may not be included. Disposition of a repurchase agreement at its expiration date should not be included.

7. The purchase or sales of securities in transactions not described in paragraphs (1) through (6) above should be evaluated by the Fund based upon the guidelines established in those paragraphs and classified accordingly. The agents considered in Item 41 may be persons or companies not registered under the Exchange Act as securities brokers. The persons or companies from whom the investment company purchased or to whom it sold portfolio instruments on a principal basis may be persons or entities not registered under the Exchange Act as securities dealers.

Item 43. Payments for brokerage and research. During the reporting period, did the Fund pay commissions to broker-dealers for "brokerage and research services" within the meaning of section 28(e) of the Exchange Act (15 U.S.C. 78bb)? [Y/N]

Part D: Additional Questions for Closed-End Management Investment Companies and Small Business Investment Companies

Item 44. Securities issued by Registrant. Indicate by checking below which of the following securities have been issued by the Registrant. Indicate all that apply.

a. Common stock: ____

  i. Title of class: ____

  ii. Exchange where listed: ____

  iii. Ticker symbol: ____

b. Preferred stock: ____

  1. Title of class: ____

2. Exchange where listed: ____

3. Ticker symbol: ____

c. Warrants: ____

i. Title of class: ____

ii. Exchange where listed: ____

iii. Ticker symbol: ____

d. Convertible securities: ____

i. Title of class: ____

ii. Exchange where listed: ____

iii. Ticker symbol: ____

e. Bonds: ____

i. Title of class: ____

ii. Exchange where listed: ____

iii. Ticker symbol: ____

f. Other: ____. If other, describe: ______.

i. Title of class: ____

ii. Exchange where listed: ____

iii. Ticker symbol: ____

Instruction. For any security issued by the Fund that is not listed on a securities exchange but that has a ticker symbol, provide that ticker symbol.

Item 45. Rights offerings.

a. Did the Fund make a rights offering with respect to any type of security during the reporting period? [Y/N] If yes, answer the following as to each rights offering made by the Fund:

b. Type of security.

i. Common stock: ____

ii. Preferred stock: ____

iii. Warrants: ____

iv. Convertible securities: ____

v. Bonds: ____

vi. Other: ____. If other, describe: ______.

c. Percentage of participation in primary rights offering: ___

Instruction. For Item 45.c, the "percentage of participation in primary rights offering" is calculated as the percentage of subscriptions exercised during the primary rights offering relative to the amount of securities available for primary subscription.

Item 46. Secondary offerings.

a. Did the Fund make a secondary offering during the reporting period? [Y/N]

b. If yes, indicate by checking below the type(s) of security. Indicate all that apply.

   i. Common stock: ____

   ii. Preferred stock: ____

   iii. Warrants: ____

   iv. Convertible security: ____

   v. Bonds: ____

   vi. Other: ____. If other, describe: ______.

Item 47. Repurchases.

a. Did the Fund repurchase any outstanding securities issued by the Fund during the reporting period? [Y/N]

b. If yes, indicate by checking below the type(s) of security. Indicate all that apply:

   i. Common stock: ____

   ii. Preferred stock: ___

   iii. Warrants: ____

   iv. Convertible securities: ____

   v. Bonds: ____

   vi. Other: ____. If other, describe: ______.

Item 48. Default on long-term debt.

a. Were any issues of the Fund's long-term debt in default at the close of the reporting period with respect to the payment of principal, interest, or amortization? [Y/N] If yes, provide the following:

   i. Nature of default: ____

   ii. Date of default: ____

   iii. Amount of default per $1,000 face amount: ____

iv. Total amount of default: ____

Instruction. The term "long-term debt" means debt with a period of time from date of initial issuance to maturity of one year or greater.

Item 49. Dividends in arrears.

a. Were any accumulated dividends in arrears on securities issued by the Fund at the close of the reporting period? [Y/N] If yes, provide the following:

i. Title of issue: ____

ii. Amount per share in arrears: ____

Instruction. The term "dividends in arrears" means dividends that have not been declared by the board of directors or other governing body of the Fund at the end of each relevant dividend period set forth in the constituent instruments establishing the rights of the stockholders.

Item 50. Modification of securities. Have the terms of any constituent instruments defining the rights of the holders of any class of the Registrant's securities been materially modified? [Y/N] If yes, provide the attachment required by Item 79.b.ii.

Item 51. Management fee (closed-end companies only). Provide the Fund's advisory fee as of the end of the reporting period as percentage of net assets: ____

Instruction. Base the percentage on amounts incurred during the reporting period.

Item 52. Net annual operating expenses. Provide the Fund's net annual operating expenses as of the end of the reporting period (net of any waivers or reimbursements) as a percentage of net assets: ____

Item 53. Market price. Market price per share at end of reporting period: ____

Instruction. Respond to this item with respect to common stock issued by the Registrant only.

Item 54. Net asset value. Net asset value per share at end of reporting period: ____

Instruction. Respond to this item with respect to common stock issued by the Registrant only.

Item 55. Investment advisers (small business investment companies only).

a. Provide the following information about each investment adviser (other than a sub-adviser) of the Fund:

i. Full name: ____

ii. SEC file number (*e.g.*, 801-): ____

iii. CRD number: _____

iv. LEI, if any: _____

v. State, if applicable: _____

vi. Foreign country, if applicable: ____

vii. Was the investment adviser hired during the reporting period? [Y/N]

1. If the investment adviser was hired during the reporting period, indicate the investment adviser's start date: ____

b. If an investment adviser (other than a sub-adviser) to the Fund was terminated during the reporting period, provide the following with respect to each investment adviser:

i. Full name: ____

ii. SEC file number (*e.g.*, 801-): ____

iii. CRD number: ____

iv. LEI, if any: ____

v. State, if applicable: _____

vi. Foreign country, if applicable: ____

vii. Termination date: ____

c. For each sub-adviser to the Fund, provide the information requested:

i. Full name: ____

ii. SEC file number (*e.g.*, 801-), if applicable: ____

iii. CRD number: _____

iv. LEI, if any: _____

v. State, if applicable: _____

vi. Foreign country, if applicable: ____

vii. Is the sub-adviser an affiliated person of the Fund's investment adviser(s)? [Y/N]

viii. Was the sub-adviser hired during the reporting period? [Y/N]

1. If the sub-adviser was hired during the reporting period, indicate the sub-adviser's start date: ____

d. If a sub-adviser was terminated during the reporting period, provide the following with respect to such sub-adviser:

i. Full name: ____

ii. SEC file number (e.g., 801-): ____

iii. CRD number: ____

iv. LEI, if any: ____

v. State, if applicable: _____

vi. Foreign country, if applicable: ____

vii. Termination date: ____

Item 56. Transfer agents (small business investment companies only).

a. Provide the following information about each person providing transfer agency services to the Fund:

i. Full name: ____

ii. SEC file number (e.g., 84- or 85-): ____

iii. LEI, if any: ____

iv. State, if applicable: ____

v. Foreign country, if applicable: ____

vi. Is the transfer agent an affiliated person of the Fund or its investment adviser(s)? [Y/N]

b. Has a transfer agent been hired or terminated during the reporting period? [Y/N]

Item 57. Custodians (small business investment companies only).

a. Provide the following information about each person that provided custodial services to the Fund during the reporting period:

i. Full name: ____

ii. LEI, if any: ____

iii. State, if applicable: ____

iv. Foreign country, if applicable: ____

v. Is the custodian an affiliated person of the Fund or its investment adviser(s)? [Y/N]

vi. Is the custodian a sub-custodian? [Y/N]

vii. With respect to the custodian, check below to indicate the type of custody:

1. Bank — section 17(f)(1) (15 U.S.C. 80a-17(f)(1)): ____
2. Member national securities exchange — rule 17f-1 (17 CFR 270.17f-1): ____
3. Self — rule 17f-2 (17 CFR 270.17f-2): ____
4. Securities depository — rule 17f-4 (17 CFR 270.17f-4): ____
5. Foreign custodian — rule 17f-5 (17 CFR 270.17f-5): ____
6. Futures commission merchants and commodity clearing organizations — rule 17f-6 (17 CFR 270.17f-6): ____
7. Foreign securities depository — rule 17f-7 (17 CFR 270.17f-7): ____
8. Insurance company sponsor — rule 26a-2 (17 CFR 270.26a-2): ____
9. Other: ____. If other, describe: ______.

b. Has a custodian been hired or terminated during the reporting period? [Y/N]

Part E: Additional Questions for Exchange-Traded Funds and Exchange-Traded Managed Funds

Item 58. Exchange where listed. Provide the securities exchange on which the Fund is listed: ____

Item 59. Authorized participants. For each authorized participant of the Fund, provide the following information:

a. Full name: ____

b. SEC file number: ____

c. CRD number: ____

d. LEI, if any: ____

e. The dollar value of the Fund shares the authorized participant purchased from the Fund during the reporting period: ____

f. The dollar value of the Fund shares the authorized participant redeemed during the reporting period: ____

Instruction. The term "authorized participant" means a broker-dealer that is also a member of a clearing agency registered with the Commission, and which has a written agreement with the Exchange-Traded Fund or Exchange-Traded Managed Fund or one of its designated service providers that allows it place orders to purchase or redeem creation units of the Exchange-Traded Fund or Exchange-Traded Managed Fund.

Item 60. Creation units. Number of Fund shares required to form a creation unit as of the last business day of the reporting period: ____

a. Total value of creation units that were purchased primarily with in-kind securities during the reporting period: ____

b. Total value of creation units that were purchased primarily with cash during the reporting period: ____

c. Total value of creation units that were redeemed primarily with in-kind securities during the reporting period: ____

d. Total value of creation units that were redeemed primarily with cash during the reporting period: ____

e. For the last creation unit purchased during the reporting period of which some or all was purchased on an in-kind basis, provide:

i. Any applicable "fixed" transaction fee expressed as dollars per creation unit: $___

ii. Any applicable "fixed" transaction fee expressed as dollars per order of one or more creation units: $___

iii. Any applicable "variable" transaction fee expressed as a percentage of the value of the in-kind portion of the creation unit: ___%

iv. Any applicable "variable" transaction fee expressed as dollars per creation unit: $___

f. For the last creation unit purchased during the reporting period of which some or all was purchased on a cash basis, provide:

i. Any applicable "fixed" transaction fee expressed as dollars per creation unit: $___

ii. Any applicable "fixed" transaction fee expressed as dollars per order of one or more creation units: $___

iii. Any applicable "variable" transaction fee expressed as a percentage of the cash portion of the creation unit: ___%

iv. Any applicable "variable" transaction fee expressed as dollars per creation unit: $___

g. For the last creation unit redeemed during the reporting period of which some or all was redeemed on an in-kind basis, provide:

i. Any applicable "fixed" transaction fee expressed as dollars per creation unit: $___

ii. Any applicable "fixed" transaction fee expressed as dollars per order of one or more creation units: $___

iii. Any applicable "variable" transaction fee expressed as a percentage of the value of the in-kind portion of the creation unit: ___%

iv. Any applicable "variable" transaction fee expressed as dollars per creation unit: $___

h. For the last creation unit redeemed during the reporting period of which some or all was redeemed on a cash basis, provide:

i. Any applicable "fixed" transaction fee expressed as dollars per creation unit: $___

ii. Any applicable "fixed" transaction fee expressed as dollars per order of one or more creation units: $___

iii. Any applicable "variable" transaction fee expressed as a percentage of the value of the cash portion of the creation unit: ___%

iv. Any applicable "variable" transaction fee expressed as dollars per creation unit: $___

Instructions.

8. The term "creation unit" means a specified number of Exchange-Traded Fund or Exchange-Traded Managed Fund shares that the fund will issue to (or redeem from) an authorized participant in exchange for the deposit (or delivery) of specified securities, cash, and other assets.

9. For this item, the term "primarily" means greater than 50%.

Item 61. Benchmark return difference (unit investment trusts only).

a. If the Fund is an Index Fund as defined in Item 27 of this Form, provide the following information:

i. The annualized difference between the Fund's total return during the reporting period and the index's return during the reporting period (i.e., the Fund's total return less the index's return):

1. Before Fund fees and expenses: ____

2. After Fund fees and expenses (*i.e.*, net asset value): ____

ii. The annualized standard deviation of the daily difference between the Fund's total return and the index's return during the reporting period:

1. Before Fund fees and expenses: ____

2. After Fund fees and expenses (*i.e.*, net asset value): ____

Part F: Additional Questions for Unit Investment Trusts

Item 62. Depositor. Provide the following information about the depositor:

a. Full name: ____

b. CRD number, if any: ____

c. LEI, if any: ____

d. State, if applicable: ____

e. Foreign country, if applicable: ____

f. Full name of ultimate parent of depositor: ____

Item 63. Third-party administrators.

a. Provide the following information about each third-party administrator of the Fund:

i. Full name: ____

ii. LEI, if any, or provide and describe other identifying number: ____

iii. State, if applicable: ____

iv. Foreign country, if applicable: ____

v. Is the third-party administrator an affiliated person of the Fund or depositor? [Y/N]

b. Has a third-party administrator been hired or terminated during the reporting period? [Y/N]

Item 64. Insurance company separate accounts. Is the Registrant a separate account of an insurance company? [Y/N]

Instruction. If the answer to Item 64 is yes, respond to Item 73 through Item 78. If the answer to Item 64 is no, respond to Item 65 through Item 72, and Item 78.

Item 65. Sponsor. Provide the following information about the sponsor:

a. Full name: ____

b. CRD number, if any: ____

c. LEI, if any: ____

d. State, if applicable: ____

e. Foreign country, if applicable: ____

Item 66. Trustees. Provide the following information about each trustee:

a. Full name: ____

b. State, if applicable: ____

c. Foreign country, if applicable: ____

Item 67. Securities Act registration. Provide the number of series existing at the end of the reporting period that had outstanding securities registered under the Securities Act: ____

Item 68. New series.

a. Number of new series for which registration statements under the Securities Act became effective during the reporting period: ____

b. Total aggregate value of the portfolio securities on the date of deposit for the new series: ____

Item 69. Series with a current prospectus. Number of series for which a current prospectus was in existence at the end of the reporting period: _____

Item 70. Number of existing series for which additional units were registered under the Securities Act.

a. Number of existing series for which additional units were registered under the Securities Act during the reporting period: ____

b. Total value of additional units: ____

Item 71. Value of units placed in portfolios of subsequent series. Total value of units of prior series that were placed in the portfolios of subsequent series during the reporting period (the value of these units is to be measured on the date they were placed in the subsequent series): ____

Item 72. Assets. Provide the total assets of all series of the Registrant combined as of the end of the reporting period: ____

Item 73. Series ID of separate account. Series identification number: ____

Item 74. Number of contracts. For each security that has a contract identification number assigned pursuant to rule 313 of Regulation S-T (17 CFR 232.313), provide the number of individual contracts that are in force at the end of the reporting period: ____

Instruction. In the case of group contracts, each participant certificate should be counted as an individual contract.

Item 75. Information on the security issued through the separate account. For each security that has a contract identification number assigned pursuant to rule 313 of Regulation S-T (17 CFR 232.313), provide the following information as of the end of the reporting period:

a. Full name of the security: ____

b. Contract identification number: ____

c. Total assets attributable to the security: ____

d. Number of contracts sold during the reporting period: ____

e. Gross premiums received during the reporting period: ____

f. Gross premiums received pursuant to section 1035 exchanges: ____

g. Number of contracts affected in connection with premiums paid in pursuant to section 1035 exchanges: ____

h. Amount of contract value redeemed during the reporting period: ____

i. Amount of contract value redeemed pursuant to section 1035 exchanges: ____

j. Number of contracts affected in connection with contract value redeemed pursuant to section 1035 exchanges: ____

Instruction. In the case of group contracts, each participant certificate should be counted as an individual contract.

Item 76. Reliance on rule 6c-7. Did the Registrant rely on rule 6c-7 under the Act (17 CFR 270.6c-7) during the reporting period? [Y/N]

Item 77. Reliance on rule 11a-2. Did the Registrant rely on rule 11a-2 under the Act (17 CFR 270.11a-2) during the reporting period? [Y/N]

Item 78. Divestments under section 13(c) of the Act.

a. If the Registrant has divested itself of securities in accordance with section 13(c) of the Act (15 U.S.C. 80a-13(c)) since the end of the reporting period immediately prior to the current reporting period and before filing of the current report, disclose the information requested below for each such divested security:

i. Full name of the issuer: ____

ii. Ticker symbol: ____

iii. CUSIP number: ____

iv. Total number of shares or, for debt securities, principal amount divested: ____

v. Date that the securities were divested: ____

vi. Name of the statute that added the provision of section 13(c) in accordance with which the securities were divested: ____

b. If the Registrant holds any securities of the issuer on the date of the filing, provide the information requested below:

i. Ticker symbol: ____

ii. CUSIP number: ____

iii. Total number of shares or, for debt securities, principal amount held on the date of the filing: ____

Instructions.

This item may be used by a unit investment trust that divested itself of securities in accordance with section 13(c). A unit investment trust is not required to include disclosure under this item; however, the limitation on civil, criminal, and administrative actions under section 13(c) does not apply with respect to a divestment that is not disclosed under this item.

If a unit investment trust divests itself of securities in accordance with section 13(c) during the period that begins on the fifth business day before the date of filing a report on Form N-CEN and ends on the date of filing, the unit investment trust may disclose the divestment in either the report or an amendment thereto that is filed not later than five business days after the date of filing the report.

For purposes of determining when a divestment should be reported under this item, if a unit investment trust divests its holdings in a particular security in a related series of transactions, the unit investment trust may deem the divestment to occur at the time of the final transaction in the series. In that case, the unit investment trust should report each transaction in the series on a single report on Form N-CEN, but should separately state each date on which securities were divested and the total number of shares or, for debt securities, principal amount divested, on each such date.

Item 78 shall terminate one year after the first date on which all statutory provisions that underlie section 13(c) have terminated.

Part G: Attachments

Item 79. Attachments

a. Attachments applicable to all Registrants. All Registrants shall file the following attachments, as applicable, with the current report. Indicate the attachments filed with the current report by checking the applicable items below:

i. Legal proceedings: ____

ii. Provision of financial support: ____

iii. Change in the Registrant's independent public accountant: ____

iv. Independent public accountant's report on internal control (management investment companies only): ____

v. Change in accounting principles and practices: ____

vi. Information required to be filed pursuant to exemptive orders: ____

vii. Other information required to be included as an attachment pursuant to Commission rules and regulations: ____

Instructions.

10. Item 79.a.i. Legal proceedings.

(a) If the Registrant responded "YES" to Item 12.a., provide a brief description of the proceedings. As part of the description, provide the case or docket number (if any), and the full names of the principal parties to the proceeding.

(b) If the Registrant responded "YES" to Item 12.b., identify the proceeding and give its date of termination.

11. Item 79.a.ii. Provision of financial support. If the Registrant responded "YES" to Item 15, provide the following information (unless the Registrant is a Money Market Fund):

(a) Description of nature of support.

(b) Person providing support.

(c) Brief description of relationship between the person providing support and the Registrant.

(d) Date support provided.

(e) Amount of support.

(f) Security supported (if applicable). Disclose the full name of the issuer, the title of the issue (including coupon or yield, if applicable) and at least two identifiers, if available (*e.g.*, CIK, CUSIP, ISIN, LEI).

(g) Value of security supported on date support was initiated (if applicable).

(h) Brief description of reason for support.

(i) Term of support.

(j) Brief description of any contractual restrictions relating to support.

12. Item 79.a.iii. Change in the Registrant's independent public accountant. If the Registrant responded "YES" to Item 18.f., provide the information called for by Item 4 of Form 8-K under the Exchange Act (17 CFR 249.308). Unless otherwise specified by Item 4, or related to and necessary for a complete understanding of information not previously disclosed, the information should relate to events occurring during the reporting period. Notwithstanding requirements in Item 4 of Form 8-K to file more frequently, Registrants need only file reports on Form N-CEN annually in accordance with the requirements of this form.

13. Item 79.a.iv. Independent public accountant's report on internal control (management investment companies only). Small business investment companies are not required to respond to this item. Each management investment company shall furnish a report of its independent public accountant on the company's system of internal accounting controls. The accountant's report shall be based on the review, study and evaluation of the accounting system, internal accounting controls, and procedures for safeguarding securities made during the audit of the financial statements for the reporting period. The report should disclose any material weaknesses in: (a) the accounting system; (b) system of internal accounting control; or (c) procedures for safeguarding securities which exist as of the end of the Registrant's fiscal year.
The accountant's report shall be furnished as an exhibit to the form and shall: (1) be addressed to the Registrant's shareholders and board of directors; (2) be dated; (3) be signed manually; and (4) indicate the city and state where issued.

    Attachments that include a report that discloses a material weakness should include an indication by the Registrant of any corrective action taken or proposed.

    The fact that an accountant's report is attached to this form shall not be regarded as acknowledging any review of this form by the independent public accountant.

14. Item 79.a.v. Change in accounting principles and practices. If the Registrant responded "YES" to Item 22, provide an attachment that describes the change in accounting principles or practices, or the change in the method of applying any such accounting principles or practices. State the date of the change and the reasons therefor. A letter from the Registrant's independent accountants, approving or otherwise commenting on the change, shall accompany the description.

15. Item 79.a.vi. Information required to be filed pursuant to exemptive orders. File as an attachment any information required to be reported on Form N-CEN or any predecessor form to Form N-CEN (e.g., Form N-SAR) pursuant to exemptive orders issued by the Commission and relied on by the Registrant.

16. Item 79.a.vii. Other information required to be included as an attachment pursuant to Commission rules and regulations. File as an attachment any other information required to be included as an attachment pursuant to Commission rules and regulations.

b. Attachments to be filed by closed-end management investment companies and small business investment companies. Registrants shall file the following attachments, as applicable, with the current report. Indicate the attachments filed with the current report by checking the applicable items bellow.

   i. Material amendments to organizational documents: ____

   ii. Instruments defining the rights of the holders of any new or amended class of securities: ____

   iii. New or amended investment advisory contracts: ____

   iv. Information called for by Item 405 of Regulation S-K: ____

   v. Code of ethics (small business investment companies only): ____

Instructions.

17. Item 79.b.i. Material amendments to organizational documents. Provide copies of all material amendments to the Registrant's charters, by-laws, or other similar organizational documents that occurred during the reporting period.

18. Item 79.b.ii. Instruments defining the rights of the holders of any new or amended class of securities. Provide copies of all constituent instruments defining the rights of the holders of any new or amended class of securities for the current reporting period. If the Registrant has issued a new class of securities other than short-term paper, furnish a description of the class called for by the applicable item of Form N-2. If the constituent instruments defining the rights of the holders of any class of the Registrant's securities have been materially modified during the reporting period, give the title of the class involved and state briefly the general effect of the modification upon the rights of the holders of such securities.

19. Item 79.b.iii. New or amended investment advisory contracts. Provide copies of any new or amended investment advisory contracts that became effective during the reporting period.

20. Item 79.b.iv. Information called for by Item 405 of Regulation S-K. Provide the information called for by Item 405 of Regulation S-K concerning failure of certain closed-end management investment company and small business investment company shareholders to file certain ownership reports.

21. Item 79.b.v. Code of ethics (small business investment companies only).

(a) (1) Disclose whether, as of the end of the period covered by the report, the Registrant has adopted a code of ethics that applies to the Registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the Registrant or a third party. If the Registrant has not adopted such a code of ethics, explain why it has not done so.

(2) For purposes of this instruction, the term "code of ethics" means written standards that are reasonably designed to deter wrongdoing and to promote: (i) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; (ii) full, fair, accurate, timely, and understandable disclosure in reports and documents that a Registrant files with, or submits to, the Commission and in other public communications made by the Registrant; (iii) compliance with applicable governmental laws, rules, and regulations; (iv) the prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and (v) accountability for adherence to the code.

(3) The Registrant must briefly describe the nature of any amendment, during the period covered by the report, to a provision of its code of ethics that applies to the Registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the Registrant or a third party, and that relates to any element of the code of ethics definition enumerated in paragraph (a)(2) of this instruction. The Registrant must file a copy of any such amendment as an exhibit to this report on Form N-CEN, unless the Registrant has elected to satisfy paragraph (a)(6) of this instruction by posting its code of ethics on its website pursuant to paragraph (a)(6)(ii) of this Instruction, or by undertaking to provide its code of ethics to any person without charge, upon request, pursuant to paragraph (a)(6)(iii) of this instruction.

(4) If the Registrant has, during the period covered by the report, granted a waiver, including an implicit waiver, from a provision of the code of ethics to the Registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, regardless of whether these individuals are employed by the Registrant or a third party, that relates to one or more of the items set forth in paragraph (a)(2) of this instruction, the Registrant must briefly describe the nature of the waiver, the name of the person to whom the waiver was granted, and the date of the waiver.

(5) If the Registrant intends to satisfy the disclosure requirement under paragraph (a)(3) or (4) of this instruction regarding an amendment to, or a waiver from, a provision of its code of ethics that applies to the Registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions and that relates to any element of the code of ethics definition enumerated in paragraph (a)(2) of this instruction by posting such information on its Internet website, disclose the Registrant's Internet address and such intention.

(6) The Registrant must: (i) file with the Commission a copy of its code of ethics that applies to the Registrant's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, as an exhibit to its report on this Form N-CEN; (ii) post the text of such code of ethics on its Internet website and disclose, in its most recent report on this Form N-CEN, its Internet address and the fact that it has posted such code of ethics on its Internet website; or (iii) undertake in its most recent report on this Form N-CEN to provide to any person without charge, upon request, a copy of such code of ethics and explain the manner in which such request may be made.

(7) A Registrant may have separate codes of ethics for different types of officers. Furthermore, a "code of ethics" within the meaning of paragraph (a)(2) of this instruction may be a portion of a broader document that addresses additional topics or that applies to more persons than those specified in paragraph (a)(1) of this instruction. In satisfying the requirements of paragraph (a)(6) of this instruction, a Registrant need only file, post, or provide the portions of a broader document that constitutes a "code of ethics" as defined in paragraph (a)(2) of this instruction and that apply to the persons specified in paragraph (a)(1) of this instruction.

(8) If a Registrant elects to satisfy paragraph (a)(6) of this instruction by posting its code of ethics on its Internet website pursuant to paragraph (a)(6)(ii), the code of ethics must remain accessible on its website for as long as the Registrant remains subject to the requirements of this instruction and chooses to comply with this instruction by posting its code on its Internet website pursuant to paragraph (a)(6)(ii).

(9) The Registrant does not need to provide any information pursuant to paragraphs (a)(3) and (4) of this instruction if it discloses the required information on its Internet website within five business days following the date of the amendment or waiver and the Registrant has disclosed in its most recently filed report on this Form N-CEN its Internet website address and intention to provide disclosure in this manner. If the amendment or waiver occurs on a Saturday, Sunday, or holiday on which the Commission is not open for business, then the five business day period shall begin to run on and include the first business day thereafter. If the Registrant elects to disclose this information through its website, such information must remain available on the website for at least a 12-month period. The Registrant must retain the information for a period of not less than six years following the end of the fiscal year in which the amendment or waiver occurred. Upon request, the Registrant must furnish to the Commission or its staff a copy of any or all information retained pursuant to this requirement.

(10) The Registrant does not need to disclose technical, administrative, or other non-substantive amendments to its code of ethics.

(11) For purposes of this instruction: (i) the term "waiver" means the approval by the Registrant of a material departure from a provision of the code of ethics; and (ii) the term "implicit waiver" means the Registrant's failure to take action within a reasonable period of time regarding a material departure from a provision of the code of ethics that has been made known to an executive officer, as defined in rule 3b-7 under the Exchange Act (17 CFR 240.3b-7), of the Registrant.

(b) (1) Disclose that the Registrant's board of directors has determined that the Registrant either: (i) has at least one audit committee financial expert serving on its audit committee; or (ii) does not have an audit committee financial expert serving on its audit committee.

(2) If the Registrant provides the disclosure required by paragraph (b)(1)(i) of this instruction, it must disclose the name of the audit committee financial expert and whether that person is "independent." In order to be considered "independent" for purposes of this instruction, a member of an audit committee may not, other than in his or her capacity as a member of the audit committee, the board of directors, or any other board committee: (i) accept directly or indirectly any consulting, advisory, or other compensatory fee from the issuer; or (ii) be an "interested person" of the investment company as defined in Section 2(a)(19) of the Act (15 U.S.C. 80a-2(a)(19)).

(3) If the Registrant provides the disclosure required by paragraph (b)(1)(ii) of this instruction, it must explain why it does not have an audit committee financial expert.

(4) If the Registrant's board of directors has determined that the Registrant has more than one audit committee financial expert serving on its audit committee, the Registrant may, but is not required to, disclose the names of those additional persons. A Registrant choosing to identify such persons must indicate whether they are independent pursuant to paragraph (b)(2) of this instruction.

(5) For purposes of this instruction, an "audit committee financial expert" means a person who has the following attributes: (i) an understanding of generally accepted accounting principles and financial statements; (ii) the ability to assess the general application of such principles in connection with the accounting for estimates, accruals, and reserves; (iii) experience preparing, auditing, analyzing, or evaluating financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of issues that can reasonably be expected to be raised by the Registrant's financial statements, or experience actively supervising one or more persons engaged in such activities; (iv) an understanding of internal controls and procedures for financial reporting; and (v) an understanding of audit committee functions.

(6) A person shall have acquired such attributes through: (i) education and experience as a principal financial officer, principal accounting officer, controller, public accountant, or auditor or experience in one or more positions that involve the performance of similar functions; (ii) experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor, or person performing similar functions; (iii) experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements; or (iv) other relevant experience.

(7) (i) A person who is determined to be an audit committee financial expert will not be deemed an "expert" for any purpose, including without limitation for purposes of Section 11 of the Securities Act (15 U.S.C. 77k), as a result of being designated or identified as an audit committee financial expert pursuant to this instruction; (ii) the designation or identification of a person as an audit committee financial expert pursuant to this instruction does not impose on such person any duties, obligations, or liability that are greater than the duties, obligations, and liability imposed on such person as a member of the audit committee and board of directors in the absence of such designation or identification; (iii) the designation or identification of a person as an audit committee financial expert pursuant to this instruction does not affect the duties, obligations, or liability of any other member of the audit committee or board of directors.

(8) If a person qualifies as an audit committee financial expert by means of having held a position described in paragraph (b)(6)(iv) of this Instruction, the Registrant shall provide a brief listing of that person's relevant experience.

SIGNATURES

Pursuant to the requirements of the Investment Company Act of 1940, the Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

____

(Registrant)

Date ________________________________

____

(Signature)*

*Print full name and title of the signing officer under his/her signature.

66. Form N-CSR (referenced in §274.128) is amended by:

a. In Item 11(a), removing the phrase "90 days" and adding in its place "180 days";

b. In Item 11(b), removing the phrase "the second fiscal quarter of";

c. Removing the instruction to Item 11(b);

d. In paragraph 4(c) of the certification exhibits listed in Item 12, removing the phrase "90 days" and adding in its place "180 days";

e. In paragraph 4(d) of the certification exhibits listed in Item 12, removing the phrase "the second fiscal quarter of";

f. In Item 12, removing the instruction to paragraph (a)(2).

Note: The text of Form N-CSR does not and these amendments will not appear in the *Code of Federal Regulations*.

67. Section 274.130 is removed and reserved.

68. Section 274.150 is added to read as follows:

§274.150 Form N-PORT, Monthly portfolio holdings report.

(a) Except as provided in paragraph (b) of this section, this form shall be used by registered management investment companies or exchange-traded funds organized as unit investment trusts, or series thereof, to file reports pursuant to §270.30b1-9 of this chapter not later than 30 days after the end of each month.

(b) Form N-PORT shall not be filed by a registered open-end management investment company that is regulated as a money market fund under §270.2a-7 of this chapter or a small business investment company registered on Form N-5 (§§239.24 and 274.5 of this chapter), or series thereof.

Note: The text of Form N-PORT will not appear in the *Code of Federal Regulations*.

FORM N-PORT
MONTHLY PORTFOLIO INVESTMENTS REPORT

Form N-PORT is to be used by a registered management investment company, or an exchange-traded product organized as a unit investment trust, or series thereof ("fund"), other than a fund that is regulated as a money market fund ("money market fund") under rule 2a-7 under the Investment Company Act of 1940 [15 U.S.C. 80a] ("Act") (17 CFR 270.2a-7) or a small business investment company ("SBIC") registered on Form N-5 (17 CFR 239.24 and 274.5), to file monthly portfolio holdings reports pursuant to rule 30b1-9 under the Act (17 CFR 270.30b1-9). The Commission may use the information provided on Form N-PORT in its regulatory, enforcement, examination, disclosure review, inspection, and policymaking roles.

GENERAL INSTRUCTIONS

A. Rule as to Use of Form N-PORT

Form N-PORT is the reporting form that is to be used for monthly reports of funds other than money market funds and SBICs under section 30(b) of the Act, as required by rule 30b1-9 under the Act (17 CFR 270.30b1-9). Funds must report information about their portfolios and each of their portfolio holdings as of the last business day, or last calendar day, of the month. Reports on Form N-PORT must be filed with the Commission no later than 30 days after the end of each month. Each fund is required to file a separate report.

A fund may file an amendment to a previously filed report at any time, including an amendment to correct a mistake or error in a previously filed report. A fund that files an amendment to a previously filed report must provide information in response to all items of Form N-PORT, regardless of why the amendment is filed.

B. Application of General Rules and Regulations

The General Rules and Regulations under the Act contain certain general requirements that are applicable to reporting on any form under the Act. These general requirements shall be carefully read and observed in the preparation and filing of reports on this Form, except that any provision in the Form or in these instructions shall be controlling.

C. Filing of Reports

Reports must be filed electronically using the Commission's Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system in accordance with Regulation S-T. Consult the EDGAR Filer Manual and Appendices for EDGAR filing instructions.

D. Paperwork Reduction Act Information

A fund is not required to respond to the collection of information contained in Form N-PORT unless the form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to the Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090. OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. 3507.

E. Definitions

References to sections and rules in this Form N-PORT are to the Act, unless otherwise indicated. Terms used in this Form N-PORT have the same meanings as in the Act or related rules, unless otherwise indicated.

As used in this Form N-PORT, the terms set out below have the following meanings:

"Class" means a class of shares issued by a Multiple Class Fund that represents interests in the same portfolio of securities under rule 18f-3 [17 CFR 270.18f-3] or under an order exempting the Multiple Class Fund from one or more provisions of section 18 [15 U.S.C. 80a-18].

"Controlled Foreign Corporation" has the meaning provided in section 957 of the Internal Revenue Code [26 U.S.C. 957].

"Exchange-Traded Product" means an open-end management investment company (or Series or Class thereof) or unit investment trust, the shares of which are listed and traded on a national securities exchange, and that has formed and operates under an exemptive order under the Act granted by the Commission or in reliance on an exemptive rule under the Act adopted by the Commission.

"Fund" means the Registrant or a separate Series of the Registrant. When an item of Form N-PORT specifically applies to a Registrant or a Series, those terms will be used.

"Illiquid Asset" means an asset that cannot be sold or disposed of by the Fund in the ordinary course of business within seven calendar days, at approximately the value ascribed to them by the Fund.

"Investment Grade" refers to an investment that is sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time and is subject to no greater than moderate credit risk.

"ISIN" means, with respect to any security, the "international securities identification number" assigned by a national numbering agency, partner, or substitute agency that is coordinated by the Association of National Numbering Agencies.

"LEI" means, with respect to any company, the "legal entity identifier" as assigned or recognized by the Global LEI Regulatory Oversight Committee or the Global LEI Foundation. In the case of a financial institution, if a "legal entity identifier" has not been assigned, then provide the RSSD ID, if any, assigned by the National Information Center of the Board of Governors of the Federal Reserve System.

"Multiple Class Fund" means a Fund that has more than one Class.

"Non-Investment Grade" refers to an investment that is not Investment Grade.

"Registrant" means a management investment company, or an Exchange-Traded Product organized as a unit investment trust, registered under the Act.

"Restricted Security" has the meaning defined in rule 144(a)(3) under the Securities Act of 1933 [17 CFR 230.144(a)(3)].

"Series" means shares offered by a Registrant that represent undivided interests in a portfolio of investments and that are preferred over all other series of shares for assets specifically allocated to that series in accordance with rule 18f-2(a) [17 CFR 270.18f-2(a)].

"Swap" means either a "security-based swap" or a "swap" as defined in sections 3(a)(68) and (69) of the Securities Exchange Act of 1934 [15 U.S.C. 78c(a)(68) and (69)] and any rules, regulations, or interpretations of the Commission with respect to such instruments.

F. Public Availability

Information reported on Form N-PORT for the third month of each fund's fiscal quarter will be made publicly available 60 days after the end of the fund's fiscal quarter.

The SEC does not intend to make public the information reported on Form N-PORT for the first and second months of each fund's fiscal quarter, or any information reported in Part D of this Form. However, the SEC may use information reported on this Form in its regulatory programs, including examinations, investigations, and enforcement actions.

G. Responses to Questions

In responding to the items on this Form, the following guidelines apply unless otherwise specifically indicated:

- A fund is required to respond to every item of this form. If an item requests information that is not applicable, for example, an LEI for a counterparty that does not have an LEI, respond N/A;
- If an item requests the name of an entity, provide the full name to the extent known, and do not use abbreviations (other than abbreviations that are part of the full name);
- If an item requests information expressed as a percentage, enter the response as a percentage (not a decimal), rounded to the nearest hundredth of one percent (*e.g.*, 5.27%);
- If an item requests a monetary value, report the amount rounded to the nearest hundredth (*e.g.*, if U.S. dollars, round to the nearest penny);
- For currencies other than U.S. dollars, also report the applicable three-letter alphabetic currency code pursuant to the International Organization for Standardization ("ISO") 4217 standard;
- If an item requests a unique identifier, such an identifier may be internally generated by the fund or provided by a third party, but should be consistently used across the fund's filings for reporting that investment so that the Commission, investors, and other users of the information can track the investment from report to report;
- If an item requests a numerical value other than a percentage or a dollar value, provide information rounded to the nearest hundredth;
- If an item requests a date, provide information in mm/dd/yyyy format; and
- If an item requests information regarding a "holding" or "investment," separately report information as to each holding or investment that is recorded in the Fund's books as part of a larger transaction. For example, two or more partially offsetting legs of a transaction entered into with the same counterparty under a common master agreement shall each be separately reported.

H. Signature and Filing of Report

If the report is filed in paper pursuant to a hardship exemption from electronic filing (see Item 201 *et seq.* of Regulation S-T (17 CFR 232.201 *et seq.*)), eight complete copies of the report shall be filed with the Commission. At least one complete copy of the report shall be filed with each exchange on which any class of securities of the registrant is registered. At least one complete copy of the report filed with the

Commission and one such copy filed with each exchange must be manually signed. Copies not manually signed must bear typed or printed signatures.

The report must be signed by the Registrant, and on behalf of the Registrant by an authorized officer of the Registrant. The name of each person who signs the report shall be typed or printed beneath his or her signature. See rule 302 of Regulation S-T [17 CFR 232.302] regarding signatures on forms filed electronically and rule 8b-11 under the Act (17 CFR 270.8b-11) concerning signatures pursuant to powers of attorney.

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM N-PORT
MONTHLY SCHEDULE OF PORTFOLIO INVESTMENTS

Part A: General Information

Item A.1. Information about the Registrant.

a. Name of Registrant.

b. Investment Company Act file number for Registrant: (*e.g.*, 811-__________).

c. CIK number of Registrant.

d. LEI of Registrant.

e. Address and telephone number of Registrant.

Item A.2. Information about the Series

a. Name of Series.

b. EDGAR series identifier (if any).

c. LEI of Series.

Item A.3. Reporting period.

a. Date of fiscal year-end.

b. Date as of which information is reported.

Item A.4. Does the Fund anticipate that this will be its final filing on Form N-PORT? [Y/N]

Part B: Information About the Fund

Report the following information for the Fund and its consolidated subsidiaries.

Item B.1. Assets and liabilities. Report amounts in U.S. dollars.

a. Total assets, including assets attributable to miscellaneous securities reported in Part D.

b. Total liabilities.

c. Net assets.

Item B.2. Certain assets and liabilities. Report amounts in U.S. dollars.

a. Assets attributable to miscellaneous securities reported in Part D.

b. Assets invested in a Controlled Foreign Corporation for the purpose of investing in certain types of instruments such as, but not limited to, commodities.

c. Borrowings attributable to amounts payable for notes payable, bonds, and similar debt, as reported pursuant to rule 6-04(13)(a) of Regulation S-X [17 CFR 210.6-04(13)(a)].

d. Payables for investments purchased either (i) on a delayed delivery, when-issued, or other firm commitment basis, or (ii) on a standby commitment basis.

e. Liquidation preference of outstanding preferred stock issued by the Fund.

Item B.3. Portfolio level risk metrics. If the Fund's notional value of debt investments is 20% or more of the Fund's net asset value, provide:

a. Interest Rate Risk. For each currency to which the fund is exposed and for each of the following maturities: 1 month, 3 month, 6 month, 1 year, 2 years, 3 years, 5 years, 7 years, 10 years, 20 years, and 30 years, provide the change in value of the portfolio resulting from a 1 basis point change in interest rates (DV01).

b. Credit Spread Risk. Provide the change in value of the portfolio resulting from a 1 basis point change in credit spreads (SDV01/CR01/CS01), aggregated by Investment Grade and Non-Investment Grade exposures, for each of the following maturities: 1 month, 3 month, 6 month, 1 year, 2 years, 3 years, 5 years, 7 years, 10 years, 20 years, and 30 years.

Calculate notional value as the sum of the absolute values of: (i) the value of each debt security, (ii) the notional amount of each swap, including, but not limited to, total return swaps, interest rate swaps credit default swaps, for which the underlying reference asset or assets are debt securities or an interest rate; and (iii) the delta-adjusted notional amount of any option for which the underlying reference asset is an asset described in clause (i) or (ii). Report zero for maturities to which the fund has no exposure. For exposures that fall between any of the listed maturities in (a) and (b), use linear interpolation to approximate exposure to each maturity listed above. For exposures outside of the range of maturities listed above, include those exposures in the nearest maturity.

Item B.4. Securities lending counterparties. For each counterparty to the fund in any securities lending transaction, provide the following information:

a. Name of counterparty.

b. LEI of counterparty (if any).

c. Aggregate value of all securities on loan to the counterparty.

Item B.5. Return information.

a. Monthly total returns of the Fund for each of the preceding three months. If the fund is a Multiple Class Fund, report returns for each class. Such returns shall be calculated in accordance with the methodologies outlined in Item 26(b)(1) of Form N-1A, Instruction 13 to sub-Item 1 of Item 4 of Form N-2, or Item 26(b)(i) of Form N-3, as applicable.

b. Class identification number(s) (if any) of the class(es) for which returns are reported.

c. For each of the preceding three months, monthly net realized gain (loss) and net change in unrealized appreciation (or depreciation) attributable to derivatives for each of the following categories: commodity contracts, credit contracts, equity contracts, foreign exchange contracts, interest rate contracts, and other contracts. Report in U.S. dollars. Losses and depreciation shall be reported as negative numbers.

d. For each of the preceding three months, monthly net realized gain (loss) and net change in unrealized appreciation (or depreciation) attributable to investments other than derivatives. Report in U.S. dollars. Losses and depreciation shall be reported as negative numbers.

Item B.6. Flow information. Provide the aggregate dollar amounts for sales and redemptions/repurchases of Fund shares during each of the preceding three months. The amounts to be reported under this Item should be after any front-end sales load has been deducted and before any deferred or contingent deferred sales load or charge has been deducted. Shares sold shall include shares sold by the Fund to a registered unit investment trust. For mergers and other acquisitions, include in the value of shares sold any transaction in which the Fund acquired the assets of another investment company or of a personal holding company in exchange for its own shares. For liquidations, include in the value of shares redeemed any transaction in which the Fund liquidated all or part of its assets. Exchanges are defined as the redemption or repurchase of shares of one fund or series and the investment of all or part of the proceeds in shares of another fund or series in the same family of investment companies.

a. Total net asset value of shares sold (including exchanges but excluding reinvestment of dividends and distributions).

b. Total net asset value of shares sold in connection with reinvestments of dividends and distributions.

c. Total net asset value of shares redeemed or repurchased, including exchanges.

Part C: Schedule of Portfolio Investments

For each investment held by the Fund and its consolidated subsidiaries, disclose the information requested in Part C. A Fund may report information for securities in an aggregate amount not exceeding five percent of its total assets as miscellaneous securities in Part D in lieu of reporting those securities in Part C, provided that the securities so listed are not restricted, have been held for not more than one year prior to the end of the reporting period covered by this report, and have not been previously been reported by name to the shareholders of the Fund or to any exchange, or set forth in any registration statement, application, or annual report or otherwise made available to the public.

Item C.1. Identification of investment.

a. Name of issuer (if any).

b. LEI of issuer (if any).

c. Title of the issue or description of the investment.

d. CUSIP (if any).

e. At least one of the following other identifiers:

   i. ISIN.

   ii. Ticker (if ISIN is not available).

   iii. Other unique identifier (if ticker and ISIN are not available). Indicate the type of identifier used.

Item C.2. Amount of each investment.

a. Balance. Indicate whether amount is expressed in number of shares, principal amount, or other units. For derivatives contracts, as applicable, provide the number of contracts.

b. Currency. Indicate the currency in which the investment is denominated.

c. Value. Report values in U.S. dollars. If currency of investment is not denominated in U.S. dollars, provide the exchange rate used to calculate value.

d. Percentage value compared to net assets of the Fund.

Item C.3. Indicate payoff profile among the following categories (long, short, N/A). For derivatives, respond N/A to this Item and respond to the relevant payoff profile question in Item C.11.

Item C.4. Asset and issuer type. Select the category that most closely identifies the instrument among each of the following:

a. Asset type (short-term investment vehicle (*e.g.*, money market fund, liquidity pool, or other cash management vehicle), repurchase agreement, equity-common, equity-preferred, debt, derivative-commodity, derivative-credit, derivative-equity, derivative-foreign exchange, derivative-interest rate, structured note, loan, ABS-mortgage backed security, ABS-asset backed commercial paper, ABS-collateralized bond/debt obligation, ABS-other, commodity, real estate, other). If "other," provide a brief description.

b. Issuer type (corporate, U.S. Treasury, U.S. government agency, U.S. government sponsored entity, municipal, non-U.S. sovereign, private fund, registered fund, other). If "other," provide a brief description.

Item C.5. Country of investment or issuer. Report the ISO country code that corresponds to the country of investment or issuer based on the concentrations of the risk and economic exposure of the investments. If different from the country of the risk and economic exposure, also provide the country where the issuer is organized.

Item C.6. Is the investment a Restricted Security? [Y/N]

Item C.7. Is the investment an Illiquid Asset? [Y/N]

Item C.8. Indicate the level within the fair value hierarchy in which the fair value measurements fall pursuant to U.S. Generally Accepted Accounting Principles (ASC 820, Fair Value Measurement). [1/2/3]

Item C.9. For debt securities, also provide:

a. Maturity date.

b. Coupon.

   i. Select the category that most closely reflects the coupon type among the following (fixed, floating, variable, none).

   ii. Annualized rate.

c. Currently in default? [Y/N]

d. Are there any interest payments in arrears or have any coupon payments been legally deferred by the issuer? [Y/N]

e. Is any portion of the interest paid in kind? [Y/N] Enter "N" if the interest may be paid in kind but is not actually paid in kind.

f. For convertible securities, also provide:

   i. Mandatory convertible? [Y/N]

   ii. Contingent convertible? [Y/N]

   iii. Description of the reference instrument, including the name of issuer, title of issue, and currency in which denominated, as well as CUSIP of reference instrument, ISIN (if CUSIP is not available), ticker (if CUSIP and ISIN are not available), or other identifier (if CUSIP, ISIN, and ticker are available). If other identifier provided, indicate the type of identifier used.

   iv. Conversion ratio per US$1000 notional, or, if bond currency is not in U.S. dollars, per 1000 units of the relevant currency, indicating the relevant currency. If there is more than one conversion ratio, provide each conversion ratio.

   v. Delta.

Item C.10. For repurchase and reverse repurchase agreements, also provide:

a. Select the category that reflects the transaction (repurchase, reverse repurchase). Select "repurchase agreement" if the Fund is the cash lender and receives collateral. Select "reverse repurchase agreement" if the Fund is the cash borrower and posts collateral.

b. Counterparty.

   i. Cleared by central counterparty? [Y/N] If Y, provide the name of the central counterparty.

   ii. If N, provide the name and LEI (if any) of counterparty.

c. Tri-party? [Y/N]

d. Repurchase rate.

e. Maturity date.

f. Provide the following information concerning the securities subject to the repurchase agreement (*i.e.*, collateral). If multiple securities of an issuer are subject to the repurchase agreement, those securities may be aggregated in responding to Items C.10.f.i-iii.

   i. Principal amount.

   ii. Value of collateral.

   iii. Category of investments that most closely represents the collateral, selected from among the following (asset-backed securities; agency collateralized mortgage obligations; agency debentures and agency strips; agency mortgage-backed securities; private label collateralized mortgage obligations; corporate debt securities; equities; money market; U.S. Treasuries (including strips); other instrument). If "other instrument," include a brief description, including, if applicable, whether it is a collateralized debt obligation, municipal debt, whole loan, or international debt.

Item C.11. For derivatives, also provide:

a. Category of derivative that most closely represents the investment, selected from among the following (forward, future, option, swaption, swap, warrant, other). If "other," provide a brief description.

b. Counterparty.

   i. Provide the name and LEI (if any) of counterparty (including a central counterparty).

c. For options and warrants, including options on a derivative (e.g., swaptions) provide:

i. Type, selected from among the following (put, call). Respond call for warrants.

ii. Payoff profile, selected from among the following (written, purchased). Respond purchased for warrants.

iii. Description of reference instrument.

1. If the reference instrument is a derivative, indicate the category of derivative from among the categories listed in sub-Item C.11.a. and provide all information required to be reported on this Form for that category.

2. If the reference instrument is an index, and if the index's components are publicly available on a website and are updated on that website no less frequently than quarterly, identify the index and provide the index identifier, if any. If the index's components are not publicly available in that manner, and the notional amount of the derivative represents 1% or less of the net asset value of the Fund, provide a narrative description of the index. Otherwise, provide the name, identifier, number of shares or notional amount or contract value as of the trade date (all of which would be reported as negative for short positions), value, and unrealized appreciation or depreciation of every component in the index. The identifier shall include CUSIP of the index component, ISIN (if CUSIP is not available), ticker (if CUSIP and ISIN are not available), or other identifier (if CUSIP, ISIN, and ticker are not available). If other identifier provided, indicate the type of identifier used.

3. If the reference instrument is neither a derivative or an index, the description of the reference instrument shall include the name of issuer and title of issue, as well as CUSIP of reference instrument, ISIN (if CUSIP is not available), ticker (if CUSIP and ISIN are not available), or other identifier (if CUSIP, ISIN, and ticker are available). If other identifier provided, indicate the type of identifier used.

iv. Number of shares or principal amount of underlying reference instrument per contract.

v. Exercise price or rate.

vi. Expiration date.

vii. Delta.

viii. Unrealized appreciation or depreciation.

d. For futures and forwards (other than foreign exchange forwards), provide:

   i. Payoff profile, selected from among the following (long, short).

   ii. Description of reference instrument, as required by sub-Item C.11.c.iii.

   iii. Expiration date.

   iv. Aggregate notional amount or contract value on trade date.

   v. Unrealized appreciation or depreciation.

e. For foreign exchange forwards and swaps, provide:

   i. Amount and description of currency sold.

   ii. Amount and description of currency purchased.

   iii. Settlement date.

   iv. Unrealized appreciation or depreciation.

f. For swaps (other than foreign exchange swaps), provide:

   i. Description and terms of payments necessary for a user of financial information to understand the terms of payments to be paid and received, including, as applicable, description of the reference instrument, obligation, or index (including the information required by sub-Item C.11.c.iii), financing rate, floating rate, fixed rates, and payment frequency.

      1. Description and terms of payments to be received from another party.

      2. Description and terms of payments to be paid to another party.

   ii. Termination or maturity date.

   iii. Upfront payments or receipts.

   iv. Notional amount.

   v. Unrealized appreciation or depreciation.

g. For other derivatives, provide:

   i. Description of information sufficient for a user of financial information to understand the nature and terms of the investment, including as applicable, among other things, currency, payment terms, payment rates, call or put feature, exercise price, and information required by sub-Item C.11.c.iii.

   ii. Termination or maturity (if any).

   iii. Notional amount(s).

iv. Delta (if applicable).

v. Unrealized appreciation or depreciation.

Item C.12. Securities lending.

a. Does any amount of this investment represent reinvestment of cash collateral received for loaned securities? [Y/N] If Yes, provide the value of the investment representing cash collateral.

b. Does any portion of this investment represent non-cash collateral received for loaned securities? [Y/N] If yes, provide the value of the securities representing non-cash collateral.

c. Is any portion of this investment on loan by the Registrant? [Y/N] If Yes, provide the value of the securities on loan.

Part D: Miscellaneous Securities

Report miscellaneous securities, if any, using the same Item numbers and reporting the same information that would be reported for each investment in Part C if it were not a miscellaneous security. Information reported in this Item will be nonpublic.

Part E: Explanatory Notes (if any)

The Fund may provide any information it believes would be helpful in understanding the information reported in this Form. The Fund may also explain any assumptions that it made in responding to any Item in this Form. To the extent responses relate to a particular Item, provide the Item number(s), as applicable.

Part F: Exhibits

For reports filed for the end of the first and third quarters of the Fund's fiscal year, attach the Fund's complete portfolio holdings as of the close of the period covered by the report. These portfolio holdings must be presented in accordance with the schedules set forth in §§210.12-12 – 12-14 of Regulation S-X [17 CFR 210.12-12 – 12-14].

SIGNATURES

The Registrant has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

Registrant: ________________________ By (Signature): ____________________

Name of Signing Officer: ____

Title of Signing Officer: ____

Date: ____

By the Commission.

Robert W. Errett

Robert W. Errett
Deputy Secretary

Dated: May 20, 2015

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 275 and 279

Release No. IA-4091; File No. S7-09-15

RIN 3235-AL75

AMENDMENTS TO FORM ADV AND INVESTMENT ADVISERS ACT RULES

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission is proposing amendments to Form ADV that are designed to provide additional information regarding advisers, including information about their separately managed account business; incorporate a method for private fund adviser entities operating a single advisory business to register using a single Form ADV; and make clarifying, technical and other amendments to certain Form ADV items and instructions. The Commission also is proposing amendments to the Advisers Act books and records rule and technical amendments to several Advisers Act rules to remove transition provisions that are no longer necessary.

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

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

Electronic comments:

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

- Send an e-mail to rule-comments@sec.gov. Please include File No. S7-09-15 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-09-15. 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 website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 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 available publicly.

Studies, memoranda or other substantive items may be added by the Commission or staff to the comment file during this rulemaking. A notification of the inclusion in the comment file of any such materials will be made available on the Commission's website. To ensure direct electronic receipt of such notifications, sign up through the "Stay Connected" option at www.sec.gov to receive notifications by e-mail.

FOR FURTHER INFORMATION CONTACT: Bridget D. Farrell, Senior Counsel, Sarah A. Buescher, Branch Chief, or Daniel S. Kahl, Assistant Director, at (202) 551-6787 or IArules@sec.gov, Investment Adviser Regulation Office, Division of Investment Management, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Commission is proposing amendments to rules 204-2 [17 CFR 275.204-2], 202(a)(11)(G)-1 [17 CFR 275.202(a)(11)(G)-1], 203-1 [17 CFR 275.203-1], and 204-1 [17 CFR 275.204-1] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] ("Advisers Act" or "Act"),[1] and amendments to Form ADV [17 CFR 279.1] under the Advisers Act. The Commission is also proposing to rescind rule 203A-5 [17 CFR 275.203A-5] under the Advisers Act.

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1 15 U.S.C. 80b. Unless otherwise noted, when we refer to the Advisers Act, or any paragraph of the Advisers Act, we are referring to 15 U.S.C. 80b of the United States Code, at which the Advisers Act is codified, and when we refer to rules under the Advisers Act, or any paragraph of these rules, we are referring to Title 17, Part 275 of the Code of Federal Regulations [17 CFR 275], in which these rules are published.

I. BACKGROUND

Form ADV is used by investment advisers to register with the Commission and with the states. The information collected on Form ADV serves a vital role in our regulatory program and our ability to protect investors. Our staff uses Form ADV data to prepare for, conduct, and implement our risk-based examination program of investment advisers, and that data also assists our staff in conducting investigations and bringing enforcement actions. In addition to providing information about each investment adviser, Form ADV data is also aggregated by our staff across investment advisers to obtain census data and to monitor industry trends. Census data and industry trend information inform our regulatory program and the assessment of emerging risks. Importantly, Form ADV also benefits clients and prospective clients because the information filed by advisers is available to the public on our website.[2]

We have amended Form ADV several times to improve our ability to oversee investment advisers. Most recently we significantly enhanced reporting requirements for advisers to private funds in connection with the Dodd-Frank Wall Street Reform and Consumer Protection Act's ("Dodd-Frank Act's")[3] private fund adviser registration requirements.[4] Today, we are proposing a more limited set of amendments to Part 1A of Form ADV in three areas: revisions to fill certain data gaps and to enhance current reporting requirements; amendments to incorporate "umbrella registration" for private fund advisers; and clarifying, technical and other amendments to existing items and instructions.[5]

Several of the proposed amendments to Form ADV relate to separately managed accounts. Investment advisers manage assets of pooled investment vehicles, including registered and unregistered funds. Advisers also manage assets of other clients, such as pension plans,

2 Information on Form ADV is available to the public through the Investment Adviser Public Disclosure System ("IAPD"), which allows the public to access the most recent Form ADV filing made by an investment adviser and is available at http://www.adviserinfo.sec.gov.

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

4 *See Rules Implementing Amendments to the Investment Advisers Act of 1940*, Investment Advisers Act Release No. 3221 (June 22, 2011), [76 FR 42950 (July 19, 2011)] ("*Implementing Release*").

5 In general, this release discusses the Commission's proposed rule and form amendments that would affect advisers registered with the Commission. We understand that the state securities authorities intend to consider similar changes that affect advisers registered with the states, who are also required to complete Form ADV Part 1B as part of their state registrations. We will accept any comments and forward them to the North American Securities Administrators Association ("NASAA") for consideration by the state securities authorities. We request that you clearly indicate in your comment letter which of your comments relate to these items. Commenters alternatively may send comments relating to these items directly to NASAA at the following e-mail address: NASAAcomments@nasaa.org.

endowments, foundations, other institutional clients and retail clients, through separately managed accounts. We currently collect detailed information about pooled investment vehicles,[6] but little specific information regarding separately managed accounts. The proposed amendments to Form ADV would require an adviser to provide certain aggregate information on separately managed accounts it advises, including information on regulatory assets under management, investments and use of derivatives and borrowings.[7] Other examples of information we propose to collect from advisers include information on the use of social media and information on an adviser's other offices.[8] These items, and others discussed below, are designed to improve the depth and quality of the information we collect on investment advisers and to facilitate our risk monitoring initiatives.

We also are proposing amendments to Part 1A that would establish a more efficient method for the registration of multiple private fund adviser entities operating a single advisory business on one Form ADV ("umbrella registration"). Form ADV was designed to accommodate the typical registration of an investment adviser that is a single legal entity. Advisers of private funds frequently are organized using multiple legal entities, and the staff has provided guidance to private fund advisers regarding umbrella registration within the confines of the current form.[9] The proposed amendments to incorporate umbrella registration into Form ADV would make the availability of umbrella registration more widely known to advisers. Uniform filing requirements for umbrella registration in Form ADV also would provide more

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6 *See, e.g.,* Form ADV, Part 1A, Section 7.B.(1) of Schedule D; and Form PF [17 CFR 279.9].

7 Proposed Form ADV, Part 1A, Item 5.K.(1)-(4) and Section 5.K.(1)-(3) of Schedule D.

8 Proposed Form ADV, Part 1A, Items 1.I. and 1.F and Sections 1.I. and 1.F .of Schedule D.

9 *See* American Bar Association, Business Law Section, SEC Staff Letter (Jan. 18, 2012), *available at* http://www.sec.gov/divisions/investment/noaction/2012/aba011812.htm (the "2012 ABA Letter").

consistent data about, and create a clearer picture of, groups of advisers that operate as a single business by grouping Form ADV data for each legal entity registered under the umbrella. Uniform filing requirements also would allow for greater comparability across private fund advisers.

The last group of amendments we are proposing to Part 1A are clarifying, technical, and other amendments that are informed by our staff's experience with the form and responding to inquiries by advisers and their service providers. Among other things, these amendments should assist filers and their service providers by making the form easier to understand and complete.

We also are proposing several amendments to Advisers Act rules unrelated to the revisions to Form ADV described above. First, we are proposing amendments to the books and records rule, rule 204-2, that would require advisers to make and keep supporting documentation that demonstrates performance calculations or rates of return in any written communications that the adviser circulates or distributes, directly or indirectly, to any person. The proposed amendments also would require advisers to maintain originals of all written communications received and copies of written communications sent by an investment adviser related to the performance or rate of return of any or all managed accounts or securities recommendations.[10] As discussed more fully below, we believe that these proposed amendments would better protect investors from fraudulent performance claims. Finally, we are proposing several technical amendments to rules under the Advisers Act to remove transition provisions that were adopted in conjunction with previous rulemaking initiatives, but that are no longer necessary.

[10] Rule 204-2 under the Advisers Act.

We note that in December 2014, the Financial Stability Oversight Council ("FSOC") issued a notice requesting comment on aspects of the asset management industry, which includes, among other entities, registered investment advisers. Although this rulemaking proposal is independent of FSOC, the notice included requests for comment on additional data or information that would be helpful to regulators and market participants. In response to the notice, several commenters discussed issues concerning data that are relevant to this proposal, including data regarding separately managed accounts and are cited in the discussion below.[11]

II. DISCUSSION

A. Proposed Amendments to Form ADV

1. Information Regarding Separately Managed Accounts

Several of the amendments to Form ADV that we are proposing today are designed to collect more specific information about advisers' separately managed accounts.[12] For purposes of reporting on Form ADV, we consider advisory accounts other than those that are pooled investment vehicles (*i.e.*, registered investment companies, business development companies, and pooled investment vehicles that are not investment companies (*i.e.*, private funds)) to be separately managed accounts. We currently collect detailed information about pooled investment vehicles that advisers manage, but little specific information regarding separately

11 *See* Notice Seeking Comment on Asset Management Products and Activities, 79 FR 77488 (Dec. 24, 2014) ("FSOC Request for Comment").

12 In response to the FSOC Request for Comment, *supra* note 11, some commenters expressed support for collecting additional information regarding separately managed accounts. *See, e.g.,* Comment Letter of Americans for Financial Reform (March 27, 2015); Comment Letter of State Street Corporation (March 25, 2015); and Comment Letter of The Systemic Risk Council (March 25, 2015). Other commenters did not support additional reporting regarding separately managed accounts. *See, e.g.*, Comment Letter of Money Management Institute (March 25, 2015) and Comment Letter of Wellington Management Group LLP (March 25, 2015).

managed accounts.[13] The proposed amendments are designed to enhance our staff's ability to effectively carry out our risk-based examination program and other risk assessment and monitoring activities with respect to these separately managed accounts and their investment advisers.

The proposed amendments regarding separately managed accounts would require more detailed information than we currently receive in response to Item 5 of Part 1A and Section 5 of Schedule D.[14] Item 5 and Section 5 currently require advisers to provide information about their advisory business including percentages of types of clients and assets managed for those clients. We propose to collect information specifically about separately managed accounts, including types of assets held, and the use of derivatives and borrowings in the accounts. Advisers that report that they have regulatory assets under management attributable to separately managed accounts in response to Item 5.K.(1) would be required to complete several questions in Sections 5.K.(1), 5.K.(2) and 5.K.(3) of Schedule D regarding those accounts.

First, we propose to require advisers to report the approximate percentage of separately managed account regulatory assets under management invested in ten broad asset categories, such as exchange-traded equity securities and U.S. government/agency bonds.[15] These

13 Registered investment companies and business development companies report information about their portfolio holdings and investment strategies on reports filed with the Commission, including in their registration statements and shareholder reports. Today, in a contemporaneous release, we are proposing rule and form amendments for registered investment companies that are designed to modernize the reporting of information to the Commission. *See Investment Company Reporting Modernization*, Investment Company Act Release No. 31610, May 20, 2015. Investment advisers to private funds file reports with the Commission on Form PF. Form PF also collects information about private fund parallel managed accounts.

14 *See* section II.A.2. for a discussion of other proposed amendments to Item 5 of Part 1A.

15 Proposed Form ADV, Part 1A, Schedule D, Section 5.K.(1)(a)-(b). The Glossary to Proposed Form ADV includes "Sovereign Bonds," "Investment Grade" and "Non-Investment Grade," which are terms used in the list of asset categories. The definitions are consistent with those in Form PF.

categories are designed to collect general information about the broad categories of assets held in separately managed accounts. We believe that collecting information about the types of assets held in these accounts would allow us to better monitor this segment of the investment advisory industry by, for instance, allowing us to identify advisers that specialize in certain asset classes. Advisers would report this information annually. For advisers with at least $10 billion in regulatory assets under management attributable to separately managed accounts, we propose to collect both mid-year and year-end data on an annual basis.

Second, we propose to require advisers with at least $150 million in regulatory assets under management attributable to separately managed accounts to report information on the use of borrowings and derivatives in those accounts.[16] For advisers with at least $150 million but less than $10 billion in regulatory assets under management attributable to separately managed accounts, we propose reporting of the number of accounts that correspond to certain categories of gross notional exposure, and the weighted average amount of borrowings (as a percentage of net asset value) in those accounts.[17] For purposes of this proposed item, gross notional exposure

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16 The $150 million threshold is consistent with Form PF, which requires investment advisers registered with the Commission that advise one or more private funds and have at least $150 million in private fund assets under management to file Form PF.

17 The Glossary to Proposed Form ADV includes "gross notional value", "borrowings" and "net asset value." The Glossary to Proposed Form ADV defines "borrowings" as "[S]ecured borrowings and unsecured borrowings, collectively. Secured borrowings are obligations for borrowed money in respect of which the borrower has posted collateral or other credit support and should include any reverse repos (*i.e.*, any sale of securities coupled with an agreement to repurchase the same (or similar) securities at a later date at an agreed price). Unsecured borrowings are obligations for borrowed money in respect of which the borrower has not posted collateral or other credit support." The Glossary to Proposed Form ADV defines "gross notional value" as "The gross nominal or notional value of all transactions that have been entered into but not yet settled as of the reporting date. For contracts with variable nominal or notional principal amounts, the basis for reporting is the nominal or notional principal amounts as of the reporting date. For options, use delta adjusted notional value." The Glossary to Proposed Form ADV defines "net asset value" as "With respect to any client, the gross assets of the client's accounts minus any outstanding indebtedness or other accrued but unpaid liabilities." These definitions are consistent with those in Form PF.

is the percentage obtained by dividing (i) the sum of (a) the dollar amount of any borrowings and (b) the gross notional value of all derivatives, by (ii) the net asset value of the account. Reporting on the use of borrowings and derivatives would only be required with respect to separately managed accounts with a net asset value of at least $10 million. Advisers with at least $10 billion in regulatory assets under management attributable to separately managed accounts would have to report the gross notional exposure and borrowing information described above, as well as the weighted average gross notional value of derivatives (as a percentage of the net asset value) in each of six different categories of derivatives.[18] We are proposing to collect information about gross notional exposure, borrowings, and gross notional value of derivatives because we believe it is important for us to better understand the use of derivatives and borrowings by advisers in separately managed accounts.[19] We are proposing to use these measures because they are commonly used metrics in assessing the use of derivatives and are comparable to information collected on Form PF regarding private funds. This reporting would be required for advisers managing at least $150 million in regulatory assets under management attributable to separately managed accounts, but all advisers to separately managed accounts would be required to report in Section 5.K.(1) the percentage of separately managed account assets held in derivatives.

Advisers would be required to update the derivatives and borrowings information annually when filing their annual updating amendment to Form ADV, which is consistent with

[18] Proposed Form ADV, Part 1A, Schedule D, Section 5.K.(2)(a).

[19] In response to the FSOC Request for Comment, *supra* note 11, several commenters discussed a variety of measures for reporting leverage (which includes derivatives and borrowings). *See, e.g.,* Comment Letter of the Asset Management Group of the Securities Industry and Financial Markets Association and the Investment Adviser Association (March 25, 2015); Comment Letter of BlackRock, Inc. (March 25, 2015); Comment Letter of Fidelity Investments (March 25, 2015); and Comment Letter of Managed Funds Association (March 25, 2015).

the requirement for updating other information in Item 5 of Form ADV. In addition, advisers with at least $10 billion in separately managed account regulatory assets under management would be required to report both mid-year and year-end information as part of their annual filing.[20] Note that we are not proposing that advisers file information semi-annually. Rather, when filing an annual amendment, the adviser would be required to provide information as of each semi-annual period. Requiring less detailed reporting for advisers that manage less than $10 billion in separately managed account assets, and requiring reporting on borrowings and derivatives only with respect to separately managed accounts with a net asset value of at least $10 million, are designed to balance our regulatory need for this information while seeking to minimize the reporting burden on smaller advisers where appropriate. Our staff estimates that approximately six percent of advisers that manage separately managed accounts would be required to provide the more detailed semi-annual information.[21] The proposed amendments are designed to provide mid-year and end of year data points to assist our staff in identifying the use of borrowings and derivative exposures in large separately managed accounts as part of the staff's risk assessment and monitoring programs, and to allow Commission staff to identify and monitor trends in borrowings and derivatives transactions in separately managed accounts.

Finally, we propose to require advisers to identify any custodians that account for at least ten percent of separately managed account regulatory assets under management, and the amount

20 Proposed Form ADV, Part 1A, Schedule D, Section 5.K.(2)(a).

21 We propose to focus the proposed semi-annual reporting requirements on the top five to ten percent of registered investment advisers to separately managed accounts. Based on IARD data as of April 1, 2015, of the 8,500 registered investment advisers that reported regulatory assets under management from clients other than registered investment companies, business development companies and pooled investment vehicles (indicating that they have assets under management attributable to separately managed accounts) approximately 535 (approximately 6.3%) reported at least $10 billion in regulatory assets under management attributable to separately managed account clients. Having additional information about these larger advisers assists the staff in risk assessment.

of the adviser's regulatory assets under management attributable to separately managed accounts held at the custodian.[22] Information about assets held, custodians and the use of borrowings and derivatives in separately managed accounts is similar to information collected about pooled investment vehicles, and it would significantly improve our understanding of this segment of advisers' accounts. This information would allow examination staff to identify advisers whose clients use the same custodian in the event, for example, a concern is raised about a particular custodian.[23] Advisers frequently have client accounts at many custodians as a result of client requirements. Accordingly, we are proposing a ten percent threshold in order to focus the proposed reporting requirements on the identification of custodians that serve a significant number of advisers' separately managed account clients.

We request comment on the changes we propose to make to Form ADV regarding separately managed accounts.

- Advisers would be required to update separately managed account information annually. Should we require more frequent reporting, such as quarterly reporting? Should an adviser be required to update information on separately managed accounts any time the adviser files an other-than-annual amendment to Form ADV? Is it appropriate to require

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22 Proposed Form ADV, Part 1A, Item 5.K.(4) and Schedule D, Section 5.K.(3). We acknowledge that advisers that have custody (or whose related persons have custody) of client assets also currently report the number of persons who act as qualified custodians for their clients in connection with advisory services provided to clients in response to Part 1A, Item 9.F. The proposed item would provide the Commission with more detailed information about custodians by requiring advisers to separately managed accounts to identify all custodians, not just qualified custodians, that service ten percent or greater of separately managed account client assets, and would require a response whether or not the adviser or the adviser's related person has custody of assets in separately managed accounts.

23 Information about custodians of separately managed accounts also would complement similar information that we obtain for pooled investment vehicles. *See* Form ADV, Part 1A, Schedule D, Section 7.B.(1), Question 25. Registered investment companies are required to identify their custodians, *see, e.g.,* Form N-1A, Item 19(h)(3) [17 CFR 274.11A].

semi-annual data in annual reporting instead of semi-annual reporting for advisers that manage at least $10 billion in separately managed accounts? Why or why not?

- In order to better understand the use of derivatives in separately managed accounts, would we need more data points from each adviser than the annual and semi-annual proposed data points? Why or why not?
- Are the $10 million, $150 million and $10 billion thresholds appropriate? Why or why not? Should we require advisers that manage less than $150 million in assets under management attributable to separately managed accounts to report additional information about those accounts or report semi-annual information?
- Should we ask about the investment strategies used in separately managed accounts as opposed or in addition to asset types? If so, how should we define the investment strategies so that information reported to us is meaningful? Should we use some or all of the investment strategies listed in Form PF for private funds?[24] Is there other information about separately managed accounts that we should consider instead?
- Is there any overlap among the proposed asset types? If so, which particular types? Are there any additional asset types that should be included?
- Would disclosure of aggregate holdings, derivatives and borrowings in separately managed accounts raise concerns, in light of Section 210(c) of the Advisers Act, regarding the identity, investments, or affairs of any clients owning those accounts when clients are not identified? If so, please explain, and address whether there are ways in which the Commission could address these concerns and still request comparable information.

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[24] *See, e.g.,* Form PF, Section 1c, Item B., Question 20.

- Would the disclosure of information about separately managed accounts in the aggregate be useful for risk monitoring and data analysis purposes? Why or why not?
- Are the proposed definitions related to Schedule D, Section 5.K.(1) and (2) sufficiently clear to allow advisers to provide the requested information? If not, please explain why and provide alternative definitions or suggestions. Would a definition of "derivatives" improve the reporting requirements? If so, how should that term be defined? For instance, should it be defined broadly to include instruments whose price is dependent on or derives from one or more underlying assets? Alternatively, should it be defined to mean futures and forward contracts, options, swaps, security-based swaps, combinations of the foregoing, or any similar instruments, or should it be defined in some other manner? If, so, how?
- Are gross notional exposures and gross notional values appropriate measures of the use of derivatives? Are there alternative or additional measures that we should consider?
- Would the disclosure of information about separately managed accounts affect or influence business or other decisions by advisers?
- Is ten percent an appropriate threshold for information on custodians that serve a significant number of separately managed accounts? Should it be higher or lower? If so, why?
- Should we require advisers to report information about the use of securities lending and repurchase agreements in separately managed accounts? If so, is there specific information we should collect, and should we require information only from advisers that manage a large amount of separately managed account assets? Are securities lending arrangements and repurchase agreements used by separately managed accounts to such

an extent that we should require all advisers that manage separately managed accounts to report this information?

- Is there additional information we should collect that would assist us in learning more about separately managed accounts?
- Is the information required to answer these proposed questions readily available to advisers? If not, why?

2. Additional Information Regarding Investment Advisers

In addition to the proposals outlined above regarding separately managed accounts, we are proposing to add several new questions and amend existing questions on Form ADV regarding identifying information, an adviser's advisory business, and affiliations. These items, developed through our staff's experience in examining and monitoring investment advisers, are designed to enhance our understanding and oversight of investment advisers and to assist our staff in its risk-based examination program.

Additional Identifying Information:

We propose several amendments to Item 1 of Part 1A of Form ADV to improve certain identifying information that we obtain. Item 1 currently requires an adviser to provide a Central Index Key number ("CIK Number") in Item 1.N only if the adviser is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934.[25] We propose to remove this question from Item 1.N. and add a question to Item 1.D. that would require an adviser to provide all of its CIK Numbers if it has one or more such numbers assigned,[26]

25 Form ADV, Part 1A, Item 1.N.

26 The SEC assigns CIK numbers in EDGAR not only to identify entities as public reporting companies, but also when an entity is registered with the SEC in another capacity, such as a transfer agent.

regardless of public reporting company status.[27] Requiring registrants to provide all of their assigned CIK numbers, if any, would improve our staff's ability to use and coordinate Form ADV information with information from other sources to investigate relationships relating to investment advisers.

Item 1.I of Part 1A of Form ADV currently asks whether an adviser has one or more websites, and Section 1.I. of Schedule D requests the website address. We propose to amend Item 1.I. to ask whether the adviser has one or more websites or websites for social media platforms, such as Twitter, Facebook and LinkedIn, and request the social media addresses in addition to the adviser's website address in Section 1.I. of Schedule D.[28] Along with websites, advisers increasingly utilize social media to communicate and it would be useful for this information to be available to us and the general public. Our staff could use this information to help prepare for examinations of investment advisers and compare information that advisers disseminate across different social media platforms as well as identifying and monitoring new platforms. Current and prospective clients could use this information to learn more about advisers and make more informed decisions regarding the selection of advisers.

We propose amending Item 1.F of Part 1A of Form ADV and Section 1.F. of Schedule D to expand the information provided about an adviser's offices other than its principal office and place of business. We currently require an adviser to provide contact and other information about its principal office and place of business, and, if an adviser conducts advisory activities

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27 Proposed Form ADV, Part 1A, Item 1.D.(3).

28 Proposed Form ADV, Part 1A, Item 1.I. and Section 1.I. of Schedule D.

from more than one location, about its largest five offices in terms of number of employees.[29] In order to assist Commission examination staff to learn more about an investment adviser's business and identify locations to conduct examinations, we are now proposing that advisers provide us with the total number of offices at which they conduct investment advisory business and provide information in Schedule D about their 25 largest offices in terms of number of employees.[30] We propose 25 offices as the number to be reported because it would provide a complete listing of offices for the vast majority of investment advisers, and provide valuable information about the main business locations for the few advisers that have a very large number of offices.[31]

In addition to providing contact information for the 25 largest offices, we propose to amend Section 1.F. of Schedule D to require advisers to report each office's CRD branch number (if applicable) and the number of employees who performed advisory functions from each office, identify from a list of securities-related activities the business activities conducted from each office, and describe any other investment-related business conducted from each office. This information would help our staff assess risk, because it provides a better understanding of an investment adviser's operations and the nature of activities conducted in its top 25 offices. In addition, if the staff wanted to focus on offices that conducted a combination of activities, such as those that engaged in municipal advisory activities as well as investment advisory activities, it would have that information readily available.

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29 Form ADV, Part 1A, Item 1.F. and Section 1.F. of Schedule D.

30 Proposed Form ADV, Part 1A, Item 1.F. and Section 1.F. of Schedule D.

31 IAPD Investment Adviser Registered Representative State Data as of April 1, 2015 shows that a majority of SEC-registered advisers (approximately 98%) have 25 or fewer offices, but that many of the remaining two percent have many multiples of 25 offices.

Item 1.J. of Form ADV currently requires each adviser to provide the name and contact information for the adviser's chief compliance officer. We propose to amend Item 1.J. to require an adviser to report whether its chief compliance officer is compensated or employed by any person other than the adviser (or a related person of the adviser) for providing chief compliance officer services, and, if so, to report the name and IRS Employer Identification Number (if any) of that other person. Our examination staff has observed a wide spectrum of both quality and effectiveness of outsourced chief compliance officers and firms. Identifying information for these third-party service providers, like others on Form ADV,[32] would allow us to identify all advisers relying on a particular service provider and could be used to improve our ability to assess potential risks.

We propose to amend Item 1.O. to require advisers to report their own assets within a range.[33] We added this item in 2011, and it currently requires an adviser to check a box to indicate if it has assets of $1 billion or more, in connection with the Dodd-Frank Act's requirements concerning certain incentive-based compensation arrangements.[34] Requiring advisers to report assets within a given range would provide more accurate data for use in Commission rulemaking arising from ongoing Dodd-Frank Act implementation.[35]

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32 For example, advisers provide the names and addresses of independent public accountants that perform audits or surprise examinations and that prepare internal control reports on Form ADV, Part 1A, Schedule D, Section 9.C.

33 Proposed Form ADV, Part 1A, Item 1.O.

34 *See Implementing Release*, *supra* note 4; Section 956 of the Dodd-Frank Act. We also propose to move the instruction for how to report "assets" for the purpose of Item 1.O. from the Instructions for Part 1A to Form ADV to Item 1.O. in order to emphasize this instruction.

35 *See, e.g.,* Section 165(i) of the Dodd-Frank Act, which requires the Commission and other financial regulators to establish methodologies for the conduct of stress tests required by section 165 of the Act.

We request comment on the proposed changes to Item 1 of Part 1A and Section 1 of Schedule D.

- Are there concerns with providing all CIK numbers assigned to an adviser? If so, please explain those concerns.
- Are there concerns with providing social media information for advisers? If so, please explain those concerns. Are there ways that we could address these concerns and still request comparable information?
- Would the proposed social media information be useful to investors? Why or why not?
- Is there additional social media information that we should collect? Should we ask advisers whether they permit employees to have social media accounts associated with the advisers' business? And, if so, should we ask advisers to identify the number or percentage of employees that have those accounts? How burdensome would it be for advisers to report that information?
- As proposed, information would be required regarding an adviser's 25 largest offices. We selected 25 in order to balance the burden to investment advisers with providing this information with our need for information about additional offices. If instead we were to require all offices to be reported, would the burden on advisers be significant? Should we decrease the number of offices or provide another standard to identify the offices that should be reported?
- Would additional information about an adviser's offices be helpful to investors? Why or why not?
- Are there concerns related to disclosure of information regarding outsourced chief compliance officers? If so, please explain those concerns.

- In addition to the identification of outsourced chief compliance officers, should we also request information about advisers' use of third-party compliance auditors? If so, what information should we request?
- Are there any concerns related to disclosing the range of an adviser's own assets? If so, please explain those concerns. Should the ranges be different than proposed? Why or why not?
- Are the proposed requirements clearly stated?
- Do advisers readily have access to the data and information requested by these proposed changes?

Additional Information About Advisory Business:

In addition to the proposed amendments to Item 5 regarding separately managed accounts discussed above, we are proposing a number of other amendments to Item 5. Item 5 currently requires an adviser to provide approximate ranges for three important data points concerning the adviser's business – the number of advisory clients, the types of advisory clients, and regulatory assets under management attributable to client types.[36] We propose to amend these items to require an adviser to report the number of clients and amount of regulatory assets under management attributable to each category of clients as of the date the adviser determines its regulatory assets under management.[37] Replacing ranges with more precise information would provide more accurate information about investment advisers and would significantly enhance

36 Form ADV, Part 1A, Item 5.C.(1), Item 5.D.(1)-(2).

37 Proposed Form ADV, Part 1A, Item 5.D.(1)-(2). The categories of clients are the same as those in Item 5.D. of the current Form ADV, except that we propose adding "sovereign wealth funds and foreign official institutions" as a client category, and specifying that state or municipal government entities include government pension plans, and that government pension plans should not be counted as pension and profit sharing plans.

our ability to analyze data across investment advisers because providing actual numbers of clients and regulatory assets under management allows us to see the scale and concentration of assets by client type. It will also allow us to determine the regulatory assets under management attributable to separately managed accounts. We believe that the information needed for providing the number of clients and amount of regulatory assets under management should be readily available to advisers because, among other reasons, advisers are producing this data to answer the current iterations of these questions on Form ADV, and advisers typically base their advisory fees on client assets under management. We also propose to require reporting on the number of clients for whom an adviser provided advisory services but does not have regulatory assets under management in order to obtain a more complete understanding of the adviser's advisory business.[38] This information also would assist in our risk assessment process and increase the effectiveness of our examinations.

We are proposing several targeted additions to Item 5 and Section 5 of Schedule D to inform our risk-based exam program and other risk monitoring initiatives. An adviser that elects to report client assets in Part 2A of Form ADV differently from the regulatory assets under management it reported in Part 1A of Form ADV would be required to check a box noting that election.[39] This information would allow our examination staff to review across advisers the

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38 Proposed Form ADV, Part 1A, Item 5.C.(1). An example of a situation where an adviser provides investment advice but does not have regulatory assets under management is a nondiscretionary account or a one-time financial plan, depending on the facts and circumstances.

39 Proposed Form ADV, Part 1A, Item 5.J.(2). Form ADV, Part 2A, Item 4.E. requires an investment adviser to disclose the amount of client assets it manages on a discretionary basis and on a non-discretionary basis. The method used by an adviser to compute the amount of client assets it manages can be different from the method used to compute regulatory assets under management required for Item 5.F. in Part 1A. As discussed in the proposing release for Part 2, the regulatory assets under management calculation for Part 1A is designed for a particular purpose (*i.e.*, for making a bright line determination about whether an adviser should register with the Commission or with the states) and permitting a different calculation for Part 2 disclosure may be appropriate to enable advisers to make disclosure that is more indicative to clients

extent to which advisers report assets under management in Part 2A that differ from the regulatory assets under management reported in Part 1A of Form ADV. Having this information would allow our staff to better understand the situations in which the calculations differ, and assist us in analyzing whether those differences require a regulatory response. In addition, we propose to add a question asking the approximate amount of an adviser's regulatory assets under management that is attributable to non-U.S. clients[40] to complement the current requirement that each adviser report the percentage of its clients that are non-U.S. persons, which, based on our experience, is not always a reliable indicator of an adviser's relationships with non-U.S. clients.[41] Our examination staff could use this information to better understand the extent of investment advice provided to non-U.S. clients which would assist us in our risk assessment process.

Section 5.G.(3) of Schedule D currently requires the SEC File Number for registered investment companies and business development companies advised by the adviser. We propose adding to Section 5.G.(3) a requirement that advisers report the regulatory assets under management of all parallel managed accounts related to a registered investment company or business development company that is advised by the adviser.[42] This information would be helpful because it would permit our staff to assess the accounts and consider how an adviser

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about the nature of their business. *See Amendments to Form ADV*, Investment Advisers Act Release No. 2711 (March 3, 2008) [73 FR 13958 (March. 14, 2008)].

40 Proposed Form ADV, Part 1A, Item 5.F.(3).

41 Form ADV, Part 1A, Item 5.C.(2). For example, an adviser may report a significant percentage of clients that are non-U.S. persons, but the regulatory assets under management attributable to those clients is a small percentage of the adviser's regulatory assets under management.

42 Proposed Form ADV, Part 1A, Section 5.G.(3) of Schedule D. The Glossary to Proposed Form ADV includes "parallel managed account," which would be defined as: "With respect to any registered investment company or business development company, a parallel managed account is any managed account or other pool of assets that you advise and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified investment company or business development company that you advise."

manages conflicts of interest between parallel managed accounts and registered investment companies or business development companies advised by the adviser. This information also would show the extent of any shift in assets between parallel managed accounts and registered investment companies or business development companies.

Finally, we propose to amend Item 5 to obtain additional information concerning wrap fee programs.[43] Item 5.I. of Part 1A currently requires an adviser to indicate whether it serves as a sponsor of or portfolio manager for a wrap fee program. We propose to amend Item 5.I. to require an adviser to report the total amount of regulatory assets under management attributable to acting as a sponsor and/or portfolio manager of a wrap fee program.[44] Section 5.I.(2) of Schedule D currently requires advisers to list the name and sponsor of each wrap fee program for which the adviser serves as portfolio manager. We propose amending Section 5.I.(2) to add questions that would require an adviser to provide any SEC File Number and CRD Number for sponsors to those wrap fee programs.[45] This information would help us better understand a particular adviser's business and assist in our risk assessment and examination process by making it easier for our staff to identify the extent to which the firm acts as sponsor or portfolio manager of wrap fee programs and collect information across investment advisers involved in a particular wrap fee program. Wrap fee accounts are held by a large number of retail clients, and we believe additional information about the capacity in which advisers serve these accounts would help us better protect investors.

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43 Form ADV, Glossary defines a wrap fee program as "[a]ny advisory program under which a specified fee or fees not based directly upon transactions in a *client's* account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of *client* transactions." We are not proposing any change to this definition.

44 Proposed Form ADV, Part 1A, Item 5.I.

45 Proposed Form ADV, Part 1A, Section 5.I.(2) of Schedule D.

We request comment on the additional changes we propose to make to Item 5 and related sections of Schedule D.

- Please describe any benefits or concerns with using more precise numbers in Item 5, rather than ranges.
- Is there any overlap among the categories of clients, and if so, among which particular categories? How could we address any overlaps?
- Please describe any concerns with providing information on: (a) the number of clients for whom investment advisers provide advisory services but do not have regulatory assets under management; (b) the regulatory assets under management attributable to non-U.S. clients; or (c) parallel managed accounts. Are there other types of information advisers could report that would meet our goals?
- Would the additional information on wrap fee programs be helpful to investors and other market participants? Should any additional information be required?
- Would advisers readily have access to the data requested?
- Are the proposed requirements clearly stated?

Additional Information about Financial Industry Affiliations and Private Fund Reporting:

Part 1A, Section 7.A. of Schedule D requires information on an adviser's financial industry affiliations and Section 7.B.(1) of Schedule D requires information on private funds managed by the adviser. We are proposing amendments to Sections 7.A. and 7.B.(1) of Schedule D that would require advisers to provide identifying numbers (*e.g.*, Public Company Accounting Oversight Board ("PCAOB") registration numbers[46] and CIK numbers[47]) in several

[46] Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 23(e).

questions to allow us to better compare information across data sets and understand relationships of advisers to other financial service providers. We are also proposing a new question that would require advisers to report the percentage of a private fund owned by qualified clients, as defined in rule 205-3 under the Advisers Act.[48] This information would help us better understand the nature of investors in private funds.

We request comment on the proposed changes to Sections 7.A. and 7.B.(1) of Schedule D.

- Would advisers readily have access to the data requested?
- Please describe any concerns with providing: (a) identifying numbers; or (b) the percentage of a private fund owned by qualified clients.
- Are the requirements clearly stated?

3. Umbrella Registration

The Dodd-Frank Act, among other things, repealed the private adviser exemption that used to be in section 203(b)(3) of the Advisers Act.[49] As a result, many previously unregistered advisers to private funds,[50] including hedge funds and private equity funds, were required to

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47 Proposed Form ADV, Part 1A, Section 7.A of Schedule D, Question 4(b).

48 Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 15(b).

49 Section 403 of the Dodd-Frank Act. Section 203(b)(3) of the Advisers Act (the "private adviser exemption") previously exempted any investment adviser from registration if the investment adviser (i) had fewer than 15 clients in the preceding 12 months, (ii) did not hold itself out to the public as an investment adviser and (iii) did not act as an investment adviser to a registered investment company or a company that elected to be a business development company.

50 Section 202(a)(29) of the Advisers Act defines the term "private fund" as "an issuer that would be an investment company, as defined in section 3 of the Investment Company Act of 1940 (15 U.S.C. 80a-3), but for section 3(c)(1) or 3(c)(7) of that Act."

register under the Advisers Act. Today, about 4,364 registered investment advisers provide advice on approximately $10.1 trillion in assets to approximately 28,532 private funds clients.[51]

For a variety of tax, legal and regulatory reasons, advisers to private funds may be organized as a group of related advisers that are separate legal entities but effectively operate as - and appear to investors and regulators to be - a single advisory business. Although these separate legal entities effectively operate as a single advisory business,[52] Form ADV is designed to accommodate the registration request of an adviser structured as a single legal entity. As a result, a private fund adviser organized as a group of related advisers could have to file multiple registration forms for the same advisory business. Multiple Form ADVs for a single advisory business may distort the data we collect on Form ADV and use in our regulatory program, be less efficient and more costly for advisers, and may be confusing to the public researching an adviser on our website.

Our staff provided guidance to private fund advisers before the compliance date of the Dodd-Frank Act private fund adviser registration requirements designed to address concerns raised by advisers.[53] The guidance provided conditions under which the staff believed one

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51 Based on IARD data as of April 1, 2015.

52 We will treat as a single adviser two or more affiliated advisers that are separate legal entities but are operationally integrated, which could result in a requirement for one or both advisers to register. *See Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Release No. 3222 (June 22, 2011) [76 FR 39646 (July 6, 2011)] ("*Exemptions Release*"); *see also In the Matter of TL Ventures Inc.*, Investment Advisers Act Release No. 3859 (June 20, 2014) (settled action).

53 *See* 2012 ABA Letter. The Division of Investment Management previously provided no-action relief to enable a special purpose vehicle ("SPV") that acts as a private fund's general partner or managing member to essentially rely upon its parent adviser's registration with the Commission rather than separately register. *See* American Bar Association Subcommittee on Private Investment Entities, SEC Staff Letter (Dec. 8, 2005), Question G1, *available at* http://www.sec.gov/divisions/investment/noaction/aba120805.htm (the "2005 ABA Letter").

adviser (the "filing adviser") may file a single Form ADV on behalf of itself and other advisers that are controlled by or under common control with the filing adviser (each, a "relying adviser"), provided that they conduct a single advisory business (collectively an "umbrella registration"). We believe that the staff's position has been successful in addressing the registration concerns that can arise from the legal structures of private fund advisers. Most advisers that can rely on umbrella registration are doing so, with approximately 750 filing advisers and approximately 2,500 relying advisers filing umbrella registrations.[54]

The method outlined in the staff guidance for filing Form ADV on behalf of multiple entities is limited, however, by the form being designed for a single legal entity, and in some cases complicates data collection and analysis on umbrella registrants and can confuse filers and the public.[55] The amendments to Part 1A that we propose would yield additional and more consistent data about, and create a clearer picture of, groups of private fund advisers that operate as a single business, while codifying the concept of umbrella registration and simplifying the process of registration for such advisers. The amendments also would allow for greater comparability across private fund advisers.

Under the amendments we are proposing, umbrella registration would be available where a filing adviser and one or more relying advisers conduct a single private fund advisory business

54 Based on IARD data as of April 1, 2015.

55 Under the guidance provided by the staff, for example, umbrella registration is appropriate where a relying adviser is not prohibited from registering with the Commission by section 203A of the Advisers Act. *See* 2012 ABA Letter, *supra* note 9. However, a relying adviser does not currently have a way to answer Item 2 regarding the basis on which it is eligible for SEC registration. In addition, relying advisers often must list owners and executive officers in a confusing manner in Schedules A and B which were not designed to accommodate multiple advisers and do not always provide the Commission staff with useful information on the owners of each relying adviser. Also, the filing adviser currently discloses its reliance on the 2012 ABA Letter in the Miscellaneous Section of Schedule D.

and each relying adviser is controlled by or under common control with the filing adviser. As proposed, umbrella registration would only be available in the scenario of a private fund adviser operating as a single business through multiple legal entities. At this time, we do not believe umbrella registration would be appropriate for advisers that are related but that operate separate advisory businesses as it would compromise data quality and complicate analyses that rely on data from Form ADV.[56] In addition, providing for disparate businesses to register on a single Form ADV as it is designed today would limit investors' ability to assess information on investment advisers because, based on our experience, reporting information about multiple advisers' businesses together on a single form would make Part 1A difficult to understand.

Accordingly, we are proposing amendments to Form ADV's General Instructions that would establish conditions for an adviser to assess whether umbrella registration is available. The conditions, which are indicia of a single advisory business, include the following:

1. The filing adviser and each relying adviser advise only private funds and clients in separately managed accounts that are qualified clients (as defined in rule 205-3 under the Advisers Act) and are otherwise eligible to invest in the private funds advised by the filing adviser or a relying adviser and whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those private funds;

[56] The filing of a single Form ADV for exempt reporting advisers in a manner similar to the filing of an umbrella registration for registered advisers also would not be available as the conditions of a single advisory business are designed, in part, to reflect requirements that only apply to registered advisers, including the requirement for compliance policies and procedures pursuant to rule 206(4)-7 under the Advisers Act and for a code of ethics pursuant to rule 204A-1 under the Advisers Act. An exempt reporting adviser is an investment adviser that qualifies for the exemption from registration under section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under rule 203(m)-1 under the Advisers Act because it is an adviser solely to private funds and has assets under management in the United States of less than $150 million. *See* Form ADV Glossary.

2. The filing adviser has its principal office and place of business in the United States and, therefore, all of the substantive provisions of the Advisers Act and the rules thereunder apply to the filing adviser's and each relying adviser's dealings with each of its clients, regardless of whether any client or the filing adviser or relying adviser providing the advice is a United States person; [57]
3. Each relying adviser, its employees and the persons acting on its behalf are subject to the filing adviser's supervision and control and, therefore, each relying adviser, its employees and the persons acting on its behalf are "persons associated with" the filing adviser (as defined in section 202(a)(17) of the Advisers Act);
4. The advisory activities of each relying adviser are subject to the Advisers Act and the rules thereunder, and each relying adviser is subject to examination by the Commission; and
5. The filing adviser and each relying adviser operate under a single code of ethics adopted in accordance with rule 204A-1 under the Advisers Act and a single set of written policies and procedures adopted and implemented in accordance with rule 206(4)-(7) under the Advisers Act and administered by a single chief compliance officer in accordance with that rule.[58]

57 As we have previously stated, we do not apply most of the substantive provisions of the Advisers Act to the non-U.S. clients of a non-U.S. adviser registered with the Commission. *See Exemptions Release, supra* note 52, at section II.D. The Glossary to Form ADV provides that "United States person" has the same meaning as in rule 203(m)-1 under the Advisers Act, which includes any natural person that is resident in the United States.

58 Under this approach, the code of ethics and written policies and procedures must be administered as if the filing adviser and each relying adviser are part of a single entity, although they may take into account, for example, that a relying adviser operating in a different jurisdiction may have obligations that differ from the filing adviser or another relying adviser.

The conditions are drawn from our experience with examining investment advisers and are designed to capture advisers to private funds that operate as a single business through commonality of the application of the Advisers Act and rules to all entities, implementation of compliance requirements, and advisory services. They are designed to include advisers to private funds (as discussed in condition 1) that operate as a single business. Conditions 2 and 4 provide assurance that our staff has access to and can readily examine the filing and relying advisers and that the Advisers Act and the rules thereunder fully apply to all advisers under the umbrella registration and clients of those advisers. Conditions 3 and 5 are designed to address the requirement that the filing and relying advisers operate as a single business. Advisers that operate under common supervision and control and have a single set of compliance policies and procedures and code of ethics are likely to operate as a single business. Finally, the conditions are the same as those in the staff's guidance that many investment advisers have relied on since 2012 (except that the staff's guidance also included disclosure conditions for Form ADV, the substance of which is covered elsewhere in this proposal).[59]

In addition, we propose to amend the General Instructions to provide advisers using umbrella registration directions on completing Form ADV for the filing adviser and each relying adviser, including details for filing umbrella registration requests and the timing of filings and amendments in connection with an umbrella registration.[60] To satisfy the requirements of Form ADV while using umbrella registration, the filing adviser would be required to file, and update as required, a single Form ADV (Parts 1 and 2) that relates to, and includes all information concerning, the filing adviser and each relying adviser, and must include this same information

[59] *See* 2012 ABA Letter, *supra* note 9, Question 4.

[60] *See* Proposed Form ADV General Instruction 5.

in any other reports or filings it must make under the Advisers Act or the rules thereunder (*e.g.*, Form PF). The proposed revisions to the form's Instructions and Form ADV would further specify those questions that should be answered solely with respect to the filing adviser and those that require the filing adviser to answer on behalf of itself and its relying adviser(s).[61] Additionally, we propose amending the Glossary to add the following three terms: (i) "filing adviser;"[62] (ii) "relying adviser;"[63] and (iii) "umbrella registration."[64]

We also are proposing a new schedule to Part 1A – Schedule R – that would have to be filed for each relying adviser.[65] Schedule R would require identifying information, basis for SEC registration, and ownership information about each relying adviser, some of which is already filed by an adviser relying on the staff guidance.[66] This new schedule would consolidate in one location important information for each relying adviser and address the problem the staff faced in its guidance that resulted in information regarding relying advisers being submitted in response to a number of different items on the Form, in ways not consistent across advisers, due to the fact

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61 *See, e.g.,* statements added to Proposed Form ADV, Instructions and Part 1A, Items 1, 2, 3, 7, 10 and 11.

62 "Filing Adviser" would mean: "An investment adviser eligible to register with the SEC that files (and amends) a single *umbrella registration* on behalf of itself and each of its *relying advisers.*" *See* Proposed Form ADV Glossary.

63 "Relying Adviser" would mean: "An investment adviser eligible to register with the SEC that relies on a *filing adviser* to file (and amend) a single *umbrella registration* on its behalf." *See* Proposed Form ADV Glossary.

64 "Umbrella Registration" would mean: "A single registration by a *filing adviser* and one or more *relying advisers* who collectively conduct a single advisory business and that meet the conditions set forth in General Instruction 5." *See* Proposed Form ADV Glossary.

65 Advisers that choose to file an umbrella registration would be directed by Item 1.B. to complete a new Schedule R for each relying adviser. Proposed Form ADV, Part 1A, Item 1.B.(2).

66 Schedule R would require the following information for each relying adviser: identifying information (Section 1); basis for SEC registration (Section 2); form of organization (Section 3) and control persons (Section 4). For basis for SEC registration (Section 2), we do not include categories that would make the relying adviser ineligible for umbrella registration, such as serving as an adviser to a registered investment company.

that Form ADV was not designed to accommodate umbrella registration.[67] Finally, we propose to add a new question to Schedule D that would require advisers to identify the filing advisers and relying advisers that manage or sponsor private funds reported on Form ADV. This information would allow us to identify the specific adviser managing the private fund reported on Form ADV if it is part of an umbrella registration.[68]

Advisers registering in reliance on the staff's umbrella registration approach outlined in the 2012 ABA Letter do not provide information about each relying adviser's address, CRD, unique identifier numbers, basis for registration or form of organization. Our proposal would require this information to be reported. We believe that certain information that we propose requiring as part of umbrella registration (such as mailing address and basis for registration) would be the same for nearly all relying advisers, and the filing adviser could check a box indicating that the mailing address of the relying advisers is the same as that of the filing adviser. Advisers relying on the 2012 ABA Letter do not currently identify the filing adviser or relying adviser that advises private funds reported on Section 7.B.(1) of Schedule D, and our proposal would require this information to be reported. We believe that this information would help us better understand the management of private funds, would provide information to contact relying advisers, and would help us better understand the relationship between relying advisers and filing advisers.

67 Under the staff's guidance in the 2012 ABA Letter, an adviser reports in its Form ADV (Miscellaneous Section of Schedule D) that it and its relying advisers are together filing a single Form ADV in reliance on the position expressed in the letter and identifies each relying adviser by completing a separate Section 1.B., Schedule D, of Form ADV for each relying adviser and identifying it as such by including the notation "(relying adviser)." *See* 2012 ABA Letter, *supra* note 9, Question 4.

68 Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 3(b).

We request comment on the changes we propose to make to Form ADV regarding umbrella registration.

- Should we amend Form ADV to accommodate umbrella registration? Why or why not?
- Would these amendments be helpful for private fund advisers and investors?
- Is umbrella registration appropriate or should we require separate registration by each adviser?
- Would umbrella registration provide more consistent and clear information about groups of private fund advisers that operate as a single business? Why or why not?
- Are there additional or different conditions we should consider for umbrella registration?
- Should we require that the availability of umbrella registration be expanded to include advisers with clients that are not primarily private funds, and if so, what are the legal structures that it should accommodate and are the proposed conditions sufficient to capture only single advisory businesses?
- We are not proposing to make filing an umbrella registration mandatory, because we believe it is appropriate to permit advisers to file a separate Form ADV for each relying adviser if they choose to do so.[69] Should umbrella registration be required? Should firms indicate if they could, but chose not to, rely on umbrella registration?
- Are the proposed amendments to the instructions and Form ADV sufficient to implement umbrella registration? If not, what amendments are necessary?
- Should we require more, less or different information on proposed Schedule R? What information should be added or deleted?

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69 Under the proposed amendments, multiple private advisers operating a single advisory business may elect to apply separately for registration.

4. Proposed Clarifying, Technical and Other Amendments to Form ADV

We are proposing several amendments to Form ADV that are designed to clarify the form and its instructions. We believe these proposed amendments to Form ADV would make the filing process clearer and therefore more efficient for advisers, and increase the reliability and the consistency of information provided by investment advisers. More reliable and consistent information would improve our staff's ability to interpret, understand, and place in context the information provided by advisers, and also would allow our staff to make comparisons across investment advisers, and improve the risk assessment and examination program. Many of these proposed amendments are derived from questions frequently received by our staff.

Proposed Amendments to Item 2:

Item 2.A. of Part 1A of Form ADV requires an adviser to select the basis upon which it is eligible to register with the Commission, and Item 2.A.(9) includes as a basis that the adviser is eligible for registration because it is a "newly formed adviser" relying on rule 203A-2(c) because it expects to be eligible for SEC registration within 120 days.[70] Section 2.A.(9) of Schedule D. is entitled "Newly Formed Adviser" and requests the adviser to make certain representations. Our staff has received questions about whether the exemption from the prohibition on Commission registration contained in rule 203A-2(c) under the Advisers Act applies *only* to entities that have been "newly formed," *i.e.,* newly created as corporate or other legal entities. It does not only apply to newly created entities and therefore we propose to delete the phrase "newly formed adviser" from Item 2.A.(9) and Section 2.A.(9) of Schedule D. Section 2.A.(9) would be

[70] Form ADV, Part 1A, Item 2.A.(9) and Section 2.A.(9) of Schedule D.

renamed "Investment Advisers Expecting to be Eligible for Commission Registration within 120 Days."[71]

Proposed Amendments to Item 4:

Item 4 of Part 1A of Form ADV addresses successions of investment advisers, and the Instructions to Item 4 provide that a new organization has been created under certain circumstances, including if the adviser has changed its structure or legal status (*e.g.*, form of organization or state of incorporation). Our staff frequently receives questions from investment advisers regarding this item and we propose adding to Item 4 and Section 4 of Schedule D text that is currently contained in the Instructions to Item 4 that succeeding to the business of a registered investment adviser includes, for example, a change of structure or legal status (*e.g.*, form of organization or state of incorporation).[72]

Proposed Amendments to Item 7:

Item 7 of Part 1A of Form ADV and corresponding sections of Schedule D require advisers to report information about their financial industry affiliations and the private funds they advise. We propose several technical amendments to Item 7. We propose to revise Item 7.A., which requires advisers to check whether their related persons are within certain categories of the financial industry, to clarify that advisers should not disclose in response to this item that some of their employees perform investment advisory functions or are registered representatives of a broker-dealer, because this information should instead be reported on Items 5.B.(1) and 5.B.(2) of Part 1A, respectively. Items 5.B.(1) and 5.B.(2) request information about an adviser's

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71 Proposed Form ADV, Part 1A, Item 2.A.(9); *see* rule 203A-2(c) under the Advisers Act.

72 Proposed Form ADV, Part 1A, Item 4.A.

employees. Adding this text to Form ADV should assist filers in filling out the form as well as provide more accurate data to us and the general public.[73]

Item 7.B. of Part 1A of Form ADV asks whether the adviser serves as adviser to any private fund. Section 7.B.(1) of Schedule D requires advisers to provide information about the private funds they manage. We propose adding text to Item 7.B. clarifying that Section 7.B.(1) of Schedule D should not be completed if another SEC-registered adviser or SEC exempt reporting adviser reports the information required by Section 7.B.(1) of Schedule D. Currently the instructions only refer to another adviser. We also propose several amendments to Section 7.B.(1) of Schedule D. Question 8 of Section 7.B.(1) currently asks whether the private fund is a "fund of funds," and if it is, whether the private fund invests in funds managed by the adviser or a related person of the adviser. Below those two questions there is currently a note informing advisers when they should answer yes to the first question regarding whether the private fund is a "fund of funds." We propose renaming the first question as Question 8(a), moving the note to directly after Question 8(a), and making the second question Question 8(b).[74] We believe these proposed changes would assist filers in answering Question 8.

Question 10 of Section 7.B.(1) of Schedule D asks the adviser to identify the category of the private fund. We propose to delete text in Question 10 that directs advisers to refer to the underlying funds of a fund of funds when selecting the type of fund, in order to reconcile differences with Form PF, which permits advisers to disregard any private fund's equity

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[73] Proposed Form ADV, Part 1A, Item 7. The staff has provided this clarification and it is currently available online at our staff's Frequently Asked Questions on Form ADV and IARD, *available at* http://www.sec.gov/divisions/investment/iard/iardfaq.shtml.

[74] Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Questions 8(a)-(b).

investments in other private funds.[75] Question 19 of Section 7.B.(1) of Schedule D asks whether the adviser's clients are solicited to invest in the private fund. We propose to add text to Question 19 to make clear that the adviser should not consider feeder funds as clients of the adviser to a private fund when answering whether the adviser's clients are solicited to invest in the private fund.[76] This is a common question that our staff receives and the intent of Question 19 is not to capture affiliated feeder funds. Question 21 of Section 7.B.(1) of Schedule D asks whether the private fund relies on an exemption from registration of its securities under Regulation D of the Securities Act of 1933 and Question 22 asks for the private fund's Form D file number. We propose a clarifying revision to Question 21 to ask if the private fund has ever relied on an exemption from registration of its securities under Regulation D, in order to better reflect the intention of the Question.[77] The current Question 21, if answered in the negative, would not require the adviser to provide the private fund's Form D file number in Question 22, meaning we would not receive Form D file numbers in the event there was past reliance on Regulation D.[78]

We propose a revision to Question 23(a)(2). Currently, this question requires an adviser to check a box to indicate whether the private fund's financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP").[79] We propose to add text instructing advisers that they are required to answer Question 23(a)(2) only if they answer

75 Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 10. *See* General Instruction 7 to Form PF.

76 Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 19.

77 Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 21.

78 Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 21.

79 Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 23(a)(2).

"yes" to Question 23(a)(1), which asks whether the private fund's financial statements are subject to an annual audit.[80] This revision will clarify when an adviser is actually required to answer Question 23(a)(2). We also propose to revise Question 23(g). The question currently asks whether the private fund's audited financial statements are distributed to private fund investors. We propose adding "for the most recent fiscal year" to clarify the question. In addition, we propose to revise Question 23(h). This question currently asks whether the report prepared by the auditing firm contains an unqualified opinion.[81] This question has prompted questions from advisers regarding which report and what timeframe the question refers to. We propose to clarify the question to ask whether all of the reports prepared by the auditing firm since the date the adviser last filed its annual updating amendment contain unqualified opinions.[82] Finally, we propose adding Question 25(g), which would request the legal entity identifier, if any, for a private fund custodian that is not a broker-dealer, or that is a broker-dealer but does not have an SEC registration number. This information would help our examination staff more readily identify the use of particular custodians by private funds.

Proposed Amendments to Item 8:

In order to address a frequent question from filers, we propose to clarify that advisers should answer Item 8 based on the types of participation and interest the adviser expects to engage in during the next year. Item 8.B.(2) of Part 1A of Form ADV currently asks whether the adviser or any related person of the adviser recommended purchase of securities to advisory clients for which the adviser or any related person of the adviser serves as underwriter, general or

80 Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 23(a)(2).

81 Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 23(h).

82 Proposed Form ADV, Part 1A, Section 7.B.(1) of Schedule D, Question 23(h).

managing partner, or purchaser representative.[83] The current wording has caused confusion regarding the treatment of purchaser representatives. We are proposing to reword the question to ask whether the adviser or any related person of the adviser recommends to advisory clients or acts as a purchaser representative for advisory clients with respect to the purchase of securities for which the adviser or any related person of the adviser serves as underwriter or general or managing partner. This proposed edit is designed to clarify that the question applies to any related person who recommends to advisory clients or acts as a purchaser representative for advisory clients with respect to the purchase of securities for which the adviser or any related person of the adviser serves as underwriter, general or managing partner.[84]

Item 8.H. of Part 1A of Form ADV asks whether the adviser or any related person of the adviser, directly or indirectly, compensates any person for client referrals. We are proposing revisions to Item 8.H. to break the question into two parts to increase our understanding of compensation for client referrals. Proposed Item 8.H.(1) would cover compensation to persons other than employees for client referrals.[85] Proposed Item 8.H.(2) would cover compensation to employees, in addition to employees' regular salaries, for obtaining clients for the firm.[86] Item 8.I. asks whether the adviser or any related person of the adviser directly or indirectly receives compensation from any person for client referrals. We have also proposed wording to clarify that Item 8.I. is not designed to include the regular salary that the adviser pays to an employee.[87] We

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[83] Form ADV, Part 1A, Item 8.B.(2).

[84] Proposed Form ADV, Part 1A, Item 8.B.(2).

[85] Proposed Form ADV, Part 1A, Item 8.H.(1).

[86] Proposed Form ADV, Part 1A, Item 8.H.(2).

[87] Proposed Form ADV, Part 1A, Item 8.I.

have proposed these edits to better understand how advisers compensate both their staff and third parties for client referrals. The proposed revisions to this item do not change the scope of the information collected, but instead provide more precise information about compensation for client referrals.

Proposed Amendments to Section 9.C. of Schedule D:

Section 9.C. of Schedule D requests information about independent public accountants that perform surprise examinations in connection with the Advisers Act custody rule, rule 206(4)-2. We propose two changes to Section 9.C. of Schedule D. First, we propose to add text requiring an adviser to provide the PCAOB registration number of the adviser's independent public accountant to improve our staff's ability to cross-reference information submitted through other systems and monitor compliance with the custody rule.[88] Section 9.C.(6) currently requires advisers to report whether any report prepared by an independent public accountant that audited a pooled investment vehicle or examined internal controls contained an unqualified opinion. We propose to amend Section 9.C.(6) in a manner similar to Section 7.B.(1) of Schedule D, Question 23(h) as described above to provide clarity to filers. Accordingly, the question would now ask whether all of the reports prepared by the independent public accountant since the date of the last annual updating amendment have contained unqualified opinions.[89]

Proposed Amendments to Disclosure Reporting Pages:

Item 11 of Part 1A of Form ADV requires registered advisers and exempt reporting advisers to provide information about their disciplinary history and the disciplinary history of

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88 Proposed Form ADV, Part 1A, Section 9.C.(3) of Schedule D.

89 Proposed Form ADV, Part 1A, Section 9.C.(6) of Schedule D.

their advisory affiliates. Those advisers who report an event for purposes of Item 11 are directed to complete a Disclosure Reporting Page ("DRP") to provide the details of the event. DRPs can be removed from Form ADV under certain circumstances, including when "the adviser is registered or applying for registration with the SEC and the event was resolved in the adviser's or advisory affiliate's favor."[90] We propose amending this text in each DRP to add "or reporting as an exempt reporting adviser with the SEC" after "applying for registration with the SEC" to clarify that both registered and exempt reporting advisers may remove a DRP from their Form ADV record if a criminal, regulatory or civil judicial action was resolved in the adviser's (or advisory affiliate's) favor.[91] This proposal would make disciplinary reporting uniform across registered and exempt reporting advisers, consistent with requiring exempt reporting advisers to report disciplinary events on Form ADV.

Proposed Amendments to Instructions and Glossary:

Together with the proposed amendments to Part 1A, we are also proposing conforming amendments to the General Instructions and the Glossary for Form ADV. As discussed above, we propose to amend the General Instructions to include instructions regarding umbrella registration. We also propose to remove outdated references to "Special One-Time Dodd-Frank Transition Filing for SEC Registered Advisers" and "recent" amendments to Form ADV Part 2

90 Form ADV, Part 1.A., Criminal, Regulatory Action and Civil Judicial Action Disclosure Reporting Pages.

91 Proposed Form ADV, Part 1A, Criminal, Regulatory Action and Civil Judicial Action Disclosure Reporting Pages.

that are no longer needed. We propose to update the definition of "Legal Entity Identifier" to reflect recent advancements in this protocol.[92]

Where applicable, we propose to make technical revisions to specify that an adviser must "apply for registration" (rather than simply "register") to more accurately reflect the rule text. We also propose to delete text in the instructions related to Item 1.O. because this text is proposed to appear directly in the corresponding section of Part 1 of Form ADV. We propose to add text clarifying that a change in information related to Item 1.O. does not necessitate a prompt other-than-annual amendment (as changes to Item 1 otherwise do).

We request comment on our proposed clarifying, technical and other amendments.

- Are the proposed amendments necessary? Should we consider different or additional amendments? If so, please specify.
- Are there any ambiguities or concerns that we should address in the form, instructions or glossary?
- Should we ask additional questions in Section 7.B.(1) of Schedule D regarding an adviser's reliance on Regulation D? If so, what additional information should we request?
- Are the proposed amendments regarding payment for client referrals in Item 8 clear? Why or why not?

92 The proposed definition of Legal Entity Identifier is: A "legal entity identifier" assigned or recognized by the Global LEI Regulatory Oversight Committee (ROC) or the Global LEI Foundation (GLEIF). *See* Proposed Form ADV: Glossary. In Item 1, we propose removing outdated text referring to the "legal entity identifier" as being "in development" in the first half of 2011.

B. Proposed Amendments to Investment Advisers Act Rules

1. Proposed Amendments to Books and Records Rule

We are proposing two amendments to the Advisers Act books and records rule, rule 204-2, that would require investment advisers to maintain additional materials related to the calculation and distribution of performance information.

Rule 204-2(a)(16) currently requires advisers that are registered or required to be registered with us to maintain records supporting performance claims in communications that are distributed or circulated to ten or more persons.[93] Although it has been our staff's experience that investment advisers routinely make and preserve communications containing performance information and records to support the performance claims, the books and records rule requires such records only when the communication is distributed to ten or more persons. We are proposing to amend rule 204-2(a)(16) by removing the ten or more persons condition and replacing it with "any person." Accordingly, advisers would be required to maintain the materials listed in rule 204-2(a)(16) that demonstrate the calculation of the performance or rate of return in any communication that the adviser circulates or distributes, directly or indirectly, to any person. The veracity of performance information is important regardless of whether it is a personalized client communication or in an advertisement sent to ten or more persons.

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93 Rule 204-2(a)(16) requires advisers to make and keep "All accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons (other than persons connected with such investment adviser); provided, however, that, with respect to the performance of managed accounts, "the retention of all account statements, if they reflect all debits, credits, and other transactions in a client's account for the period of the statement, and all worksheets necessary to demonstrate the calculation of the performance or rate of return of all managed accounts shall be deemed to satisfy the requirements of this paragraph."

Rule 204-2(a)(7) currently requires advisers that are registered or required to be registered with us to maintain certain categories of written communications received and copies of written communications sent by such advisers.[94] We are proposing to amend rule 204-2(a)(7) to require advisers to also maintain originals of all written communications received and copies of written communications sent by an investment adviser relating to the performance or rate of return of any or all managed accounts or securities recommendations. We believe these records would be useful in examining and evaluating adviser performance claims. A recent enforcement action demonstrated to us the disadvantages of not requiring investment advisers to maintain records forming the basis of performance calculations or performance communications sent to individuals.[95]

Based on our staff's experience, we believe that most advisers already maintain this information as part of their compliance with rule 206(4)-1 under the Advisers Act, which regulates advertisements by investment advisers. The proposed amendments would provide our examination staff with additional information to review an adviser's compliance with rule 206(4)-1 and would assist us in enforcing rule 206(4)-1 in cases of fraudulent advertising. Investors would benefit to the extent that the proposed amendments reduce the incidence of misleading or fraudulent advertising.

[94] Rule 204-2(a)(7) requires advisers to make and keep: "Originals of all written communications received and copies of all written communications sent by such investment adviser relating to (i) any recommendation made or proposed to be made and any advice given or proposed to be given, (ii) any receipt, disbursement or delivery of funds or securities, or (iii) the placing or execution of any order to purchase or sell any security."

[95] *In the Matter of Michael R. Pelosi*, Investment Advisers Act Release No. 3141 (Jan. 14, 2011); Initial Decision Release No. 448 (Jan. 5, 2012); Investment Advisers Act Release No. 3805 (Mar. 27, 2014) (Commission opinion dismissing proceeding against associated person of registered investment adviser charged with providing false and misleading performance information because the record lacked an evidentiary basis from which to determine that the performance information was materially false or misleading).

We request comment on the proposed amendments to rule 204-2.

- Do investment advisers currently maintain these records? If so, are there concerns with making these required records?
- Are there alternate means that would be sufficient to collect performance information and client communications regarding performance?
- Are there exceptions that we should consider?

2. Proposed Technical Amendments to Advisers Act Rules

We are proposing technical amendments to several rules under the Advisers Act and the withdrawal of transition rule 203A-5 under the Advisers Act. The proposed amendments would remove transition provisions from rules where the transition process is complete. Three of the provisions were added as part of the implementation of the Dodd-Frank Act. Two provisions were added when we amended Form ADV and several Advisers Act rules to require advisers to electronically file their brochures with the Commission.

Rule 203A-5

The Dodd-Frank Act amended section 203A of the Advisers Act to prohibit from SEC registration "mid-sized" advisers that generally have assets under management of between $25 million and $100 million.[96] Rule 203A-5 provided a temporary exemption from the prohibition on registration for mid-sized advisers to facilitate their transition to state registration.[97] We propose withdrawing rule 203A-5 because the transition of mid-sized advisers from SEC to state registration was completed in June 2012.

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96 *See* Section 410 of the Dodd-Frank Act.

97 *See Implementing Release, supra* note 4.

Rule 202(a)(11)(G)-1(e)

Section 409 of the Dodd-Frank Act created a new exclusion from the definition of "investment adviser" in section 202(a)(11)(G) of the Advisers Act for family offices. The Commission adopted rule 202(a)(11)(G)-1[98] defining a family office and provided two extended transition periods for family offices with certain charitable organization clients and family offices relying on the rescinded "private adviser" exemption.[99] We propose removing paragraph (e) of rule 202(a)(11)(G)-1 because subparagraph (1) of the transition provisions provided for by it expired on December 31, 2013 and subparagraph (2) expired on March 30, 2012.

Rule 203-1(e)

Rule 203-1 outlines the procedures for advisers to register with the Commission. Paragraph (e) of the rule was added as part of the implementation of the Dodd-Frank Act and allowed companies that were relying on the rescinded "private adviser" exemption[100] to remain exempt from registration until March 30, 2012 under certain conditions.[101] We propose removing paragraph (e) from Rule 203-1 because the transition for private advisers is now complete.

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98 *Family Offices*, Investment Advisers Act Release No. 3220 (June 22, 2011) [76 FR 37983 (June 29, 2011)].

99 Section 203(b)(3) of the Advisers Act as in effect before July 21, 2011, repealed by section 403 of the Dodd-Frank Act.

100 *Id.*

101 *See Implementing Release, supra* note 4. The rule 203-1(e) exemption from registration requires not only reliance on the former private adviser exemption but also that an adviser have fifteen or fewer clients in the preceding twelve months and neither hold itself out to the public as an investment adviser nor act as an investment adviser to a registered investment company or business development company.

Rule 203-1(b) and Rule 204-1(c)

Rule 203-1 and Rule 204-1 were amended in 2010 to provide transition periods for advisers to file narrative brochures required by Part 2A of Form ADV electronically with the Investment Adviser Registration Depository ("IARD").[102] Rule 203-1(b), entitled "transition to electronic filing," requires investment advisers applying for registration after January 1, 2011 to file their brochures electronically unless they receive a continuing hardship exemption.[103] Rule 204-1(c) requires investment advisers that are required to file a brochure and had a fiscal year that ended on or after December 31, 2010 to electronically file a Part 2A brochure as part of their next annual updating amendment. We propose removing paragraph (b) from rule 203-1 and paragraph (c) from rule 204-1 because the transition to electronic filing is now complete.[104]

We request comment on these proposed changes.

- Is there any benefit to keeping any of these provisions?

III. ECONOMIC ANALYSIS

A. Introduction

The Commission is sensitive to the benefits and costs of its rules. The following economic analysis identifies and considers the benefits and costs—including the effects on efficiency, competition, and capital formation—that would result from the proposed amendments to Form ADV and the proposed amendments to and rescission of certain rules under the

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102 *Amendments to Form ADV*, Investment Advisers Act Release No. 3060 (July 28, 2010) [75 FR 49233 (Aug. 12, 2010)].

103 The continuing hardship exemption under rule 203-3 will not be withdrawn by these technical amendments.

104 We propose redesignating current paragraphs (c) and (d) of Rule 203-1 as (b) and (c) and redesignating current paragraphs (d) and (e) of Rule 204-1 as (c) and (d).

Investment Advisers Act. The economic effects of the proposed amendments are discussed below and have informed the policy choices described in this release.

We are proposing amendments to Form ADV and the Advisers Act books and records rule 204-2, and technical amendments to several other rules under the Advisers Act. In summary, and as discussed in greater detail in section II. above, we are proposing the following amendments to Form ADV and Advisers Act rules:

- Amendments to Form ADV that are designed to fill certain data gaps and enhance current reporting provided by investment advisers in order to improve the depth and quality of the information we collect on investment advisers and to facilitate our risk monitoring objectives;
- Amendments to Form ADV to incorporate "umbrella registration" for private fund advisers;
- Clarifying, technical and other amendments to Part 1A of Form ADV;
- Amendments to the Advisers Act books and records rule that would require advisers to make and keep supporting documentation that demonstrates performance calculations or rates of return in any written communications that the investment adviser circulates or distributes; and
- Technical amendments to several rules under the Advisers Act to remove transition provisions that are no longer necessary.

We rely on information reported by investment advisers to us on Form ADV to monitor trends, assess emerging risks, inform policy choices and rulemaking, and assist Commission staff in examination and enforcement efforts. We believe that the proposed amendments to Form ADV would improve the information provided by investment advisers to the Commission, clients and prospective clients and would improve investor protection by informing policy choices and focusing examination activities. We also believe that the proposed amendments to the Advisers Act books and records rule would improve investor protections by providing useful information to evaluate advisers' performance claims.

The regulatory regime as it exists today for investment advisers serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation of the proposed amendments are discussed. The baseline includes the current requirement for investment advisers to file Form ADV, the staff guidance that permits filing advisers to file a single Form ADV on behalf of itself and each relying adviser,[105] the current requirements for investment advisers to maintain books and records, and other current rules under the Advisers Act. The parties that would be affected by the proposed amendments are investment advisers that file Form ADV, including private fund advisers that rely on, or will rely on, umbrella registration, and investment advisers that currently manage, or will manage, separately managed accounts, the Commission, current and future advisory clients and other current and future users of investment adviser information reported on Form ADV, including third-party information providers.

Based on IARD system data as of April 2015, approximately 11,600 investment advisers are registered with the Commission, and 2,914 exempt reporting advisers file reports with the Commission. Approximately 8,500 investment advisers registered with us (73%) reported assets under management attributable to separately managed account clients. Of those 8,500 advisers, approximately 5,366 advisers reported regulatory assets under management attributable to separately managed account clients of at least $150 million but less than $10 billion and

[105] *See* 2012 ABA Letter, *supra* note 9.

approximately 535 advisers reported regulatory assets under management attributable to separately managed account clients of at least $10 billion.[106] Advisers with at least $10 billion in regulatory assets under management attributable to separately managed accounts would be subject to proposed additional reporting on separately managed accounts on Form ADV. Approximately 750 registered advisers to private funds currently submit a single Form ADV on behalf of themselves and 2,500 relying advisers, relying on the 2012 ABA Letter. All investment advisers registered or required to be registered with us are subject to the Advisers Act books and records rule.

We have sought, where possible, to quantify the costs, benefits, and effects on efficiency, competition, and capital formation expected to result from the proposed amendments to Form ADV and Investment Advisers Act rules, and reasonable alternatives. As discussed below, in certain cases, we are unable to quantify the economic effects because we lack the information necessary to provide reasonable estimates. The economic effects of the proposal also depend upon a number of factors some of which we cannot estimate, such as the extent to which investor protection and our ability to oversee investment advisers will improve, and the extent to which investors would utilize the information in Form ADV to choose or retain an investment adviser. Therefore, some of the discussion below is qualitative in nature. We request comment on all aspects of the economic effects of the amendments that we are proposing, such as the costs and benefits, effects on efficiency, competition and capital formation, and reasonable alternatives to the proposed amendments. We request that commenters identify sources of data and information

[106] Based on IARD data as of April 1, 2015. These estimates are approximations because Form ADV currently collects information about assets under management by client type and the number of clients of each type in broad ranges. Proposed Item 5.D.(1)-(2) would require advisers to specify their assets under management and number of clients by client type, which will benefit our ability to understand and oversee the investment advisers that advise these accounts and recognize potential risks.

as well as provide data and information to assist us in analyzing the economic consequences of the proposed rulemaking.

B. Proposed Amendments to Form ADV

Some of the proposed amendments to Form ADV are designed to address certain gaps in information, such as information about advisers' separately managed accounts. We are also proposing to collect additional information on Form ADV on topics such as social media, offices, foreign clients, and wrap fee accounts. These items are designed to improve the depth and quality of information that we collect on investment advisers, which would be important for oversight activities. We are also proposing amendments to Form ADV to establish a more efficient method for advisers to private funds that are organized as multiple legal entities to register with us using a single Form ADV ("umbrella registration"). Finally, we are proposing a number of clarifying, technical and other amendments to Form ADV.

1. Economic Baseline and Affected Market Participants

As noted above, the investment adviser regulatory regime currently in effect serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation, of the proposed amendments to Form ADV are discussed. Form ADV is used by investment advisers to register with the SEC and with the states. Once registered, an investment adviser is required to file an annual amendment within 90 days of the end of its fiscal year end, and more frequently if required by the instructions to Form ADV.[107] Form ADV is also used by exempt reporting advisers to submit, and periodically update, reports to us by completing a limited subset of items on Form ADV. Information filed on Form ADV is

[107] *See* Rule 204-1(a) under the Advisers Act.

publicly available through the IAPD website.[108] The parties that would be directly affected by the proposed amendments to Form ADV are: investment advisers that file Form ADV with the Commission; the Commission; current and future advisory clients; and other current and future users of information filed on Form ADV, including third-party information providers.

2. Benefits

As discussed in section II. above, the proposed amendments to Form ADV would improve our ability to oversee investment advisers and identify potential risks by increasing the amount, usefulness, consistency, and reliability of the information disclosed by investment advisers, which would enhance our staff's ability to effectively carry out the risk-based examination program and other risk monitoring activities, and could improve investor protection by informing policy choices and focusing examination activities. The enhanced reporting requirements should also improve the ability of clients and potential clients of investment advisers to make more informed decisions about the selection and retention of investment advisers.

We are proposing that advisers report additional information on Form ADV regarding separately managed accounts, which are clients other than registered investment companies, business development companies and other pooled investment vehicles, such as private funds, and are designed to meet the needs of institutional and individual investors. Based on IARD data, more than 73% of investment advisers registered with us indicate that they manage assets of separately managed accounts.[109] We do not currently collect additional information specific to separately managed accounts managed by investment advisers. We currently collect detailed

[108] Certain personal identifying information is not made public.

[109] Based on IARD data as of April 1, 2015.

information about registered investment companies and private funds, but only limited information regarding the management of separately managed accounts. The absence of information about separately managed accounts, such as information about investments, compared to the information we receive describing registered investment companies and private funds, limits our ability to understand, monitor and oversee the investment advisers that advise these accounts, and recognize the potential risks relating to these accounts.[110]

The proposed amendments are intended to enhance our ability to effectively carry out our risk-based examination program and other risk-monitoring activities in relation to advisers of separately managed accounts. The additional information regarding separately managed accounts would assist us in addressing regulatory issues, anticipating the implications of various regulatory actions that we may consider, and identifying areas for additional examination and enforcement activities. The proposed amendments are also intended to improve our ability to monitor risks related to those advisers that manage greater amounts of regulatory assets under management in separately managed accounts, while reducing the potential reporting burden for those advisers that manage lesser amounts of regulatory assets under management in these accounts.

In addition to information regarding separately managed accounts, the proposed amendments to Form ADV include requests for additional information that we believe would be useful to our risk assessment, examination and oversight of investment advisers. For example, we propose requesting information regarding social media platforms used by investment advisers. This information would assist our staff with examinations and provide them with better awareness of an adviser's social media activities and how advisers use social media to

110 *See, e.g.*, Form N-1A for investment companies and Form PF for private funds.

communicate with their clients and prospective clients. We also are proposing to request additional information about an adviser's participation in and assets under management attributable to wrap fee programs. These programs are widely used by individual retail clients, and we believe it would be useful for us and the public to learn more about an adviser's participation in these programs. For example, if our staff identifies an issue with a particular wrap fee program, then this information also would assist the staff in identifying other advisers associated with the program. Other proposed items that would assist our examination activities include replacing ranges with more precise information about the number of advisory clients and related assets under management, the total number of offices that conduct investment advisory business, and information regarding each adviser's top 25 largest offices in terms of employees.

For several items, we are proposing additional identifying information, such as the CIK numbers for all advisers that have obtained one or more of them, PCAOB registration numbers for auditing firms, and the SEC file number and the CRD number for sponsors of wrap fee programs. The identifiers will improve our ability and that of other current and future users of Form ADV information to cross-reference information from Form ADV with information from other sources to investigate and obtain a more complete understanding of the business and relationships of investment advisers.

The proposed amendments to Form ADV that would incorporate the concept of umbrella registration and establish a method on Form ADV for certain private fund advisers to use umbrella registration would clarify, simplify, and therefore make more efficient the filing procedures for these advisers and provide greater certainty about the availability of umbrella registration. The proposed amendments also would improve the consistency and quality of the information that private fund advisers disclose about their business and provide a more complete picture of groups of private fund advisers that operate as a single business, thus allowing for greater comparability across private fund advisers. As of April 1, 2015, approximately 750 registered advisers indicated on Form ADV that they relied on the 2012 ABA Letter. Additional advisers may be eligible to use umbrella registration but do not currently do so.

The proposed clarifying, technical and other amendments to Form ADV would make the filing process clearer and therefore more efficient for advisers, and increase the reliability and the consistency of information provided by investment advisers. More reliable and consistent information would improve our staff's ability to interpret and evaluate the information provided by advisers, make comparisons across investment advisers, and better identify the investment advisers that may need additional outreach or examination. To the extent the proposed clarifying and technical amendments would make Form ADV easier to understand and complete, the proposed amendments would decrease future costs, especially for those investment advisers registering with us for the first time.

As discussed above, an improvement in our ability to oversee the business and assess the risks of investment advisers would benefit clients and prospective clients of investment advisers. To the extent that these proposed amendments would allow our staff to identify potential risks at investment advisers before any clients are disadvantaged, clients and potential clients would benefit. In addition, an increase in the amount, consistency and usefulness of information disclosed by investment advisers would allow advisory clients and potential advisory clients to make more informed decisions about the selection and retention of investment advisers. For example, these proposed amendments should allow prospective clients to review, either directly from Form ADV or through third-party information providers, additional or more precise information about the number of clients and amount of regulatory assets under management attributable to various client types which may provide useful information about an adviser's experience and business practices. As another example, the proposed amendments should allow clients and potential clients to identify the social media platforms of an investment adviser from which additional information about the adviser may be available. An increase in the ability of clients and potential clients to differentiate investment advisers could result in a limited increase in competition among investment advisers for clients. The proposed amendments would likely not have a significant effect on capital formation or on the ability of investors to efficiently allocate capital across investments because the proposed amendments do not directly relate to the amount of capital investors allocate to investments or their ability to allocate capital across investments.

3. Costs

The proposed amendments to Form ADV would require investment advisers to provide additional information about certain aspects of their business, including separately managed accounts, social media platforms, wrap fee programs and offices. Reporting this additional information would impose additional costs on investment advisers, but we believe that much of the information we propose requesting on Form ADV would be readily available because, based on our experience, we understand that it is information used by advisers to conduct their business.

Costs would vary across advisers, depending on the nature of an adviser's business and its business model. For example, advisers that manage a limited number of separately managed accounts or that manage smaller amounts of assets under management in those accounts would have fewer reporting requirements than advisers that manage a large number of or assets in such accounts. In addition, advisers with a large number of offices would be required to report more information on a greater number of offices than what is currently required in Form ADV. To the extent possible, we have attempted to quantify these costs. As discussed in section IV., for purposes of the increased Paperwork Reduction Act burden for Form ADV, we estimate that each adviser would incur average costs in connection with the proposed amendments to Form ADV of approximately $750,[111] for a total aggregate cost of $8,700,000.[112]

The proposed amendments regarding the reporting of information about separately managed accounts may have a limited impact on competition between advisers that manage a significant number of separately managed accounts and those that manage a small number of such accounts. If disclosure of aggregate information about separately managed accounts resulted in public disclosure of sensitive information about a small number of clients' derivative exposures because an adviser has only one or a very small number of separately managed account clients, then that adviser could be competitively disadvantaged compared with an adviser with numerous separately managed account clients because of concerns that the public disclosure of derivatives exposures would indirectly reveal sensitive information about a particular separately managed account client. We believe that this possible concern is mitigated by the fact that the proposed item does not require the disclosure or reporting of positions or specific exposures or of client identities.

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111 We estimate that each adviser will spend, on average, 2 hours to complete the proposed questions regarding separately managed accounts. We further estimate that the proposed amendments to Part 1A that request other additional information would take each adviser, on average, 1 hour to complete. As a result, we estimate a three hour increase in the total average time burden related to the proposed amendments to Form ADV. We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the Securities Industry Financial Markets Association's *Management & Professional Earnings in the Securities Industry 2013* ("SIFMA *Management and Professional Earnings Report*"), modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for a senior compliance examiner and a compliance manager are $217 and $283 per hour, respectively. [1.5 hours x $217 = $325.5] + [1.5 hours x $283 = $424.5] = $750.

112 11,600 advisers x $750 = $8,700,000.

Regarding the proposed amendments to Form ADV that would codify umbrella registration, we estimate that each adviser that files Schedule R would incur average costs of approximately $250,[113] for a total aggregate cost of $187,500.[114] We do not believe the proposed amendments to provide for umbrella registration would impose significant costs on investment advisers because advisers currently relying on the 2012 ABA Letter are already reporting much of the information that would be reported on proposed Schedule R. The additional information that would be reported for relying advisers on Schedule R, such as basis for SEC registration and form of organization, should be readily available to filing advisers.

We do not believe that the proposed clarifying, technical and other amendments to Form ADV would result in any additional costs for investment advisers and could result in some cost savings to the extent that advisers have fewer questions to research when completing the form. We have identified provisions of Form ADV that have caused confusion among filers in the past or that have resulted in inconsistent or unreliable information. Discussed above, the proposed clarifications and revisions to the questions and instructions of Form ADV would increase the efficiency of investment advisers to disclose information, and our ability to oversee investment advisers. We do not anticipate that the proposed clarifying, technical and other amendments would have a significant impact on competition or capital formation because they do not directly relate to investors' ability to differentiate among investment advisers or the amount of capital

113 We estimate that for purposes of the PRA, the filing adviser would spend on average 1 hour completing the proposed Schedule R on behalf of its relying advisers. We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA *Management and Professional Earnings Report*, modified to account for an 1,800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for a senior compliance examiner and a compliance manager are $217 and $283 per hour, respectively. [.5 hours x $217 = $108.5] + [.5 hours x $283 = $141.5] = $250.

114 750 advisers x $250 = $187,500.

that investors allocate to investments or their ability to efficiently allocate capital across securities.

We do not believe the proposed amendments to Form ADV would increase costs for exempt reporting advisers. Exempt reporting advisers are required to complete only a limited number of items in Part 1A of Form ADV (consisting of Items 1, 2.B., 3, 6, 7, 10, 11 and corresponding schedules) and would not be eligible to file proposed Schedule R. We are proposing limited amendments to the items that exempt reporting advisers are required to complete, including the proposed amendments to Item 1 regarding the use of social media and the reporting of information on up to 25 offices. Of the approximately 2,914 exempt reporting advisers that file information with us on Form ADV, approximately 17 reported that they had five or more other offices. Therefore, there would be a minimal increase in costs for these advisers to report this information.

4. Alternatives

Alternatives to the proposed amendments to Form ADV include the disclosure of different additional information from investment advisers. For example, with respect to separately managed accounts, we could have proposed requiring information as of each quarter, proposed other reporting thresholds to differentiate smaller and larger amounts of regulatory assets under management, or proposed narrower asset categories. Other examples include additional information describing an adviser's use of social media platforms, and additional information about the size and operations of offices.

When determining the specific proposed amendments to Form ADV for purposes of this proposal, we considered what information would be important for our oversight activities and for advisory clients and prospective clients, and the costs to investment advisers to provide this information. Additional information could improve our ability to oversee investment advisers and protect advisory clients and potential advisory clients, and increase clients' ability to make more informed decisions about the selection and retention of investment advisers. However, we currently believe the one-time and ongoing reporting costs for investment advisers to provide this information in addition to what we have proposed could be significant when compared to its potential benefits. Another alternative to the proposed amendments to Form ADV would be for us not to require investment advisers to report additional information but instead for us to undertake targeted examinations of investment advisers. We believe it is more efficient to compile information about advisers that can then be utilized to identify specific advisers for examination. An absence of information about advisers would reduce our ability to identify industry trends and assess risks.

C. Proposed Amendments to Investment Advisers Act Rules

As discussed above, we are proposing amendments to the Advisers Act books and records rule, and technical amendments to several other rules to remove transition provisions where the transition process is complete. The discussion below focuses on the proposed amendments to the Advisers Act books and records rule, because the technical amendments are clarifying or ministerial in nature and therefore should have little, if any, economic effects.

The proposed amendments to rule 204-2 would require investment advisers to maintain records supporting performance claims in communications that are distributed or circulated to any person. Advisers also would be required to maintain originals of all written communications received and copies of all written communications sent relating to the performance or rate of return of any or all managed accounts or securities recommendations. The proposal would require investment advisers to maintain records that they have already created, rather than create new records. We believe that most investment advisers currently maintain the information proposed to be required under the rule, as part of their compliance with the Advisers Act advertising rule (rule 206(4)-1) or as a result of their implementation of recordkeeping controls to comply with the current requirements of rule 204-2. Under the proposed amendments, each respondent would be required to retain records in the same manner and for the same period of time as currently required under rule 204-2.

1. Economic Baseline and Affected Market Participants

As noted above, the investment adviser regulatory regime currently in effect serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation, of the proposed amendments to the Advisers Act books and records rule (rule 204-2). The parties that would be directly affected by the proposed amendments to rules under the Advisers Act include: investment advisers registered with the Commission; the Commission; and current and future investment advisory clients. As discussed above, approximately 11,600 investment advisers are currently registered with the Commission.

2. Benefits

The proposed amendments to the Advisers Act books and records rule (rule 204-2) would benefit the clients and prospective clients of investment advisers by improving our ability to oversee investment advisers and making available to our examination staff all records necessary to evaluate performance information.

The proposed amendments to the books and records rule would provide our enforcement and examination staff with additional information to review an adviser's compliance with the Advisers Act advertising rule, rule 206(4)-1, regardless of the number of clients or prospective clients that receive performance communications. The increased efficiency in examining and enforcing the rule may increase investor protection by increasing the disincentive for misleading or fraudulent communications, which may reduce the incidence of fraud. In addition, investors may benefit from the proposed amendments to the books and records rule as these records would assist us in enforcing rule 206(4)-1 against, for example, fraudulent performance advertising.

To the extent that the proposed amendments to the rule reduce misleading or fraudulent communications, the competitive position of investment advisers could be improved because clients and potential clients would receive more accurate information regarding an adviser's performance and thus would be better able to differentiate advisers based on skill. In addition, to the extent that the proposed amendments to the rule improve the ability of clients and potential clients to differentiate advisers based on skill, potential clients may be more likely to obtain investment advice from an investment adviser, which would increase the ability of investment advisers to compete for investor capital. The proposed amendments could improve the ability of investors to better or more efficiently allocate capital across investments to the extent that the current allocation of capital is based on misleading or fraudulent information, which in turn could promote capital formation.

3. Costs

We estimate that for purposes of the PRA, advisers would incur an aggregate cost of approximately $324,800 per year for the total hours advisory personnel would spend in complying with the proposed recordkeeping requirements.[115] A possible non-quantifiable cost as a result of the proposed recordkeeping requirements would be discouraging advisers from

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115 We estimate that for purposes of the PRA, the proposed amendments to rule 204-2 would increase the burden by 0.5 hours per adviser annually. We expect that the function of recording and maintaining records of performance information and communications would be performed by a combination of compliance clerks and general clerks at a cost of $64 per hour and $53 per hour, respectively. We anticipate that compliance clerks will perform an estimated 0.1 hours of this work and clerical staff will perform the remaining 0.4 hours. Therefore the total cost per adviser would be (0.1 hours x $64 per hour = $6.4) + (0.4 hour x $53 = $21.2) = approximately $28 for a total cost of $324,800 (11,600 advisers x $28).

creating and communicating custom performance information to individual clients, who would then lose the benefit of having that information available to them. Although we believe that such a response to the rule would be unlikely, a decrease in communications could reduce the ability of clients and potential clients to compare advisers and potentially decrease competition.

Included in this cost estimate is our expectation that these costs would vary among firms, depending on a number of factors, including the degree to which advisers already maintain correspondence, performance information, and the inputs and worksheets used to generate performance information. Compliance costs also would vary depending on the degree to which performance figure determination and the recordkeeping process is automated, and the amount of updating to the adviser's recordkeeping policy that would be required.

4. Alternatives

An alternative to the proposed amendments to rule 204-2 would be to not propose the amendments. The proposed amendments are designed to address a potential recordkeeping gap that could limit our ability to examine and oversee advisers and ultimately protect investors. The proposed amendment to require maintenance of the performance calculations and communications regardless of the number of clients or potential clients that receive the information would address this issue. An alternative that would require maintenance of records supporting performance claims in communications that are distributed or circulated to less than the current threshold of ten persons could reduce our ability to examine and oversee advisers. We believe that the limited costs of these amendments are appropriate given its benefits.

D. Request for Comment

We request comment on our estimates and assumptions regarding the costs and benefits of the proposed amendments to Form ADV and certain rules under the Investment Advisers Act. Commenters are requested to provide empirical data to support their views. In addition to our general request for comment on the costs and benefits of the proposed amendments, we request the following specific comment on certain aspects of our economic analysis.

- To what extent would clients and prospective clients use information reported in Form ADV to select or retain investment advisers? Are there other benefits to clients and prospective clients or to other interested parties not outlined above?
- To what extent would advisers benefit from incorporation of umbrella registration into Form ADV?
- Do commenters expect that advisers would incur costs in addition to, or that differ from, the costs we outlined above? In particular, do commenters expect that advisers would incur costs different from the costs we outline above with respect to the collection or retention of additional information?
- What are the benefits and costs of the proposed reporting thresholds for separately managed account information? Are there other thresholds that would increase benefits and be just as costly or provide similar benefits and be more cost effective? Please explain.
- Would any of the effects of these proposed amendments be large enough to affect the behavior of investment advisers or their clients? For instance, would the public disclosure of aggregate separately managed account information raise confidentiality

concerns, and would disclosure impact a client's selection of an investment adviser? Please explain.

IV. PAPERWORK REDUCTION ACT ANALYSIS

Certain provisions of our proposal contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA"),[116] and we are submitting the proposed collections of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The titles for the collections of information we are proposing to amend are: (i) "Form ADV;" and (ii) "Rule 204-2 under the Investment Advisers Act of 1940." An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number.

A. Form ADV

Form ADV (OMB Control No. 3235-0049) is the two-part investment adviser registration form. Part 1 of Form ADV contains information used primarily by Commission staff, and Part 2 is the client brochure. We are not proposing changes to Part 2 at this time. We use the information to determine eligibility for registration with us and to manage our regulatory and examination programs. Clients use certain of the information to determine whether to hire or retain an adviser. The collection of information is necessary to provide advisory clients, prospective clients, and the Commission with information about the adviser and its business, conflicts of interest and personnel. Rule 203-1 under the Advisers Act requires every person applying for investment adviser registration with the Commission to file Form ADV. Rule 204-4

[116] 44 U.S.C. 3501-3520.

under the Advisers Act requires certain investment advisers exempt from registration with the Commission ("exempt reporting advisers") to file reports with the Commission by completing a limited number of items on Form ADV. Rule 204-1 under the Advisers Act requires each registered and exempt reporting adviser to file amendments to Form ADV at least annually, and requires advisers to submit electronic filings through the IARD. The paperwork burdens associated with rules 203-1, 204-1, and 204-4 are included in the approved annual burden associated with Form ADV and thus do not entail separate collections of information.

These collections of information are found at 17 CFR 275.203-1, 275.204-1, 275.204-4 and 275.279.1 and are mandatory. Responses are not kept confidential. The respondents are investment advisers registered with the Commission or applying for registration with the Commission and exempt reporting advisers. Based on IARD system data as of April 2015, approximately 11,600 investment advisers are registered with the Commission, and 2,914 exempt reporting advisers file reports with the Commission.

The currently approved total annual burden estimate for all advisers of completing, amending and filing Form ADV (Part 1 and Part 2) with the Commission is 154,402 hours. This burden is based on an average total hour burden of 40.74 hours per Commission-registered adviser for the first year that an adviser completes Form ADV but excluding private fund reporting.[117]

As discussed above, we are proposing amendments to Form ADV that are designed to provide additional information about investment advisers and their clients, including clients in separately managed accounts, provide for umbrella registration for private fund advisers and

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117 The currently approved one-time initial cost burden for outside legal and compliance consulting fees in connection with initial preparation of Part 2 of Form ADV is $3,600,000. We are not proposing any amendments to Part 2 of Form ADV and therefore we are not modifying this estimate.

clarify and address technical and other issues in certain Form ADV items and instructions. The amendments we are proposing would increase the information requested in Part 1A of Form ADV, and we expect that this would correspondingly increase the average burden to an adviser filing Form ADV.

We discuss below, in three subsections, the estimated revised collection of information requirements for Form ADV: first, we provide estimates for the revised and new burdens resulting from the proposed amendments to Part 1A; second, we determine how those estimates will be reflected in the annual burden attributable to Form ADV; and third, we calculate the total revised burdens associated with Form ADV.

1. Changes in Average Burden Estimates and New Burden Estimates

As a result of the differing burdens on advisers to complete Form ADV, we have divided the effect of the proposed amendments to the form into three subsections; first we address the change to the collection of information for registered advisers as a result of our proposed amendments to Part 1A of Form ADV excluding those changes related to private funds; second, we discuss the proposed amendments to Form ADV related to registered advisers to private funds, including the proposed amendments to Section 7.B. of Schedule D and the proposed new Schedule R that would implement umbrella registration; and third, we address the proposed amendments to Form ADV affecting exempt reporting advisers.

a. Estimated Change in Burden Related to Part 1A Proposed Amendments (Not Including Private Fund Reporting)

We are proposing amendments to Part 1A, some of which are merely technical changes or very simple in nature, and others that would require more time for an adviser to prepare a response. The paperwork burdens of filing an amended Form ADV, Part 1A would vary among advisers, depending on factors such as the size of the adviser, the complexity of its operations, and the number or extent of its affiliations. Advisers should have ready access to all the information necessary to respond to the proposed items in their normal course of operations because, among other things, they likely maintain and use the proposed requested information in connection with managing client assets. We anticipate that the responses to many of the questions would be unlikely to change from year to year, which would minimize the ongoing reporting burden associated with these questions.

i. Proposed Amendments Related to Reporting of Separately Managed Account Information

The proposed amendments to Part 1A, Items 5.K.(1), 5.K.(2), 5.K.(3) and 5.K.(4) and Schedule D, Sections 5.K.(1), 5.K.(2) and 5.K.(3) are designed to collect information about the separately managed accounts managed by advisers. Those proposed amendments would enhance existing information we receive and permit us to conduct more robust risk monitoring with respect to advisers of separately managed accounts. As discussed above, the information collected about separately managed accounts would include regulatory assets under management reported by asset type, borrowings and derivatives information, and the identity of custodians that account for at least ten percent of separately managed account regulatory assets under management. We believe much of this information is readily available to advisers to separately managed accounts because, among other things, they may maintain and use this or similar information for operational reasons (*e.g.*, trading systems) and for customary account reporting to clients in separately managed accounts.

Although we understand that much of the proposed information is readily available to advisers to separately managed accounts, we expect that these amendments could subject advisers, particularly those that advise a large number of separately managed accounts and engage in borrowings and derivatives transactions on behalf of separately managed accounts, to an increased paperwork burden. For this and other reasons, as we explained above, we propose to minimize the burden on advisers with a smaller amount of separately managed account assets under management by proposing to require advisers with regulatory assets under management attributable to separately managed accounts of at least $150 million but less than $10 billion to report borrowings and derivatives information as of the date the adviser calculates its regulatory assets under management for purposes of its annual updating amendment, while those advisers with regulatory assets under management attributable to separately managed accounts of at least $10 billion would report information as of that date and six months before that date.

Considering the proposed changes in Part 1A, Items 5.K.(1), 5.K.(2), 5.K.(3) and 5.K.(4) and Schedule D, Sections 5.K.(1), 5.K.(2) and 5.K.(3) as well as our efforts to mitigate the reporting burden to advisers that manage a smaller amount of separately managed account regulatory assets under management, we estimate that each adviser will spend, on average, 2 hours to complete the questions regarding separately managed accounts in the first year a new or existing investment adviser completes these questions.[118]

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118 Based on IARD data, as of April 1, 2015, approximately 8,500 registered investment advisers, or approximately 73% of all investment advisers registered with us, reported assets under management from clients other than registered investment companies, business development companies and pooled investment vehicles, indicating that they have assets under management attributable to separately managed accounts. Of those approximately 8,500 advisers, we estimate approximately 535 (approximately 6.3%) reported at least $10 billion in regulatory assets under management from separately managed account clients.

ii. Other Additional Information Regarding Investment Advisers

We are proposing to add several new questions and amend existing questions on Form ADV regarding identifying information, an adviser's advisory business, and affiliations. The proposed questions primarily refine or expand existing questions or request information we believe that advisers already have for compliance purposes. For example, we propose to require each adviser to provide Central Index Key (CIK) numbers if it has one or more such numbers and to provide identifying information for social media platforms that it uses. Other proposed questions would require advisers to provide readily available or easily accessible information, such as the proposed amendment to Part IA, Item 1.O. that would require advisers to report their assets within ranges. However, some of the proposed questions may take longer for advisers to complete, such as the proposed amendments to Schedule D, Section 1.F that would require information about an adviser's 25 largest offices other than its principal office and place of business. While this information is readily available to an adviser because it should be aware of its offices, a clerk would be required to manually enter expanded information about the adviser's offices in the first year the adviser responds to the proposed item and then make updates in subsequent years.

We are proposing a number of amendments to Item 5 in addition to the questions relating to separately managed accounts discussed above. Like other new or revised items, we believe several of these new Item 5 questions would merely require advisers to provide readily available or easily accessible information, such as the number of clients and regulatory assets under management attributable to each category of clients during the last fiscal year. Advisers currently provide this information in ranges, and therefore likely already have available to them the more precise numbers to report. In addition, information such as whether the adviser uses different assets under management numbers in Part 1A vs. Part 2A of Form ADV should be readily available. Other proposed items would likely present greater burdens for some advisers but not others, depending on the nature and complexity of their businesses. For instance, the burden associated with the proposed disclosure regarding wrap fee programs or non-U.S. clients would depend on whether and to what extent an adviser allocates client assets to wrap fee programs or the extent to which the adviser has non-U.S. clients.

We estimate that these proposed amendments to Part 1A of Form ADV and Schedule D would take each adviser approximately 1 hour, on average, to complete in the first year a new or existing adviser responds to these proposed questions. We have arrived at this estimate, in part, by comparing the relative complexity and availability of the information required by the proposed amended items to the current form and its approved burden, and by considering the advisers affected by the proposed amendments.

iii. Proposed Clarifying, Technical and Other Amendments

We are proposing several further amendments to Form ADV that are designed to clarify the Form and its instructions and address technical issues. These proposed changes primarily refine existing questions, such as deleting the phrase "newly formed adviser" from Part IA, Item 2.A.(9) because of questions from filers about whether that phrase refers to only newly formed corporate entities, and the proposed amendments to Part IA, Item 8.B.(2) to clarify that the question applies to any related person who recommends the adviser to advisory clients or acts as a purchaser representative. Because these proposed changes do not change the scope or amount of information required to be reported on Form ADV, we do not believe that these proposed clarifying, technical and other amendments to Part 1A of Form ADV would increase or decrease the average total collection of information burden for advisers in their first year filing Form ADV.

As a result of the proposed amendments to Form ADV Part 1A discussed above, including the proposed amendments related to separately managed accounts, additional items and technical and clarifying amendments, we estimate the average total collection of information burden would increase 3 hours to 43.74 hours per adviser for the first year that an adviser completes Form ADV (Part 1 and Part 2).[119]

b. Estimated Changes in Burden Related to Private Fund Reporting Requirements

We propose several amendments to Part 1A, Schedule D, Section 7.B. that refine and enhance existing information we receive about advisers to private funds. In addition, as part of our proposal to provide for umbrella registration, we propose a new schedule to Part 1A – Schedule R – to be submitted by advisers to private funds that use umbrella registration to file a single Form ADV.

We believe the information required by the few proposed amendments to Part 1A, Schedule D, Section 7.B would be readily available or easily accessible to advisers to private funds, such as information about the percentage of a private fund owned by qualified clients, and the PCAOB registration number for a private fund auditor. Other amendments to Section 7.B. are designed to make the questions easier to answer, but do not cause a change in reporting burden, including moving certain "notes" to questions and changes to the current question

119 Currently approved estimate of the average total collection if information burden per SEC registered adviser for the first year that an adviser completes Form ADV (40.74 hours) + 2 hours to complete the proposed questions about separately managed accounts + 1 hour to complete other additional information regarding investment advisers = 43.74 hours.

regarding unqualified opinions. The currently approved total annual burden estimate for advisers making their initial filing in completing Item 7.B. and Schedule D, Section 7.B. is 1 hour per private fund. We do not estimate that the proposed amendments to Schedule D, Section 7.B would increase or decrease the total annual burden because the information is readily available to advisers.

The proposal to incorporate umbrella registration into Form ADV would codify a staff position and provide a method for certain private fund advisers that operate as a single advisory business to file a single registration form. Umbrella registration would only be available if the filing adviser and each relying adviser advise only private funds and clients in separately managed accounts that are qualified clients, as defined in rule 205-3 under the Advisers Act, that are otherwise eligible to invest in the private funds advised by the filing or a relying adviser. The filing and relying advisers would also have to satisfy certain requirements, including that each relying adviser is controlled by or under common control with the filing adviser. There has been staff guidance for single registration under defined circumstances since 2012,[120] and the proposed amendments to Form ADV would provide for umbrella registration and simplify the process of umbrella registration for advisers constituting a single advisory business. We are proposing a new schedule to Part 1A, Schedule R, that would have to be filed with respect to each relying adviser, as well as a new question to Schedule D that would link private funds reported on Form ADV to the specific (filing or relying) adviser that advises it. Schedule R would require identifying information, basis for SEC registration, and ownership information about each relying adviser.

[120] *See* 2012 ABA Letter, *supra* note 9.

We believe that much of the information we are proposing to include in Schedule R should be readily available to private fund advisers because it is information that they are already reporting either on Form ADV filings for separate advisers or on a single Form ADV filing, in reliance on the staff guidance. Accordingly, although these proposed requirements would be an increase in the information collected, the increased burden should largely be attributable to data entry and not data collection. Furthermore, some advisers who currently separately file Form ADV for each of their advisers may cumulatively have a reduced Form ADV burden by switching to umbrella registration should the new process be codified and Schedule R available. We also believe that new filing advisers using umbrella registration would readily have information available about relying advisers, because they are operating as a single advisory business.

There is no currently approved annual burden estimate of completing Schedule R because it is a new Schedule. Taking into account the scope of information we propose to request, our understanding that much of the information is readily available and currently required on Form ADV, and our belief that many private fund advisers that file an umbrella registration will have only a small number of relying advisers,[121] we estimate that advisers to private funds that elect to rely on umbrella registration will spend on average 1 hour per filing adviser completing new Schedule R for the first time.

[121] Based on IARD data as of April1, 2015, approximately 750 investment advisers rely on the 2012 ABA Letter to file Form ADV on behalf of themselves and 2,500 relying advisers, an average of approximately 3 relying advisers per filing adviser.

c. Estimated Changes in Burden Related to Exempt Reporting Adviser Reporting Requirements

Exempt reporting advisers are required to complete a limited number of items in Part 1A of Form ADV (consisting of Items 1, 2.B., 3, 6, 7, 10, 11 and corresponding schedules), and are not required to complete Part 2 and would not be eligible to file proposed Schedule R. The proposed amendments to Part 1A would revise only Items 1 and 7 for exempt reporting advisers. We believe the information required by these proposed revisions should be readily available to any adviser as part of their ongoing operations and management of client assets, and, moreover, are unlikely to require additional reporting for most exempt reporting advisers. For instance, we estimate that almost all exempt reporting advisers currently have five or fewer offices (the number of offices currently required by Form ADV) and thus would not have to provide information on additional offices.[122] Accordingly, we do not expect that the proposed amendments would increase or decrease the currently approved total annual burden estimate per exempt reporting adviser initially completing these items in Form ADV, other than Item 7.B., of 2 hours. We also do not expect that the proposed amendments would increase or decrease the currently approved total annual burden estimate per exempt reporting adviser initially completing Item 7.B. and Section 7.B. of Schedule D of 1 hour per private fund.

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122 Based on IARD data as of April 1, 2015, only 17 ERAs reported on Form ADV that they had five or more other offices.

2. Annual Burden Estimates

a. Estimated Annual Burden Applicable to All Registered Investment Advisers

i. Estimated Initial Hour Burden (Not Including Burden Applicable to Private Funds) For First Year Adviser Completes Form ADV (Part 1 and Part 2)

We estimate that, as a result of the proposed amendments to Form ADV Part 1A discussed above, other than those applicable to private funds, the average total collection of information burden per respondent would increase 3 hours to 43.74 hours per adviser for the first year that an adviser completes Form ADV (Part 1 and Part 2).

Approximately 11,600 investment advisers are currently registered with the Commission.[123] Not including private fund reporting, the estimated aggregate annual burden applicable to these advisers would be 507,384 hours[124] (34,800 hours of it attributable to the proposed amendments).[125] As with the Commission's prior Paperwork Reduction Act estimates for Form ADV, we believe that most of the paperwork burden would be incurred in advisers' initial submission of the amended Form ADV, and that over time this burden would decrease substantially because the paperwork burden would be limited to updating information.[126]

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123 Based on IARD data as of April 1, 2015. We include currently registered advisers in the estimated initial hour burden calculation because, for purposes of estimating burdens under the Paperwork Reduction Act, we assume that every new and existing registered adviser completes an initial registration in a three year period, which is the period after which estimates are required to be renewed.

124 43.74 hour per-adviser burden x 11,600 advisers = 507,384 hours.

125 3 hour per-adviser additional burden x 11,600 advisers = 34,800 hours.

126 We discuss the burden for advisers making annual updating amendments to Form ADV in section iii below.

Amortizing the burden imposed by Form ADV over a three-year period to reflect the anticipated period of time that advisers would use the revised Form would result in an average annual burden of an estimated 169,128 hours per year[127] (11,600 hours per year of it attributable to the proposed amendments),[128] or 14.58 hours per year for each adviser currently registered with the Commission.[129]

Based on IARD system data, we estimate that there will be approximately 1,000 new investment advisers filing Form ADV with us annually. Therefore, we estimate that the total annual burden applicable to these advisers for the first year that they complete Form ADV but excluding private fund reporting requirements is 43,740 hours (1,000 advisers x 43.74 hours). Amortizing the burden imposed by Form ADV for new registrants over a three-year period to reflect the anticipated period of time that advisers would use the revised Form would result in an average annual burden of an estimated 14,580 hours per year[130] (1,000 of it attributable to the proposed amendments).[131] We therefore estimate the total hour burden to be 183,708 hours per year.[132]

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127 507,384 hours/3 = 169.128 hours.

128 34,800 hours/3 = 11,600 hours.

129 169,128 hours/11,600 advisers = 14.58 hours.

130 43,740 hours/3 = 14,580 hours.

131 3,000 hours/3 = 1,000 hours.

132 14,580 hours for new registrants + 169,128 hours for existing registrants = 183,708 hours.

ii. Estimated Initial Hour Burden Applicable to Registered Advisers to Private Funds

The amount of time that a registered adviser managing private funds would incur to complete Item 7.B. and Section 7.B. of Schedule D will vary depending on the number of private funds the adviser manages. Of the advisers currently registered with us, we estimate that approximately 4,364 registered advisers advise a total of 28,532 private funds, and, on average, 300 SEC-registered advisers annually would make their initial filing with us reporting approximately 1,100 private funds.[133] The currently approved annual burden estimate for advisers making their initial filing in completing Item 7.B. and Schedule D, Item 7.B. is 1 hour per private fund. As a result, we estimate that the private fund reporting requirements that are applicable to registered investment advisers would add 29,632 hours to the overall annual burden applicable to registered advisers.[134] As noted above, we believe most of the paperwork burden would be incurred in connection with advisers' initial submission of Form ADV, and that over time the burden would decrease substantially because it would be limited to updating (instead of compiling) information. Amortizing this burden over three years, as we did above with respect to the initial filing of the rest of the form, results in an average estimated burden of 9,877 hours per year.[135]

[133] Based on IARD data as of April 1, 2015. We include existing funds of currently registered advisers in the estimated initial hour burden calculation because, for purposes of estimating burdens under the Paperwork Reduction Act, we assume that every existing registered adviser completes an initial filing completing Item 7.B and Schedule D, Item 7.B per fund in a three year period, which is the period after which estimates are required to be renewed.

[134] 1 hour x 28,532 private funds = 28,532 hours. 1 hour x 1,100 private funds = 1,100 hours. 28,532 hours + 1,100 hours = 29,632 hours.

[135] 29,632 hours/3 = 9,877 hours.

We also propose a new Schedule R to Form ADV for umbrella filing. Of the advisers currently registered with us, we estimate based on current Form ADV filings that approximately 750 registered advisers currently submit a single Form ADV on behalf of themselves and approximately 2,500 relying advisers.[136] Taking into account the scope of information we propose to request and our understanding that much of the information is readily available and is already reported by advisers, we estimate that advisers to private funds that elect to rely on umbrella registration will spend 1 hour per filing adviser completing new Schedule R. As a result, we estimate that umbrella registration would add 750[137] hours to the annual burden applicable to registered advisers. We estimate that, on average, 65 SEC registered advisers annually would make their initial filing with us as filing advisers, increasing the overall annual burden for advisers to private funds an additional 65 hours, or 815 hours in total. Amortizing these hours for a three year period as with the rest of the burdens associated with Form ADV, results in 272 additional hours per year.[138]

iii. Estimated Annual Burden Associated With Amendments, New Brochure Supplements, and Delivery Obligations

The current approved collection of information burden for Form ADV has three elements in addition to those discussed above: (1) the annual burden associated with annual and other amendments to Form ADV; (2) the annual burden associated with creating new Part 2 brochure supplements for advisory employees throughout the year; and (3) the annual burden associated

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136 Based on IARD data as of April 1, 2015.

137 750 filing advisers x 1 hour per completing Schedule R = 750 hours.

138 815 hours/3 = 271.66 hours.

with delivering codes of ethics to clients as a result of the offer of such codes contained in the brochure. We anticipate that our proposed amendments to Form ADV would increase the currently approved annual burden estimate associated with annual amendments to Form ADV from 6 hours to 7 hours per adviser, but would not impact interim updating amendments to Form ADV.

We continue to estimate that, on average, each adviser filing Form ADV through the IARD will likely amend its form two times during the year. We estimate, based on IARD data, that advisers, on average, make one interim updating amendment (at an estimated 0.5 hours per amendment) and one annual updating amendment (at an estimated 7 hours per amendment) each year. [139]

In addition, the currently approved annual burden estimates are that each investment adviser registered with us will, on average, spend 1 hour per year making interim amendments to brochure supplements, [140] and an additional 1 hour per year to prepare new brochure supplements as required by Part 2. [141] The currently approved annual burden estimate is that advisers spend an average of 1.3 hours annually to meet obligations to deliver codes of ethics to clients. [142] We are not changing these estimates as the proposed amendments do not affect these requirements. Therefore we estimate the total annual burden for advisers registered with us attributable to

139 (11,600 advisers x 0.5 hours/other than annual amendment) + (11,600 advisers x 7 hours/annual amendment) = 87,000 hours.

140 11,600 hours attributable to interim amendments to the brochure supplements = 11,600 advisers x 1 hour = 11,600 hours.

141 11,600 hours attributable to new brochure supplements = 11,600 advisers x 1 hour = 11,600 hours.

142 15,080 hours for the delivery of codes of ethics = 11,600 advisers x 1.3 hours = 15,080 hours.

amendments, brochure supplements and obligations to deliver codes of ethics to be 125,280 hours.[143]

iv. Estimated Annual Cost Burden

The currently approved total annual collection of information burden estimate for Form ADV has a one-time initial cost for outside legal and compliance consulting fees in connection with the initial preparation of Part 2 of Form ADV. We do not anticipate that the amendments we are proposing to Form ADV will affect the per adviser cost burden estimates for outside legal and compliance consulting fees. In addition to the estimated legal and compliance consulting fees, investment advisers of private funds incur costs with respect to the requirement for investment advisers to report the fair value of private fund assets.

We expect that 1,000 new advisers will register annually with the Commission. We estimate that the initial cost related to preparation of Part 2 of Form ADV would be $4,400 for legal services and $5,000 for compliance consulting services, in each case, for those advisers who engaged legal counsel or consultants. We anticipate that a quarter of these advisers would seek the help of outside legal services and half would seek the help of compliance consulting services. Accordingly, we estimate that 250 of these advisers would use outside legal services, for a total cost burden of $1,100,000,[144] and 500 advisers would use outside compliance consulting services, for a total cost burden of $2,500,000,[145] resulting in a total cost burden

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143 87,000 hours + 11,600 hours + 11,600 hours + 15,080 hours = 125,280 hours.

144 25% x 1000 SEC registered advisers = approximately 250 advisers. $4,400 for legal services x 250 advisers = $ 1,100,000.

145 50% x 1000 SEC registered advisers = 500 advisers. $5,000 for consulting services x 500 advisers = $2,500,000.

among all respondents of $3,600,000 for outside legal and compliance consulting fees related to drafting narrative brochures.[146]

We estimate that 3% of registered advisers have at least one private fund client that may not be audited. These advisers therefore may incur costs to fair value their private fund assets. Based on current IARD data, 4,364 registered advisers currently advise private funds. We therefore estimate that approximately 131 registered advisers may incur costs of $37,625 each on an annual basis, for an aggregate annual total cost of $4,928,875.[147]

Together, we estimate that the total cost burden among all respondents for outside legal and compliance consulting fees related to third party or outside valuation services and for drafting outside legal and compliance consulting fees to be $8,528,875.[148]

b. Estimated Annual Burden Applicable to Exempt Reporting Advisers

i. Estimated Initial Hour Burden

Based on IARD system data, there are approximately 2,914 exempt reporting advisers currently filing reports with the SEC.[149] The paperwork burden applicable to these exempt reporting advisers consists of the burden attributable to completing a limited number of items in

146 $1,100,000 + $2,500,000 = $3,600,000.

147 131 advisers x $37,625 = $4,928,875.

148 $3,600,000 + $4,928,875 = $8,528,875.

149 Based on IARD data as of April 1, 2015. We include existing exempt reporting advisers and their private funds in the estimated initial hour burden calculation because, for the purpose of estimating burdens under the Paperwork Reduction Act, we assume that every new and existing exempt reporting adviser completes an initial Form ADV in a three year period, which is the period after which estimates are required to be renewed.

Form ADV Part 1A as well as the burden attributable to the private fund reporting requirements of Item 7.B. and Section 7.B. of Schedule D.

The currently approved estimate of the average total collection of information burden per exempt reporting adviser for the first year that an exempt reporting adviser completes a limited subset of Part 1 of Form ADV, other than Item 7.B. and Section 7.B. of Schedule D, is 2 hours. As discussed above, we do not anticipate that our proposed amendments to Form ADV would affect the per exempt reporting adviser burden estimate. Based on IARD system data, we estimate that there will be 500 new exempt reporting advisers filing Form ADV annually. Therefore, we estimate that the total annual burden applicable to the existing and new exempt reporting advisers for the first year that they complete Form ADV but excluding private fund reporting requirements is 6,828 hours.[150] Amortizing the burden imposed by Form ADV over a three-year period to reflect the anticipated period of time that advisers would use the revised Form ADV results in an average annual burden of an estimated 2,276 hours per year.[151]

As discussed above, we estimate the burden of completing Item 7.B. and Section 7.B. of Schedule D to be 1 hour per private fund. We do not anticipate that our proposed amendments to Form ADV would affect the per exempt reporting adviser burden of completing Item 7.B. and Section 7.B. of Schedule D. Based on IARD data, we estimate that, on average, the 2,914 current exempt reporting advisers will report 9,896 funds and the projected 500 new exempt reporting advisers making their initial filing will report approximately 1,000 funds, resulting in a

150 2 hours x (2,914 reporting exempt reporting advisers + 500 new exempt reporting advisers) = 6,828 hours.

151 6,828 hours / 3 = 2,276 hours.

total annual burden of 10,896 hours.[152] Amortizing this total burden over three years as we did above for registered advisers results in an average burden of an estimated 3,632 hours per year,[153] or approximately 1 hour per year, on average, for each exempt reporting adviser.[154]

ii. Estimated Annual Burden Associated With Amendments and Final Filings

In addition to the burdens associated with initial completion and filing of the portion of the form that exempt reporting advisers are required to prepare, we estimate that, based on IARD data, each exempt reporting adviser would amend its form 2 times per year. On average, these consist of one interim updating amendment (at an estimated 0.5 hours per amendment)[155] and one annual updating amendment (at an estimated 1 hour per amendment)[156] each year. In addition, we anticipate 200 final filings by exempt reporting advisers annually (at an estimated 0.1 hours per filing).[157] We do not anticipate that our proposed amendments to Form ADV would affect the per exempt reporting adviser burden. The total annual burden associated with exempt reporting advisers filing amendments and final filings is 4,391 hours.[158]

152 9,896 funds + 1,000 funds = 10,896 funds. 10,896 x 1 hour = 10,896 hours.

153 10,896 hours /3 years = 3,632 hours per year.

154 3,632 hours per year/3,414 exempt reporting advisers = 1 hour per year.

155 2,914 x .5 hours = 1,457 hours.

156 2,914 x 1 hour = 2,914 hours.

157 200 x 0.1 hours = 20 hours.

158 1,457 hours + 2,914 hours + 20 hours = 4,391 hours. Exempt reporting advisers are not required to complete Part 2 of Form ADV and so will not incur an hour burden to prepare new brochure supplements or the cost for preparation of the brochure. Exempt reporting advisers also do not have an obligation to deliver codes of ethics to clients as required by Part 2 of Form ADV.

3. Total Revised Burdens

The revised total annual collection of information burden for SEC registered advisers to file and complete the revised Form ADV (Parts 1 and 2), including the initial burden for both existing and anticipated new registrants, private fund reporting, plus the burden associated with amendments to the form, preparing brochure supplements and delivering codes of ethics to clients, is estimated to be approximately 319,137 hours per year, for a monetized total of $79,784,000.[159]

The revised total annual collection of information burden for exempt reporting advisers to file and complete the required Items of Part 1A of Form ADV, including the burdens associated with private fund reporting, amendments to the form and final filings, would be approximately 10,299 hours per year, for a monetized total of $2,574,500.[160]

We estimate that if the proposed amendments to Form ADV are adopted, the total annual hour burden for the form would be 329,436 hours and a monetized total of $82,358,500.[161] This

159 183,708 hours per year attributable to initial preparation of Form ADV + 9,877 hours per year attributable to initial private fund reporting requirements + 272 hours per year for initial umbrella registration + 125,280 hours per year for attributable to amendments, brochure supplements and obligations to deliver codes of ethics = 319,137 hours. We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager, or persons performing similar functions. Data from the SIFMA *Management and Professional Earnings Report*, modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $217 and $283 per hour, respectively. (159,568 hours x $217) + (159,568 hours x 283) = $79,784,000.

160 2,276 hours per year attributable to initial preparation of Form ADV + 3,632 hours per year attributable to initial private fund reporting requirements + 4,391 hours per year for amendments and final filings = 10,299 hours. We expect that the performance of this function would most likely be equally allocated between a senior compliance examiner and a compliance manager, or persons performing similar functions. Data from the SIFMA *Management and Professional Earnings Report*, modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead, suggest that costs for these positions are $217 and $283 per hour, respectively. (5,149 x $217) + (5,149 x $283) = $2,574,500.

161 319,137 hours + 10,299 hours = 329,436 hours. $79,784,000 + $2,574,500 = $82,358,500.

is an increase of 175,034 hours and $45,688,073 from the currently approved burden estimates,[162] which is attributable primarily to the currently approved burden estimates not considering the amortized annual burden of Form ADV on existing registered advisers and exempt reporting advisers. The resulting blended average per adviser burden for Form ADV is 22.69 hours (for a monetized total of $5,674.42),[163] which consists of an average annual burden of 27.51 hours[164] for each of the estimated 11,600 SEC registered advisers, and 3.53 hours[165] for each of the estimated 2,914 exempt reporting advisers.

Registered investment advisers are also expected to incur an annual cost burden of $8,528,875, an increase of $4,928,875 from the current approved cost burden estimate of $3,600,000. The increase in annual cost burden is attributable to the currently approved burden not considering the cost to advisers to fair value private fund assets.

B. Rule 204-2

Rule 204-2 (OMB Control No. 3235-0278) requires investment advisers registered, or required to be registered under section 203 of the Act, to keep certain books and records relating to their advisory business. The collection of information under rule 204-2 is necessary for the Commission staff to use in its examination and oversight program, and the information is generally kept confidential.[166] The collection of information is mandatory.

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162 329,436 hours - 154,402 hours = 175,034 hours. $82,358,500 - $36,670,427 = $45,688,073.

163 329,436 hours / (11,600 registered advisers + 2,914 exempt reporting advisers) = 22.69 hours. $82,358,500 / (11,600 registered advisers + 2,914 exempt reporting advisers) = $5,674.42.

164 319,137 hours / 11,600 registered advisers = 27.51 hours.

165 10,299 hours / 2,914 exempt reporting advisers = 3.53 hours.

166 *See* section 210(b) of the Advisers Act.

The proposed amendments to rule 204-2 would require investment advisers to make and keep the following records: (i) documentation necessary to demonstrate the calculation of the performance the adviser distributes to any person, and (ii) all written communications received or sent relating to the adviser's performance.

The currently approved total annual burden for rule 204-2 is based on an estimate of 10,946 registered advisers subject to rule 204-2 and an estimated average burden of 181.45 burden hours each year per adviser, for a total of 1,986,152 hours. Based upon updated IARD data, the current approximate number of investment advisers is 11,600. As a result in the increase in the number of advisers registered with the Commission since the current total annual burden estimate was approved, the total burden estimate has increased by 118,668 hours.[167] We estimate that most advisers provide, or seek to provide, performance information to their clients. Under the proposed amendments, each adviser would be required to retain the records in the same manner, and for the same period of time, as other books and records under rule. We believe that the documentation necessary to support the performance calculations is customarily maintained, or required to be maintained by advisers already in account statements or portfolio management systems. We also believe that most advisers already maintain this information in their books and records, in order to show compliance with the Advisers Act advertising rule, rule 206(4)-1. Accordingly, the proposed amendments to rule 204-2 are estimated to increase the burden by approximately 0.5 hours per adviser annually for a total increase of 5,800 hours.[168]

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167 11,600 advisers x 181.45 hours = 2,104,820 hours. 2,104,820 hours – 1,986,152 hours = 118,668 hours.

168 11,600 advisers x 0.5 hours = 5,800 hours.

The revised annual aggregate burden would be 2,110,620 hours.[169] The revised average burden per adviser would be approximately 182 hours per year.[170]

Advisers would likely use a combination of compliance clerks and general clerks to make and keep the information and records required under the rule. The currently approved total cost burden is $108,708,557.10. We estimate the hourly wage for compliance clerks to be $64 per hour, including benefits, and the hourly wage for general clerks to be $53 per hour, including benefits.[171] For each adviser, 182 burden hours would be required to make and keep the information and records required under the rule. We anticipate that compliance clerks will perform an estimated 32 hours of this work, and clerical staff will perform the remaining 150 hours. The total cost per respondent therefore will be an estimated $9,998,[172] for a total burden cost of approximately $115,976,800,[173] an increase of $7,268,243 from the currently approved total cost per respondent.[174] The increase in cost is attributable to a larger registered investment adviser population since the most recent approval as well as the proposed rule 204-2 amendments discussed in this release.

169 1,986,152 (current approved burden) + 118,668 (burden for additional registrants) + 5,800 (burden for proposed amendments) = 2,110,620 hours.

170 2,110,620 hours/11,600 advisers = 181.9 hours.

171 Our hourly wage rate estimate for a compliance manager and compliance clerk is based on data from the SIFMA *Office Salaries in the Securities Industry Report 2013*, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35, for compliance clerks to account for bonuses, firm size, employee benefits and overhead.

172 (32 hours per compliance clerk x $64) + (150 hours per clerical staff x $53) = ($2,048 + $7,950) = $9,998.

173 $9,998 per adviser x 11,600 advisers = approximately $115,976,800.

174 $115,976,800 - $108,708,557 = $7,268,243.

C. Request for Comment

We request comment on whether our estimates for the change in burden hours and associated costs described above are reasonable. Pursuant to 44 U.S.C. 3506(c)(2)(B), the Commission solicits comments in order to: (i) evaluate whether the proposed collections of information are necessary for the proper performance of the functions of the Commission, including whether the information will have practical utility; (ii) evaluate the accuracy of the Commission's estimate of the burden of the proposed collections of information; (iii) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and (iv) determine whether there are ways to minimize the burden of the collections of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

The agency has submitted the proposed collection of information to OMB for approval. Persons wishing to submit comments on the collection of information requirements of the proposed amendments should direct them to the Office of Management and Budget, Attention Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should send a copy to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-09-15. As OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication, a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-09-15, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE, Washington, DC 20549-2736.

V. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis ("IRFA") in accordance with section 3(a) of the Regulatory Flexibility Act[175] regarding our proposed amendments to Form ADV and rule 204-2 and our proposed technical amendments to certain other rules under the Advisers Act.

A. Reason for the Proposed Action

The proposed amendments to Form ADV are designed to provide the Commission with additional information about registered investment advisers, including information about separately managed accounts, provide for umbrella registration for multiple investment advisers operating as a single advisory business, and provide technical, clarifying and other amendments to certain Form ADV provisions. The proposed amendments to Form ADV would improve the information provided by investment advisers to the Commission and the public.

We are also proposing amendments to the Advisers Act books and records rule that would require advisers to make and keep supporting documentation that demonstrates performance calculations or rates of return in any written communications that the adviser circulates or distributes, directly or indirectly, to any person. We believe that the proposed amendments to the books and records rule would improve investor protections by providing useful information in examining and evaluating advisers' performance claims.

Finally, we are proposing technical amendments to certain rules under the Advisers Act to remove transition provisions where the transition process is complete.

175 5 U.S.C. 603(a).

B. Objectives and Legal Basis

The proposed amendments to Form ADV would address certain data gaps and enhance current reporting provided by investment advisers, particularly about separately managed accounts, in order to increase our ability to effectively oversee and monitor their activities, and to incorporate umbrella registration for private fund advisers that operate as a single advisory business. The proposed amendments to the Advisers Act books and records rule would require advisers to make and keep supporting documentation that demonstrates performance calculations or rates of return in any written communications that the adviser circulates or distributes, directly and indirectly, to any persons.

The Commission is proposing amendments to Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 7sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]. The Commission is proposing to amend rule 204-2 pursuant to the authority set forth in sections 204 and 211 of the Advisers Act [15 U.S.C. 80b-4 and 80b-11]. The Commission is proposing to amend rule 202(a)(11)(G)-1 pursuant to authority in sections 202(a)(11)(G) and 206A of the Advisers Act [15 U.S.C. 80b-2(a)(11)(G) and 80b-6A]. The Commission is proposing to amend rule 203-1 pursuant to authority in section 206A of the Advisers Act [15 U.S.C. 80b-6A]. The Commission is proposing to rescind rule 203A-5 and amend rule 204-1 pursuant to authority in sections 204 and 211(a) of the Advisers Act [15 U.S.C. 80b-4 and 80b-11(a)].

C. Small Entities Subject to the Rule and Rule Amendments

In developing these proposals, we have considered their potential impact on small entities that would be subject to the proposed amendments. The proposed amendments would affect all advisers registered with the Commission and exempt reporting advisers, including small entities. Under Commission rules, for the purposes of the Advisers Act and the Regulatory Flexibility Act, an investment adviser generally is a small entity if it: (1) has assets under management having a total value of less than $25 million; (2) did not have total assets of $5 million or more on the last day of the most recent fiscal year; and (3) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[176]

Our proposed rule and Form ADV amendments would not affect most advisers that are small entities ("small advisers") because they are generally registered with one or more state securities authorities and not with us. Under section 203A of the Advisers Act, most small advisers are prohibited from registering with the Commission and are regulated by state regulators. Based on IARD data, we estimate that as of April 1, 2015, approximately 489 advisers that are small entities are registered with the Commission.[177] Because these entities are registered, they, like all SEC-registered investment advisers, would all be subject to the proposed amendments to Form ADV, rule 204-2 and other Advisers Act rules.

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176 Rule 0-7(a) under the Advisers Act.

177 Based on SEC-registered investment adviser responses to Form ADV, Item 5.F and Item 12.

The only small entity exempt reporting advisers that would be subject to the proposed amendments would be exempt reporting advisers that maintain their principal office and place of business in Wyoming or outside the United States. Advisers with less than $25 million in assets under management generally are prohibited from registering with us unless they maintain their principal office and place of business in Wyoming or outside the United States. Exempt reporting advisers are not required to report regulatory assets under management on Form ADV and therefore we do not have a precise number of exempt reporting advisers that are small entities. Exempt reporting advisers are required to report in Part 1A, Schedule D the gross asset value of each private fund they manage.[178] Based on responses to that question, we estimate that there is approximately 1 exempt reporting adviser with its principal office and place of business in Wyoming that meets the definition of small entity. Advisers with their principal office and place of business outside the United States may have additional assets under management other than what is reported in Schedule D. Based on IARD filings, approximately 18% of registered investment advisers with their principal office and place of business outside the U.S. are small entities. There are approximately 1,148 exempt reporting advisers with their principal office and place of business outside the U.S. We estimate that 18% of those advisers, approximately 206, are small entities.

D. Reporting, Recordkeeping and Other Compliance Requirements

The proposed amendments to Form ADV and rule 204-2 would impose certain reporting, recordkeeping, and compliance requirements on all Commission-registered advisers, including small advisers. All Commission-registered small advisers would be required to file Form ADV,

[178] *See* Form ADV, Part 1A, Schedule D, Section 7.B.(1).A , Question 11.

including the proposed amendments, and all Commission-registered small advisers would be subject to the proposed amended recordkeeping requirements. We do not believe that our proposed technical amendments to other Advisers Act rules would impose different reporting, recordkeeping, or other compliance requirements on small advisers.

Proposed Form ADV Amendments

The proposed amendments to Form ADV would require registered investment advisers to report different or additional information than what is currently required. Approximately 489 small advisers currently registered with us would be subject to these requirements. We expect these 489 small advisers to spend, on average, 3 hours to respond to the proposed new and amended questions, not including items relating to private fund reporting.[179] We expect the aggregate cost to small advisers associated with this process would be $366,500.[180]

In addition, of these 489 small advisers, we estimate that 4 small advisers currently rely on the 2012 ABA Letter to act as filing advisers for their relying advisers.[181] We expect that our proposed changes to codify umbrella registration would take 4 hours[182] in the aggregate, at a cost to small advisers of $1,000. [183] We do not know how many additional small advisers would use

179 *See supra* section IV. of this release.

180 We expect that performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager. Data from the SIFMA *Management and Professional Earnings Report,* modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that costs for these positions are $217 and $283 per hour, respectively. 489 small advisers x 3 hours = 1,467 hours. [733 hours x $217 = $159,061] + [733 hours x $283 = $207,439] = $366,500.

181 Based on IARD data as of April 1, 2015.

182 For purposes of the Paperwork Reduction Act, we estimated in section IV. of this release that amendments to codify umbrella registration would take an additional 1 hour per filing adviser.

183 As discussed in connection with the Paperwork Reduction Act, we expect that performance of this function will most likely be equally allocated between a senior compliance examiner and a compliance manager.

umbrella registration if it was incorporated into Form ADV. We estimate for purposes of the Paperwork Reduction Act that they would also have a burden of 1 hour per filing adviser.

We do not estimate any increase or decrease in burden related to our proposed amendments for private fund advisers, other than the hours related to proposed Schedule R or for exempt reporting advisers. The total estimated labor costs associated with our amendments that we expect will be borne by small advisers is $367,500.[184]

Proposed Amendments to Books and Records Rule

Our proposed amendments to rule 204-2's performance information recordkeeping provisions are meant to require investment advisers to make and keep the following records: (i) documentation necessary to demonstrate the calculation of the performance the adviser distributes to any person, and (ii) all written communications received or sent relating to the adviser's performance. These amendments would create reporting, recordkeeping, and other compliance requirements for small advisers. As discussed in the Paperwork Reduction Act Analysis in section IV. above, the proposed amendments to rule 204-2 would increase the burden by approximately 0.5 hours per adviser. We expect the aggregate cost to small advisers associated with our proposed amendments would be $13,415.[185]

Data from the SIFMA *Management and Professional Earnings Report*, modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that costs for these positions are $217 and $283 per hour, respectively. 4 filing advisers x 1 hour = 4 hours. [2 hours x $217 = $434] + [2 hours x $283 = 566] = $1,000.

184 $366,500 + $1,000 = $367,500. These costs are discussed in Paperwork Reduction Act Analysis in section IV. of the release.

185 As discussed in connection with the Paperwork Reduction Act, we expect that performance of this function will most likely be allocated between compliance clerks and general clerks with compliance clerks performing 17% of the function and general clerks performing 83% of the function. Data from the SIFMA *Office Salaries in the Securities Industry Report 2013*, modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, suggest that

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe there are no federal rules that duplicate, overlap, or conflict with the proposed rule and form amendments.

F. Significant Alternatives

The Regulatory Flexibility Act directs the Commission to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. In connection with the proposed Form ADV and rule amendments, the Commission considered the following alternatives: (i) the establishment of differing compliance or reporting requirements that take into account the resources available to small entities; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements under the proposed Form ADV and rule amendments for such small entities; (iii) the use of performance rather than design standards; and (iv) an exemption from coverage of the proposed Form ADV and rule amendments, or any part thereof, for such small entities.

Regarding the first and second alternatives, for certain proposed reporting requirements regarding separately managed accounts on Form ADV, we propose to require semi-annual information filed annually for advisers with regulatory assets under management attributable to separately managed accounts of $10 billion or more and annual information for other advisers.[186] Requiring less detailed reporting on these items for advisers with less than $10 billion is designed to balance our regulatory needs for this type of information while seeking to minimize

costs for these positions are $64 and $53, respectively. 489 small advisers x 0.5 hours = 244.5 hours. [0.17 x 244.5 hours x $64 = $2,660] + [0.83 x 244.5 hours x $53 = $10,755] = $13,415.

186 Proposed Form ADV, Part 1A, Schedule D, Sections 5.K.(1).

the reporting burden on advisers that manage a smaller amount of separately managed account assets where appropriate.

Regarding the first and fourth alternatives for the other proposed amendments to Form ADV and Advisers Act rules, we do not believe that different compliance or reporting requirements or an exemption from coverage of the Form ADV and rule amendments, or any part thereof, for small entities, would be appropriate. Because the protections of the Advisers Act are intended to apply equally to clients of both large and small advisers, it would be inconsistent with the purposes of the Act to specify differences for small entities under the proposed amendments.

Regarding the second alternative for the other proposed amendments to Form ADV and the Advisers Act rules, we will continue to consider whether further clarification, consolidation, or simplification of the compliance requirements is feasible or necessary, but we believe that the current proposal is clear. The remaining Form ADV amendments do not change that all SEC-registered advisers use a single form, Form ADV, and an existing filing system, IARD, for reporting and registration purposes, and this would not change for small entities. With respect to the rule 204-2 amendments, we believe that the same requirements should apply to all advisers to permit our staff to more effectively examine them.

Regarding the third alternative, we consider using performance rather than design standards with respect to the proposed amendments to Form ADV and rule 204-2 to be inconsistent with our statutory mandate to protect investors, as advisers must provide certain registration information and maintain books and records in a uniform and quantifiable manner so that it is useful to our regulatory and examination program.

G. Solicitation of Comments

We encourage written comments on matters discussed in this IRFA. We solicit comment on the number of small entities subject to the proposed Form ADV and rule amendments; and whether the proposed Form ADV and rule amendments discussed in this release could have an effect on small entities that has not been considered. We request that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of such impact.

VI. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[187] we must advise OMB whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results in or is likely to result in (1) an annual effect on the economy of $100 million or more; (2) a major increase in costs or prices for consumers or individual industries; or (3) significant adverse effects on competition, investment or innovation.

We request comment on the potential impact of the proposed amendments on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VII. STATUTORY AUTHORITY

The Commission is proposing amendments to Form ADV under section 19(a) of the Securities Act of 1933 [15 U.S.C. 77s(a)], sections 23(a) and 28(e)(2) of the Securities Exchange

187 Public Law 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

Act of 1934 [15 U.S.C. 78w(a) and 78bb(e)(2)], section 319(a) of the Trust Indenture Act of 1939 [15 U.S.C. 7sss(a)], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a-37(a)], and sections 203(c)(1), 204, and 211(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-3(c)(1), 80b-4, and 80b-11(a)]. The Commission is proposing to amend rule 204-2 pursuant to the authority set forth in sections 204 and 211 of the Advisers Act [15 U.S.C. 80b-4 and 80b-11]. The Commission is proposing to amend rule 202(a)(11)(G)-1 pursuant to authority in sections 202(a)(11)(G) and 206A of the Advisers Act [15 U.S.C. 80b-2(a)(11)(G) and 80b-6A]. The Commission is proposing to amend rule 203-1 pursuant to authority in section 206A of the Advisers Act [15 U.S.C. 80b-6A]. The Commission is proposing to rescind rule 203A-5 and amend rule 204-1 pursuant to authority in sections 204 and 211(a) of the Advisers Act [15 U.S.C. 80b-4 and 80b-11(a)].

List of Subjects in 17 CFR Parts 275 and 279

Reporting and recordkeeping requirements; Securities.

TEXT OF RULE AND FORM AMENDMENTS

For the reasons set forth in the preamble, Title 17, Chapter II of the Code of Federal Regulations is proposed to be amended as follows.

PART 275 – RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

2. Amend § 275.202(a)(11)(G)-1 by removing paragraph (e).

3. Amend § 275.203-1 by:

    a. In paragraph (a) removing the phrase "Subject to paragraph (b), to" and adding in its place "To";

    b. Removing paragraphs (b);

    c. Removing the text "NOTE TO PARAGRAPHS (a) AND (b)" and adding in its place "Note To Paragraph (a)";

    d. Redesignating paragraphs (c) and (d) as paragraphs (b) and (c); and

    e. Removing paragraph (e).

4. § 275.203A-5 is removed and reserved.

5. Amend § 275.204-1 by:

    a. In paragraph (b)(1) removing the phrase "Subject to paragraph (c) of this section, you" and adding in its place "You";

    b. Removing paragraph (c); and

    c. Redesignating paragraphs (d) and (e) as paragraphs (c) and (d).

6. Amend § 275.204-2 paragraph (a)(7) by:

    a. In paragraph (iii) removing the ":" and adding in its place ", or";

    b. Redesignating paragraphs (iii)(a) and (b) as paragraphs (iii)(A) and (B); and

    c. Adding paragraph (iv) to read as follows:

§ 275.204-2 Books and records to be maintained by investment advisers

(a) ***

(7) ***

(iv) the performance or rate of return of any or all managed accounts or securities recommendations:

*****

7. Amend § 275.204-2 (a)(16) by removing the phrase " to 10 or more persons" and adding in its place "to any person".

PART 279 – FORMS PRESCRIBED UNDER THE INVESTMENT ADVISERS ACT OF 1940

8. The authority citation for Part 279 continues to read in part as follows:

Authority: The Investment Advisers Act of 1940, 15 U.S.C. 80b-1, et seq.

9. Form ADV [referenced in §279.1] is amended by:

a. In the instructions to the form, revising the section entitled "Form ADV: General Instructions." The revised version of Form ADV: General Instructions is attached as Appendix A;

b. In the instructions to the form, revising the section entitled "Form ADV: Instructions for Part 1A." The revised version of Form ADV: Instructions for Part 1A is attached as Appendix B;

c. In the instructions to the form, revising the section entitled "Form ADV: Glossary of Terms." The revised version of Form ADV: Glossary of Terms is attached as Appendix C;

d. In the form, revising Part 1A. The revised version of Form ADV, Part 1A, is attached as Appendix D.

Note: The text of Form ADV does not and the amendments will not appear in the Code of Federal Regulations.

By the Commission.

May 20, 2015

Robert W. Errett
Deputy Secretary

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND**
- **REPORT FORM BY EXEMPT REPORTING ADVISERS**

Form ADV: General Instructions

Read these instructions carefully before filing Form ADV. Failure to follow these instructions, properly complete the form, or pay all required fees may result in your application or report being delayed or rejected.

In these instructions and in Form ADV, "you" means the investment adviser (i.e., the advisory firm). If you are a "separately identifiable department or division" (SID) of a bank, "you" means the SID, rather than your bank, unless the instructions or the form provide otherwise. If you are a *private fund* adviser filing an *umbrella registration*, "you" means the *filing adviser* and each *relying adviser*, unless the instructions or the form provide otherwise. The information in Items 1, 2, 3 and 10 (including corresponding schedules) should be provided for the *filing adviser* only. Terms that appear in *italics* are defined in the Glossary of Terms to Form ADV.

1. Where can I get more information on Form ADV, electronic filing, and the IARD?

The SEC provides information about its rules and the Advisers Act on its website: <http://www.sec.gov/iard>.

NASAA provides information about state investment adviser laws and state rules, and how to contact a *state securities authority*, on its website: <http://www.nasaa.org>.

FINRA provides information about the IARD and electronic filing on the IARD website: <http://www.iard.com>.

2. What is Form ADV used for?

Investment advisers use Form ADV to:

- Register with the Securities and Exchange Commission
- Register with one or more *state securities authorities*
- Amend those registrations;

- Report to the SEC as an *exempt reporting adviser*
- Report to one or more *state securities authorities* as an *exempt reporting adviser*
- Amend those reports; and
- Submit a final report as an *exempt reporting adviser*

3. How is Form ADV organized?

Form ADV contains four parts:

- Part 1A asks a number of questions about you, your business practices, the *persons* who own and *control* you, and the *persons* who provide investment advice on your behalf.
  - All advisers registering with the SEC or any of the *state securities authorities* must complete Part 1A.
  - *Exempt reporting advisers* (that are not also registering with any *state securities authority*) must complete only the following Items of Part 1A: 1, 2, 3, 6, 7, 10, and 11, as well as corresponding schedules. *Exempt reporting advisers* that are registering with any *state securities authority* must complete all of Form ADV.

  Part 1A also contains several supplemental schedules. The items of Part 1A let you know which schedules you must complete.

  - Schedule A asks for information about your direct owners and executive officers.
  - Schedule B asks for information about your indirect owners.
  - Schedule C is used by paper filers to update the information required by Schedules A and B (see Instruction 18).
  - Schedule D asks for additional information for certain items in Part 1A.
  - Schedule R asks for additional information about *relying advisers*.
  - Disclosure Reporting Pages (or DRPs) are schedules that ask for details about disciplinary events involving you or your *advisory affiliates*.

- Part 1B asks additional questions required by *state securities authorities*. Part 1B contains three additional DRPs. If you are applying for SEC registration or are registered only with the SEC, you do not have to complete Part 1B. (If you are filing electronically and you do not have to complete Part 1B, you will not see Part 1B.)

- Part 2A requires advisers to create narrative *brochures* containing information about the advisory firm. The requirements in Part 2A apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*.

- Part 2B requires advisers to create *brochure supplements* containing information about certain *supervised persons*. The requirements in Part 2B apply to all investment advisers registered with or applying for registration with the SEC, but do not apply to *exempt reporting advisers*.

4. When am I required to update my Form ADV?

- SEC- and State-Registered Advisers:

  - Annual updating amendments: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all items, including corresponding sections of Schedules A, B, C, and D and all sections of Schedule R for each *relying adviser*. You must submit your summary of material changes required by Item 2 of Part 2A either in the *brochure* (cover page or the page immediately thereafter) or as an exhibit to your *brochure*.

- Other-than-annual amendments: In addition to your *annual updating amendment*, if you are registered with the SEC or a *state securities authority*, you must amend your Form ADV, including corresponding sections of Schedules A, B, C, D and R, by filing additional amendments (other-than-annual amendments) promptly if:

  - you are adding or removing a *relying adviser* as part of your *umbrella registration*
  - information you provided in response to Items 1 (except 1.O), 3, 9 (except 9.A.(2), 9.B.(2), 9.E., and 9.F.), or 11 of Part 1A or Items 1, 2.A. through 2.F., or 2.I. of Part 1B or Sections 1 or 3 of Schedule R becomes inaccurate in any way;
  - information you provided in response to Items 4, 8, or 10 of Part 1A, or Item 2.G. of Part 1B, or Section 10 of Schedule R becomes materially inaccurate; or
  - information you provided in your *brochure* becomes materially inaccurate (see note below for exceptions)

Notes: Part 1: If you are submitting an other-than-annual amendment, you are not required to update your responses to Items 2, 5, 6, 7, 9.A.(2), 9.B.(2), 9.E., 9.F., or 12 of Part 1A, Items 2.H. or 2.J. of Part 1B, or Section 2 of Schedule R even if your responses to those items have become inaccurate.

Part 2: You must amend your *brochure supplements* (see Form ADV, Part 2B) promptly if any information in them becomes materially inaccurate. If you are submitting an other-than-annual amendment to your *brochure*, you are not required to update your summary of material changes as required by Item 2. You are not required to update your *brochure* between annual amendments solely because the amount of *client* assets you manage has changed or because your fee schedule has changed. However, if you are updating your *brochure* for a separate reason in between annual amendments, and the amount of *client* assets you manage listed in response to Item 4.E or your fee schedule listed in response to Item 5.A has become materially inaccurate, you should update that item(s) as part of the interim amendment.

- If you are an SEC-registered adviser, you are required to file your *brochure* amendments electronically through IARD. You are not required to file amendments to your *brochure supplements* with the SEC, but you must maintain a copy of them in your files.

- <u>If you are a state-registered adviser</u>, you are required to file your *brochure* amendments and *brochure supplement* amendments with the appropriate *state securities authorities* through IARD.

- <u>*Exempt reporting advisers*</u>:

  - <u>Annual Updating Amendments</u>: You must amend your Form ADV each year by filing an *annual updating amendment* within 90 days after the end of your fiscal year. When you submit your *annual updating amendment*, you must update your responses to all required items, including corresponding sections of Schedules A, B, C and D.

  - <u>Other-than-Annual Amendments</u>: In addition to your *annual updating amendment*, you must amend your Form ADV by filing additional amendments (other-than-annual amendments) <u>promptly</u> if:

    - information you provided in response to Items 1, 3, or 11 becomes inaccurate in any way; or
    - information you provided in response to Item 10 becomes <u>materially</u> inaccurate.

Failure to update your Form ADV, as required by this instruction, is a violation of SEC rules or similar state rules and could lead to your registration being revoked.

5. What is SEC *umbrella registration* and how can I satisfy the requirements of filing an *umbrella registration*?

An *umbrella registration* is a single registration by a *filing adviser* and one or more *relying advisers* who advise only *private funds* and certain separately managed account *clients* that are *qualified clients* and collectively conduct a single advisory business. Absent other facts suggesting that the *filing adviser* and *relying adviser(s)* conduct different businesses, *umbrella registration* is available under the following circumstances:

i. The *filing adviser* and each *relying adviser* advise only *private funds* and *clients* in separately managed accounts that are *qualified clients* and are otherwise eligible to invest in the *private funds* advised by the *filing adviser* or a *relying adviser* and whose accounts pursue investment objectives and strategies that are substantially similar or otherwise related to those *private funds*.

ii. The *filing adviser* has its *principal office and place of business* in the United States and, therefore, all of the substantive provisions of the Advisers Act and the rules thereunder apply to the *filing adviser's* and each *relying adviser's* dealings with each of its *clients*, regardless of whether any *client* or the *filing adviser* or *relying adviser* providing the advice is a *United States person*.

iii. Each *relying adviser*, its *employees* and the *persons* acting on its behalf are subject to the *filing adviser's* supervision and *control* and, therefore, each *relying adviser*, its *employees* and the *persons* acting on its behalf are "persons associated with" the *filing adviser* (as defined in section 202(a)(17) of the Advisers Act).

iv. The advisory activities of each *relying adviser* are subject to the Advisers Act and the rules thereunder, and each *relying adviser* is subject to examination by the SEC.

v. The *filing adviser* and each *relying adviser* operate under a single code of ethics adopted in accordance with SEC rule 204A-1 and a single set of written policies and procedures adopted and implemented in accordance with SEC rule 206(4)-(7) and administered by a single chief compliance officer in accordance with that rule.

To satisfy the requirements of Form ADV while using *umbrella registration* the *filing adviser* must sign, file, and update as required, a single Form ADV (Parts 1 and 2) that relates to, and includes all information concerning, the *filing adviser* and each *relying adviser* (e.g., disciplinary information and ownership information), and must include this same information in any other reports or filings it must make under the Advisers Act or the rules thereunder (e.g., Form PF). The *filing adviser* and each *relying adviser* must not be prohibited from registering with the SEC by section 203A of the Advisers Act (i.e. the *filing adviser* and each *relying adviser* must individually qualify for SEC registration).

Unless otherwise specified, references to "you" in Form ADV refer to both the *filing adviser* and each *relying adviser*. The information in Items 1, 2, 3 and 10 (including corresponding schedules) should be provided for the *filing adviser* only. A separate Schedule R should be completed for each *relying adviser*. References to "you" in Schedule R refer to the *relying adviser* only.

A *filing adviser* applying for registration with the SEC should complete a Schedule R for each *relying adviser*. If you are a *filing adviser* registered with the SEC and would like to add or delete *relying advisers* from an *umbrella registration, you* should file an other-than-annual amendment and add or delete Schedule Rs as needed.

Note: *Umbrella registration* is not available to *exempt reporting advisers*.

6. Where do I sign my Form ADV application or amendment?

You must sign the appropriate Execution Page. There are three Execution Pages at the end of the form. Your initial application, your initial report (in the case of an *exempt reporting adviser*), and all amendments to Form ADV must include at least one Execution Page.

- If you are applying for or are amending your SEC registration, or if you are reporting as an *exempt reporting adviser* or amending your report, you must sign and submit either a:
  - Domestic Investment Adviser Execution Page, if you (the advisory firm) are a resident of the United States; or

- *Non-Resident* Investment Adviser Execution Page, if you (the advisory firm) are not a resident of the United States.

- If you are applying for or are amending your registration with a *state securities authority*, you must sign and submit the State-Registered Investment Adviser Execution Page.

7. **Who must sign my Form ADV or amendment?**

The individual who signs the form depends upon your form of organization:

- For a sole proprietorship, the sole proprietor.
- For a partnership, a general partner.
- For a corporation, an authorized principal officer.
- For a "separately identifiable department or division" (SID) of a bank, a principal officer of your bank who is directly engaged in the management, direction, or supervision of your investment advisory activities.
- For all others, an authorized individual who participates in managing or directing your affairs.

The signature does not have to be notarized, and in the case of an electronic filing, should be a typed name.

8. **How do I file my Form ADV?**

Complete Form ADV electronically using the Investment Adviser Registration Depository (IARD) if:

- You are filing with the SEC (and submitting *notice filings* to any of the *state securities authorities*), or

- You are filing with a *state securities authority* that requires or permits advisers to submit Form ADV through the IARD.

  Note: SEC rules require advisers that are registered or applying for registration with the SEC, or that are reporting to the SEC as an *exempt reporting adviser*, to file electronically through the IARD system. See SEC rules 203-1 and 204-4.

To file electronically, go to the IARD website (<www.iard.com>), which contains detailed instructions for advisers to follow when filing through the IARD.

Complete Form ADV (Paper Version) on paper if:

- You are filing with the SEC or a *state securities authority* that requires electronic filing, but you have been granted a continuing hardship exemption. Hardship exemptions are described in Instruction 17.

- You are filing with a *state securities authority* that permits (but does not require) electronic filing and you do not file electronically.

9. How do I get started filing electronically?

First, obtain a copy of the IARD Entitlement Package from the following website: <http://www.iard.com/GetStarted.asp>. Second, request access to the IARD system for your firm by completing and submitting the IARD Entitlement Package. The IARD Entitlement Package must be submitted on paper. Mail the forms to: FINRA Entitlement Group, P.O. Box 9495, Gaithersburg, MD 20898-9495.

When FINRA receives your Entitlement Package, they will assign a *CRD* number (identification number for your firm) and a user I.D. code and password (identification number and system password for the individual(s) who will submit Form ADV filings for your firm). Your firm may request an I.D. code and password for more than one individual. FINRA also will create a financial account for you from which the IARD will deduct filing fees and any state fees you are required to pay. If you already have a *CRD* account with FINRA, it will also serve as your IARD account; a separate account will not be established.

Once you receive your *CRD* number, user I.D. code and password, and you have funded your account, you are ready to file electronically.

Questions regarding the Entitlement Process should be addressed to FINRA at 240.386.4848.

10. If I am applying for registration with the SEC, or amending my SEC registration, how do I make *notice filings* with the *state securities authorities*?

If you are applying for registration with the SEC or are amending your SEC registration, one or more *state securities authorities* may require you to provide them with copies of your SEC filings. We call these filings "*notice filings*." Your *notice filings* will be sent electronically to the states that you check on Item 2.C. of Part 1A. The *state securities authorities* to which you send *notice filings* may charge fees, which will be deducted from the account you establish with FINRA. To determine which *state securities authorities* require SEC-registered advisers to submit *notice filings* and to pay fees, consult the relevant state investment adviser law or *state securities authority*. See General Instruction 1.

If you are granted a continuing hardship exemption to file Form ADV on paper, FINRA will enter your filing into the IARD and your *notice filings* will be sent electronically to the *state securities authorities* that you check on Item 2.C. of Part 1A.

11. I am registered with a state. When must I switch to SEC registration?

If at the time of your *annual updating amendment* you meet at least one of the requirements for SEC registration in Item 2.A.(1) to (12) of Part 1A, you must apply for registration with the SEC within 90 days after you file the *annual updating amendment*. Once you register with the

SEC, you are subject to SEC regulation, regardless of whether you remain registered with one or more states. See SEC rule 203A-1(b)(2). Each of your *investment adviser representatives*, however, may be subject to registration in those states in which the representative has a place of business. See Advisers Act section 203A(b)(1); SEC rule 203A-3(a). For additional information, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

12. I am registered with the SEC. When must I switch to registration with a *state securities authority*?

If you check box 13 in Item 2.A. of Part 1A to report on your *annual updating amendment* that you are no longer eligible to register with the SEC, you must withdraw from SEC registration within 180 days after the end of your fiscal year by filing Form ADV-W. See SEC rule 203A-1(b)(2). You should consult state law or the *state securities authority* for the states in which you are "doing business" to determine if you are required to register in these states. See General Instruction 1. Until you file your Form ADV-W with the SEC, you will remain subject to SEC regulation, and you also will be subject to regulation in any states where you register. See SEC rule 203A-1(b)(2).

13. I am an *exempt reporting adviser*. When must I submit my first report on Form ADV?

- All *exempt reporting advisers*:
  You must submit your initial Form ADV filing within 60 days of relying on the exemption from registration under either section 203(l) of the Advisers Act as an adviser solely to one or more venture capital funds or section 203(m) of the Advisers Act because you act solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million.

- Additional instruction for advisers switching from being registered to being *exempt reporting advisers*:
  If you are currently registered as an investment adviser (or have an application for registration pending) with the SEC or with a *state securities authority*, you must file a Form ADV-W to withdraw from registration in the jurisdictions where you are switching. You must submit the Form ADV-W before submitting your first report as an *exempt reporting adviser*.

14. I am an *exempt reporting adviser*. Is it possible that I might be required to also register with or submit a report to a *state securities authority*?

Yes, you may be required to register with or submit a report to one or more *state securities authorities*. If you are required to register with one or more *state securities authorities*, you must complete all of Form ADV. See General Instruction 3. If you are required to submit a report to one or more *state securities authorities*, check the box(es) in Item 2.C. of Part 1A next to the state(s) you would like to receive the report. Each of your *investment adviser representatives* may also be subject to registration requirements. For additional information about the requirements that may apply to you, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

15. What do I do if I no longer meet the definition of an "*exempt reporting adviser*"?

- Advisers Switching to SEC Registration:

    - You may no longer be an *exempt reporting adviser* and may be required to register with the SEC if you wish to continue doing business as an investment adviser. For example, you may be relying on section 203(l) and wish to accept a *client* that is not a venture capital fund as defined in SEC rule 203(l)-1, or you may have been relying on SEC rule 203(m)-1 and reported in Section 2.B. of Schedule D to your *annual updating amendment* that you have *private fund* assets of $150 million or more.

        - If you are relying on section 203(l), unless you qualify for another exemption, you would violate the Advisers Act's registration requirement if you accept a *client* that is not a venture capital fund as defined in SEC rule 203(l)-1 before the SEC approves your application for registration. You must submit your final report as an *exempt reporting adviser* and apply for SEC registration in the same filing.

        - If you were relying on SEC rule 203(m)-1 and you reported in Section 2.B. of Schedule D to your *annual updating amendment* that you have *private fund* assets of $150 million or more, you must register with the SEC unless you qualify for another exemption. If you have complied with all SEC reporting requirements applicable to an *exempt reporting adviser* as such, you have up to 90 days after filing your *annual updating amendment* to apply for SEC registration, and you may continue doing business as a *private fund* adviser during this time. You must submit your final report as an *exempt reporting adviser* and apply for SEC registration in the same filing. Unless you qualify for another exemption, you would violate the Advisers Act's registration requirement if you accept a *client* that is not a *private fund* during this transition period before the SEC approves your application for registration, and you must comply with all SEC reporting requirements applicable to an *exempt reporting adviser* as such during this 90-day transition period. If you have not complied with all SEC reporting requirements applicable to an *exempt reporting adviser* as such, this 90-day transition period is not available to you. Therefore, if the transition period is not available to you, and you do not qualify for another exemption, your application for registration must be approved by the SEC before you meet or exceed SEC rule 203(m)-1's $150 million asset threshold.

- You will be deemed in compliance with the Form ADV filing and reporting requirements until the SEC approves or denies your application. If your application is approved, you will be able to continue business as a registered adviser.

- If you register with the SEC, you may be subject to state *notice filing* requirements. To determine these requirements, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

Note: If you are relying on SEC rule 203(m)-1 and you accept a *client* that is not a *private fund*, you will lose the exemption provided by SEC rule 203(m)-1 immediately. To avoid this result, you should apply for SEC registration in advance so that the SEC has approved your registration before you accept a *client* that is not a *private fund.*

The 90-day transition period described above also applies to investment advisers with their *principal offices and places of business* outside of the United States with respect to their *clients* who are *United States persons* (e.g., the adviser would not be eligible for the 90-day transition period if it accepted a *client* that is a *United States person* and is not a *private fund*).

- Advisers Not Switching to SEC Registration:

  - You may no longer be an *exempt reporting adviser* but may not be required to register with the SEC or may be prohibited from doing so. For example, you may cease to do business as an investment adviser, become eligible for an exemption that does not require reporting, or be ineligible for SEC registration. In this case, you must submit a final report as an *exempt reporting adviser* to update only Item 1 of Part 1A of Form ADV.

  - You may be subject to state registration requirements. To determine these requirements, consult the investment adviser laws or the *state securities authority* for the particular state in which you are "doing business." See General Instruction 1.

16. Are there filing fees?

Yes. These fees go to support and maintain the IARD. The IARD filing fees are in addition to any registration or other fee that may be required by state law. You must pay an IARD filing fee for your initial application, your initial report, and each *annual updating amendment*. There is no filing fee for an other-than-annual amendment, a final report as an *exempt reporting adviser*, or Form ADV-W. The IARD filing fee schedule is published at <http://www.sec.gov/iard>; <http://www.nasaa.org>; and <http://www.iard.com>.

If you are submitting a paper filing under a continuing hardship exemption (see Instruction 17), you are required to pay an additional fee. The amount of the additional fee depends on whether you are filing Form ADV or Form ADV-W. (There is no additional fee for filings made on Form ADV-W.) The hardship filing fee schedule is available by contacting FINRA at 240.386.4848.

17. What if I am not able to file electronically?

If you are required to file electronically but cannot do so, you may be eligible for one of two types of hardship exemptions from the electronic filing requirements.

- A **temporary hardship exemption** is available if you file electronically, but you encounter unexpected difficulties that prevent you from making a timely filing with the IARD, such as a computer malfunction or electrical outage. This exemption does not permit you to file on paper; instead, it extends the deadline for an electronic filing for seven business days. See SEC rules 203-3(a) and 204-4(e).

- A **continuing hardship exemption** may be granted if you are a small business and you can demonstrate that filing electronically would impose an undue hardship. You are a small business, and may be eligible for a continuing hardship exemption, if you are required to answer Item 12 of Part 1A (because you have assets under management of less than $25 million) and you are able to respond "no" to each question in Item 12. See SEC rule 0-7.

  If you have been granted a continuing hardship exemption, you must complete and submit the paper version of Form ADV to FINRA. FINRA will enter your responses into the IARD. As discussed in General Instruction 16, FINRA will charge you a fee to reimburse it for the expense of data entry.

18. I am eligible to file on paper. How do I make a paper filing?

When filing on paper, you must:

- Type all of your responses.
- Include your name (the same name you provide in response to Item 1.A. of Part 1A) and the date on every page.
- If you are amending your Form ADV:
  - complete page 1 and circle the number of any item for which you are changing your response.
  - include your SEC 801-number (if you have one), or your 802-number (if you have one), and your *CRD* number (if you have one) on every page.
  - complete the amended item in full and circle the number of the item for which you are changing your response.
  - to amend Schedule A or Schedule B, complete and submit Schedule C.

Where you submit your paper filing depends on why you are eligible to file on paper:

- If you are filing on paper because you have been granted a continuing hardship exemption, submit one manually signed Form ADV and one copy to: IARD Document Processing, FINRA, P.O. Box 9495, Gaithersburg, MD 20898-9495.

  If you complete Form ADV on paper and submit it to FINRA but you do not have a continuing hardship exemption, the submission will be returned to you.

- If you are filing on paper because a state in which you are registered or in which you are applying for registration allows you to submit paper instead of electronic filings, submit one manually signed Form ADV and one copy to the appropriate *state securities authorities*.

19. Who is required to file Form ADV-NR?

Every *non-resident* general partner and *managing agent* of all SEC-registered advisers and *exempt reporting advisers*, whether or not the adviser is resident in the United States, must file Form ADV-NR in connection with the adviser's initial application or report. A general partner or *managing agent* of an SEC-registered adviser or *exempt reporting adviser* who becomes a *non-resident* after the adviser's initial application or report has been submitted must file Form ADV-NR within 30 days. Form ADV-NR must be filed on paper (it cannot be filed electronically).

Submit Form ADV-NR to the SEC at the following address:

> Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549; Attn: Registrations Branch.

Failure to file Form ADV-NR promptly may delay SEC consideration of your initial application.

Federal Information Law and Requirements

Sections 203 and 204 of the Advisers Act [15 U.S.C. §§ 80b-3 and 80b-4] authorize the SEC to collect the information required by Form ADV. The SEC collects the information for regulatory purposes, such as deciding whether to grant registration. Filing Form ADV is mandatory for advisers who are required to register with the SEC and for *exempt reporting advisers*. The SEC maintains the information submitted on this form and makes it publicly available. The SEC may return forms that do not include required information. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. § 1001 and 15 U.S.C. § 80b-17.

SEC's Collection of Information

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The Advisers Act authorizes the SEC to collect the information on Form ADV from investment advisers. See 15 U.S.C. §§ 80b-3 and 80b-4. Filing the form is mandatory.

The form enables the SEC to register investment advisers and to obtain information from and about *exempt reporting advisers*. Every applicant for registration with the SEC as an adviser, and every *exempt reporting adviser*, must file the form. See 17 C.F.R. § 275.203-1 and 204-4. By accepting a form, however, the SEC does not make a finding that it has been completed or submitted correctly. The form is filed annually by every adviser, no later than 90 days after the end of its fiscal year, to amend its registration or its report. It is also filed promptly during the year to reflect material changes. See 17 C.F.R. § 275.204-1. The SEC maintains the information on the form and makes it publicly available through the IARD.

Anyone may send the SEC comments on the accuracy of the burden estimate on page 1 of the form, as well as suggestions for reducing the burden. The Office of Management and Budget has reviewed this collection of information under 44 U.S.C. § 3507.

The information contained in the form is part of a system of records subject to the Privacy Act of 1974, as amended. The SEC has published in the Federal Register the Privacy Act System of Records Notice for these records.

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND**
- **REPORT BY EXEMPT REPORTING ADVISERS**

Form ADV: Instructions for Part 1A

These instructions explain how to complete certain items in Part 1A of Form ADV.

1. Item 1: Identifying Information

Separately Identifiable Department or Division of a Bank. If you are a "separately identifiable department or division" (SID) of a bank, answer Item 1.A. with the full legal name of your bank, and answer Item 1.B. with your own name (the name of the department or division) and all names under which you conduct your advisory business. In addition, your *principal office and place of business* in Item 1.F. should be the principal office at which you conduct your advisory business. In response to Item 1.I., the website addresses and social media information you list on Schedule D should be those that provide information about your own activities, rather than general information about your bank.

2. Item 2: SEC Registration and SEC Report by *Exempt Reporting Advisers*

If you are registered or applying for registration with the SEC, you must indicate in Item 2.A. why you are eligible to register with the SEC by checking at least one of the boxes.

a. **Item 2.A.(1): Adviser with Regulatory Assets Under Management of $100 Million or More.** You may check box 1 only if your response to Item 5.F.(2)(c) is $100 million or more, or you are filing an *annual updating amendment* with the SEC and your response to Item 5.F.(2)(c) is $90 million or more. While you may register with the SEC if your regulatory assets under management are at least $100 million but less than $110 million, you must apply for registration with the SEC if your regulatory assets under management are $110 million or more. If you are a SEC-registered adviser, you may remain registered with the SEC if your regulatory assets under management are $90 million or more. See SEC rule 203A-1(a). Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

   If you are a state-registered adviser and you report on your *annual updating amendment* that your regulatory assets under management increased to $100 million or more, you may register with the SEC. If your regulatory assets under management increased to $110 million or more, you must apply for registration with the SEC within 90 days after you file that *annual updating amendment.* See SEC rule 203A-1(b)(1) and Form ADV General Instruction 11.

b. **Item 2.A.(2): Mid-Sized Adviser.** You may check box 2 only if your response to Item 5.F(2)(c) is $25 million or more but less than $100 million, and you satisfy one of the requirements below. Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

You must register with the SEC if you meet at least one of the following requirements:

- You are not required to be registered as an investment adviser with the *state securities authority* of the state where you maintain your *principal office and place of business* pursuant to that state's investment adviser laws. If you are exempt from registration with that state or are excluded from the definition of investment adviser in that state, you must register with the SEC. You should consult the investment adviser laws or the *state securities authority* for the particular state in which you maintain your *principal office and place of business* to determine if you are required to register in that state. See General Instruction 1.

- You are not subject to examination by the *state securities authority* of the state where you maintain your *principal office and place of business*. To determine whether such *state securities authority* does not conduct such examinations, see: http://www.sec.gov/divisions/investment/midsizedadviserinfo.htm.

See section 203A(a)(2) of the Advisers Act.

c. **Item 2.A.(5): Adviser to an Investment Company.** You may check box 5 only if you currently provide advisory services under an investment advisory contract to an investment company registered under the Investment Company Act of 1940 and the investment company is operational (i.e., has assets and shareholders, other than just the organizing shareholders). See sections 203A(a)(1)(B) and 203A(a)(2)(A) of the Advisers Act. Advising investors about the merits of investing in mutual funds or recommending particular mutual funds does not make you eligible to check this box.

d. **Item 2.A.(6): Adviser to a Business Development Company. You may check box 6 only** if your response to Item 5.F.(2)(c) is $25 million or more of regulatory assets under management, and you currently provide advisory services under an investment advisory contract to a company that has elected to be a business development company pursuant to section 54 of the Investment Company Act of 1940, that has not withdrawn the election, and that is operational (i.e., has assets and shareholders, other than just the organizing shareholders). See section 203A(a)(2)(A) of the Advisers Act. Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management.

e. **Item 2.A.(7): Pension Consultant.** You may check box 7 only if you are eligible for the pension consultant exemption from the prohibition on SEC registration.

   - You are eligible for this exemption if you provided investment advice to employee benefit plans, governmental plans, or church plans with respect to assets having an aggregate value of $200 million or more during the 12-month period that ended within 90 days of filing this Form ADV. You are not eligible for this exemption if you only advise plan participants on allocating their investments within their pension plans. See SEC rule 203A-2(a).

- To calculate th e value of assets for purposes of this exemption, aggregate the assets of the plans for which you provided advisory services at the end of the 12-month period. If you provided advisory services to other plans during the 12-month period, but your employment or contract terminated before the end of the 12-month period, you also may include the value of those assets.

f. **Item 2.A.(8): Related Adviser.** You may check box 8 only if you are eligible for the related adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(b). You are eligible for this exemption if you *control*, are *controlled* by, or are under common *control* with an investment adviser that is registered with the SEC, and you have the same *principal office and place of business* as that other investment adviser. Note that you may not rely on the SEC registration of an Internet adviser under rule 203A-2(e) in establishing eligibility for this exemption. See SEC rule 203A-2(e)(1)(iii). If you check box 8, you also must complete Section 2.A.(8) of Schedule D.

g. **Item 2.A.(9): Adviser Expecting to be Eligible for Registration within 120 Days.** You may check box 9 only if you are eligible for the exemption from the prohibition on SEC registration available to advisers expecting to be eligible for SEC registration within 120 days, such as a newly formed adviser. See SEC rule 203A-2(c). You are eligible for this exemption if immediately before you file your application for registration with the SEC,

- you were not registered or required to be registered with the SEC or a *state securities authority;* and

- you have a reasonable expectation that you would be eligible to register with the SEC within 120 days after the date that your registration with the SEC becomes effective.

If you check box 9, you also must complete Section 2.A.(9) of Schedule D.

You must file an amendment to Part 1A of your Form ADV that updates your response to Item 2.A. within 120 days after the SEC declares your registration effective. You may not check box 9 on your amendment; since this exemption is available only if you are not registered, you may not "re-rely" on this exemption. If you indicate on that amendment (by checking box 13) that you are not eligible to register with the SEC, you also must file a Form ADV-W to withdraw your SEC registration no later than 120 days after your registration was declared effective. You should contact the appropriate *state securities authority* to determine how long it may take to become state-registered sufficiently in advance of when you are required to file Form ADV-W to withdraw from SEC registration.

Note: If you expect to be eligible for SEC registration because of the amount of your regulatory assets under management, that amount must be $100 million or more no later than 120 days after your registration is declared effective.

h. **Item 2.A.(10): Multi-State Adviser.** You may check box 10 only if you are eligible for the multi-state adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(d). You are eligible for this exemption if you are required to register as an investment adviser with the *state securities authorities* of 15 or more states. If you check box 10, you must complete Section 2.A.(10) of Schedule D. You must complete Section 2.A.(10) of Schedule D in each *annual updating amendment* you submit.

If you check box 10, you also must:

- create and maintain a list of the states in which, but for this exemption, you would be required to register;
- update this list each time you submit an *annual updating amendment* in which you continue to represent that you are eligible for this exemption; and
- maintain the list in an easily accessible place for a period of not less than five years from each date on which you indicate that you are eligible for the exemption.

If, at the time you file your *annual updating amendment*, you are required to register in less than 15 states and you are not otherwise eligible to register with the SEC, you must check box 13 in Item 2.A. You also must file a Form ADV-W to withdraw your SEC registration. See Part 1A Instruction 2.j.

i. **Item 2.A.(11): Internet Adviser**. You may check box 11 only if you are eligible for the Internet adviser exemption from the prohibition on SEC registration. See SEC rule 203A-2(e). You are eligible for this exemption if:

- you provide investment advice to your *clients* through an interactive website. An interactive website means a website in which computer software-based models or applications provide investment advice based on personal information each *client* submits through the website. Other forms of online or Internet investment advice do not qualify for this exemption;

- you provide investment advice to all of your *clients* exclusively through the interactive website, except that you may provide investment advice to fewer than 15 *clients* through other means during the previous 12 months; and

- you maintain a record demonstrating that you provide investment advice to your *clients* exclusively through an interactive website in accordance with these limits.

j. **Item 2.A.(13): Adviser No Longer Eligible to Remain Registered with the SEC.** You must check box 13 if:

- you are registered with the SEC;

- you are filing an *annual updating amendment* to Form ADV in which you indicate in response to Item 5.F.(2)(c) that you have regulatory assets under management of less than $90 million; <u>and</u>
- you are not eligible to check any other box (other than box 13) in Item 2.A. (and are therefore no longer eligible to remain registered with the SEC).

You must withdraw from SEC registration within 180 days after the end of your fiscal year by filing Form ADV-W. Until you file your Form ADV-W, you will remain subject to SEC regulation, and you also will be subject to regulation in the states in which you register. See SEC rule 203A-1(b)(2).

k. **Item 2.B.: Reporting by *Exempt Reporting Advisers*.** You may check box 2.B.(1) <u>only</u> if you qualify for the exemption from SEC registration as an adviser solely to one or more venture capital funds. See SEC rule 203(l)-1. You may check box 2.B.(2) <u>only</u> if you qualify for the exemption from SEC registration because you act solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million. See SEC rule 203(m)-1. You may check both boxes to indicate that you qualify for both exemptions. You should check box 2.B.(3) if you act solely as an adviser to *private funds* but you are no longer eligible to check box 2.B.(2) because you have assets under management in the United States of $150 million or more. If you check box 2.B.(2) or (3), you also must complete Section 2.B. of Schedule D.

3. Item 3: Form of Organization

If you are a "separately identifiable department or division" (SID) of a bank, answer Item 3.A. by checking "other." In the space provided, specify that you are a "SID of" and indicate the form of organization of your bank. Answer Items 3.B. and 3.C. with information about your bank.

4. Item 4: Successions

a. **Succession of an SEC-Registered Adviser.** If you (1) have taken over the business of an investment adviser <u>or</u> (2) have changed your structure or legal status (e.g., form of organization or state of incorporation), a new organization has been created, which has registration obligations under the Advisers Act. There are different ways to fulfill these obligations. You may rely on the registration provisions discussed in the General Instructions, or you may be able to rely on special registration provisions for "successors" to SEC-registered advisers, which may ease the transition to the successor adviser's registration.

To determine if you may rely on these provisions, review "Registration of Successors to Broker-Dealers and Investment Advisers," Investment Advisers Act Release No. 1357 (Dec. 28, 1992). If you have taken over an adviser, follow Part 1A Instruction 4.a(1), Succession by Application. If you have changed your structure or legal status, follow Part 1A Instruction 4.a(2), Succession by Amendment. If either (1) you are a "separately identifiable department or division" (SID) of a bank that is currently registered as an investment adviser, and you are taking over your bank's advisory business; or (2) you are a SID currently registered as an investment adviser, and your bank is taking over your advisory business, then follow Part 1A Instruction 4.a(1), Succession by Application.

(1) **Succession by Application.** If you are not registered with the SEC as an adviser, and you are acquiring or assuming substantially all of the assets and liabilities of the advisory business of an SEC-registered adviser, file a new application for registration on Form ADV. You will receive new registration numbers. You must file the new application within 30 days after the succession. On the application, make sure you check "yes" to Item 4.A., enter the date of the succession in Item 4.B., and complete Section 4 of Schedule D.

Until the SEC declares your new registration effective, you may rely on the registration of the adviser you are acquiring, but only if the adviser you are acquiring is no longer conducting advisory activities. Once your new registration is effective, a Form ADV-W must be filed with the SEC to withdraw the registration of the acquired adviser.

(2) **Succession by Amendment.** If you are a new investment adviser formed solely as a result of a change in form of organization, a reorganization, or a change in the composition of a partnership, and there has been no practical change in *control* or management, you may amend the registration of the registered investment adviser to reflect these changes rather than file a new application. You will keep the same registration numbers, and you should not file a Form ADV-W. On the amendment, make sure you check "yes" to Item 4.A., enter the date of the succession in Item 4.B., and complete Section 4 of Schedule D. You <u>must</u> submit the amendment within 30 days after the change or reorganization.

b. **Succession of a State-Registered Adviser.** If you (1) have taken over the business of an investment adviser <u>or</u> (2) have changed your structure or legal status (e.g., form of organization or state of incorporation), a new organization has been created, which has registration obligations under state investment adviser laws. There may be different ways to fulfill these obligations. You should contact each state in which you are registered to determine that state's requirements for successor registration. See Form ADV General Instruction 1.

5. Item 5: Information About Your Advisory Business

a. **Newly-Formed Advisers:** Several questions in Item 5 that ask about your advisory business assume that you have been operating your advisory business for some time. Your response to these questions should reflect your current advisory business (i.e., at the time you file your Form ADV), with the following exceptions:

- base your response to Item 5.E. on the types of compensation you expect to accept;
- base your response to Item 5.G. and Item 5.J. on the types of advisory services you expect to provide during the next year; and

- skip Item 5.H.

b. **Item 5.F: Calculating Your Regulatory Assets Under Management.** In determining the amount of your regulatory assets under management, include the securities portfolios for which you provide continuous and regular supervisory or management services as of the date of filing this Form ADV.

(1) **Securities Portfolios.** An account is a securities portfolio if at least 50% of the total value of the account consists of securities. For purposes of this 50% test, you may treat cash and cash equivalents (i.e., bank deposits, certificates of deposit, bankers acceptances, and similar bank instruments) as securities. You must include securities portfolios that are:

(a) your family or proprietary accounts;

(b) accounts for which you receive no compensation for your services; and

(c) accounts of *clients* who are not *United States persons*.

For purposes of this definition, treat all of the assets of a *private fund* as a securities portfolio, regardless of the nature of such assets. For accounts of *private funds*, moreover, include in the securities portfolio any uncalled commitment pursuant to which a *person* is obligated to acquire an interest in, or make a capital contribution to, the *private fund*.

(2) **Value of Portfolio.** Include the entire value of each securities portfolio for which you provide continuous and regular supervisory or management services. If you provide continuous and regular supervisory or management services for only a portion of a securities portfolio, include as regulatory assets under management only that portion of the securities portfolio for which you provide such services. Exclude, for example, the portion of an account:

(a) under management by another *person*; or

(b) that consists of real estate or businesses whose operations you "manage" on behalf of a *client* but not as an investment.

Do not deduct any outstanding indebtedness or other accrued but unpaid liabilities.

(3) **Continuous and Regular Supervisory or Management Services.**

General Criteria. You provide continuous and regular supervisory or management services with respect to an account if:

(a) you have *discretionary authority* over and provide ongoing supervisory or management services with respect to the account; or

(b) you do not have *discretionary authority* over the account, but you have ongoing responsibility to select or make recommendations, based upon the needs of the *client*, as to specific securities or other investments the account may purchase or sell and, if such recommendations are accepted by the *client*, you are responsible for arranging or effecting the purchase or sale.

Factors. You should consider the following factors in evaluating whether you provide continuous and regular supervisory or management services to an account.

(a) **Terms of the advisory contract.** If you agree in an advisory contract to provide ongoing management services, this suggests that you provide these services for the account. Other provisions in the contract, or your actual management practices, however, may suggest otherwise.

(b) **Form of compensation.** If you are compensated based on the average value of the *client's* assets you manage over a specified period of time, that suggests that you provide continuous and regular supervisory or management services for the account. If you receive compensation in a manner similar to either of the following, that suggests you <u>do</u> <u>not</u> provide continuous and regular supervisory or management services for the account --

(i) you are compensated based upon the time spent with a *client* during a *client* visit; or

(ii) you are paid a retainer based on a percentage of assets covered by a financial plan.

(c) **Management practices.** The extent to which you actively manage assets or provide advice bears on whether the services you provide are continuous and regular supervisory or management services. The fact that you make infrequent trades (e.g., based on a "buy and hold" strategy) does not mean your services are not "continuous and regular."

Examples. You <u>may</u> provide continuous and regular supervisory or management services for an account if you:

(a) have *discretionary authority* to allocate *client* assets among various mutual funds;

(b) do not have *discretionary authority*, but provide the same allocation services, and satisfy the criteria set forth in Instruction 5.b.(3);

(c) allocate assets among other managers (a "manager of managers"), but only if you have *discretionary authority* to hire and fire managers and reallocate assets among them; or

(d) you are a broker-dealer and treat the account as a brokerage account, but only if you have *discretionary authority* over the account.

You <u>do</u> <u>not</u> provide continuous and regular supervisory or management services for an account if you:

(a) provide market timing recommendations (i.e., to buy or sell), but have no ongoing management responsibilities;

(b) provide only *impersonal investment advice* (e.g., market newsletters);

(c) make an initial asset allocation, without continuous and regular monitoring and reallocation; or

(d) provide advice on an intermittent or periodic basis (such as upon *client* request, in response to a market event, or on a specific date (e.g., the account is reviewed and adjusted quarterly)).

(4) **Value of Regulatory Assets Under Management**. Determine your regulatory assets under management based on the current market value of the assets as determined within 90 days prior to the date of filing this Form ADV. Determine market value using the same method you used to report account values to *clients* or to calculate fees for investment advisory services.

In the case of a *private fund*, determine the current market value (or fair value) of the *private fund*'s assets and the contractual amount of any uncalled commitment pursuant to which a *person* is obligated to acquire an interest in, or make a capital contribution to, the *private fund*.

(5) **Example.** This is an example of the method of determining whether an account of a *client* other than a *private fund* may be included as regulatory assets under management.

The *client's* portfolio consists of the following:

\$ 6,000,000	stocks and bonds
\$ 1,000,000	cash and cash equivalents
\$ 3,000,000	non-securities (collectibles, commodities, real estate, etc.)
\$10,000,000	Total Assets

First, is the account a securities portfolio? The account is a securities portfolio because securities as well as cash and cash equivalents (which you have chosen to include as securities) (\$6,000,000 + \$1,000,000 = \$7,000,000) comprise at least 50% of the value of the account (here, 70%). (See Instruction 5.b(1)).

Second, does the account receive continuous and regular supervisory or management services? The entire account is managed on a *discretionary basis* and is provided ongoing supervisory and management services, and therefore receives continuous and regular supervisory or management services. (See Instruction 5.b.(3)).

Third, what is the entire value of the account? The entire value of the account (\$10,000,000) is included in the calculation of the adviser's total regulatory assets under management.

6. Item 7: Financial Industry Affiliations and Private Fund Reporting

Item 7.A. and Section 7.A. of Schedule D ask questions about you and your *related persons'* financial industry affiliation. If you are filing an *umbrella registration*, you should not check Item 7.A.(2) with respect to your *relying advisers*, and you do not have to complete Section 7.A. in Schedule D for your *relying advisers*. You should complete Schedule R with respect to your *relying advisers*. Item 7.B. and Section 7.B. of Schedule D ask questions about the *private funds* that you advise. You are required to complete a Section 7.B.(1) of Schedule D for each *private fund* that you advise, except in certain circumstances described under Item 7.B. and below.

a. If your *principal office and place of business* is outside the United States, for purposes of Item 7 and Section 7.B. of Schedule D you may disregard any *private fund* that, during your last fiscal year, was not a *United States person*, was not offered in the United States, and was not beneficially owned by any *United States person.*

b. When filing Section 7.B.(1) of Schedule D for a *private fund*, you must acquire an identification number for the fund by logging onto the IARD website and using the private fund identification number generator. You must continue to use the same identification number whenever you amend Section 7.B.(1) for that fund. If you file a Section 7.B.(1) for a *private fund* for which an identification number has already been acquired by another adviser, you must not acquire a new identification number, but must instead utilize the existing number. If you choose to complete a single Section 7.B.(1) for a master-feeder arrangement under instruction 6.d. below, you must acquire an identification number also for each feeder fund.

c. If any *private fund* has issued two or more series (or classes) of equity interests whose values are determined with respect to separate portfolios of securities and other assets, then each such series (or class) should be regarded as a separate *private fund.* In Section 7.B.(1) and 7.B.(2) of Schedule D, next to the name of the *private fund*, list the name and identification number of the specific series (or class) for which you are filing the sections. This only applies with respect to series (or classes) that you manage as if they were separate funds and not a fund's side pockets or similar arrangements.

d. In the case of a master-feeder arrangement (see questions 6-7 of Section 7.B.(1) of Schedule D), instead of completing a Section 7.B.(1) for each of the master fund and each feeder fund, you may complete a single Section 7.B.(1) for the master-feeder arrangement under the name of the master fund if the answers to questions 8, 10, 21 and 23 through 28 are the same for all of the feeder funds (or, in the case of questions 24 and 25, if the feeder funds do not use a prime broker or custodian). If you choose to complete a single Section 7.B.(1), you should disregard the feeder funds, except for the following:

   (1) **Question 11**: State the gross assets for the master-feeder arrangement as a whole.

   (2) **Question 12**: List the lowest minimum investment commitment applicable to any of the master fund and the feeder funds.

(3) **Questions 13-16**: Answer by aggregating all investors in the master-feeder arrangement (but do not count the feeder funds themselves as investors).

(4) **Questions 19-20**: For purposes of these questions, the *private fund* means any of the master fund or the feeder funds. In answering the questions, moreover, disregard the feeder funds' investment in the master fund.

(5) **Question 22**: List all of the Form D SEC file numbers of any of the master fund and feeder funds.

e. Additional Instructions:

(1) **Question 9: Investment in Registered Investment Companies:** For purposes of this question, disregard any open-end management investment company regulated as a money market fund under rule 2a-7 under the Investment Company Act if the *private fund* invests in such a company in reliance on rule 12d1-1 under the same Act.

(2) **Question 10: Type of *Private Fund*:** For purposes of this question, the following definitions apply:

"<u>Hedge fund</u>" means any *private fund* (other than a securitized asset fund):

(a) with respect to which one or more investment advisers (or *related persons* of investment advisers) may be paid a performance fee or allocation calculated by taking into account unrealized gains (other than a fee or allocation the calculation of which may take into account unrealized gains solely for the purpose of reducing such fee or allocation to reflect net unrealized losses);

(b) that may borrow an amount in excess of one-half of its net asset value (including any committed capital) or may have gross notional exposure in excess of twice its net asset value (including any committed capital); or

(c) that may sell securities or other assets short or enter into similar transactions (other than for the purpose of hedging currency exposure or managing duration).

A commodity pool is categorized as a hedge fund solely for purposes of this question. For purposes of this definition, do not net long and short positions. Include any borrowings or notional exposure of another *person* that are guaranteed by the *private fund* or that the *private fund* may otherwise be obligated to satisfy.

"<u>Liquidity fund</u>" means any *private fund* that seeks to generate income by investing in a portfolio of short-term obligations in order to maintain a stable net asset value per unit or minimize principal volatility for investors.

"<u>Private equity fund</u>" means any *private fund* that is not a hedge fund, liquidity fund, real estate fund, securitized asset fund, or venture capital fund and does not provide investors with redemption rights in the ordinary course.

"Real estate fund" means any *private fund* that is not a hedge fund, that does not provide investors with redemption rights in the ordinary course, and that invests primarily in real estate and real estate related assets.

"Securitized asset fund" means any *private fund* whose primary purpose is to issue asset backed securities and whose investors are primarily debt-holders.

"Venture capital fund" means any *private fund* meeting the definition of venture capital fund in rule 203(l)-1 under the Advisers Act.

"Other *private fund*" means any *private fund* that is not a hedge fund, liquidity fund, private equity fund, real estate fund, securitized asset fund, or venture capital fund.

(3) **Question 11: Gross Assets.** Report the assets of the *private fund* that you would include in calculating your regulatory assets under management according to instruction 5.b above.

(4) **Questions 19-20: Other clients' investments:** For purposes of these questions, disregard any feeder fund's investment in its master fund. (*See* questions 6-7 for the definition of "master fund" and "feeder fund.")

7. Item 10: *Control Persons*

If you are a "separately identifiable department or division" (SID) of a bank, identify on Schedule A your bank's executive officers who are directly engaged in managing, directing, or supervising your investment advisory activities, and list any other *persons* designated by your bank's board of directors as responsible for the day-to-day conduct of your investment advisory activities, including supervising *employees* performing investment advisory activities.

8. Additional Information.

If you believe your response to an item in Form ADV Part 1A requires further explanation, or if you wish to provide additional information, you may do so on Schedule D, in the Miscellaneous section. Completion of this section is optional.

APPENDIX C

GLOSSARY OF TERMS

1. **Advisory Affiliate:** Your advisory affiliates are (1) all of your officers, partners, or directors (or any ***person*** performing similar functions); (2) all ***persons*** directly or indirectly ***controlling*** or ***controlled*** by you; and (3) all of your current ***employees*** (other than ***employees*** performing only clerical, administrative, support or similar functions).

   If you are a "separately identifiable department or division" (SID) of a bank, your ***advisory affiliates*** are: (1) all of your bank's ***employees*** who perform your investment advisory activities (other than clerical or administrative ***employees***); (2) all ***persons*** designated by your bank's board of directors as responsible for the day-to-day conduct of your investment advisory activities (including supervising the ***employees*** who perform investment advisory activities); (3) all ***persons*** who directly or indirectly ***control*** your bank, and all ***persons*** whom you ***control*** in connection with your investment advisory activities; and (4) all other ***persons*** who directly manage any of your investment advisory activities (including directing, supervising or performing your advisory activities), all ***persons*** who directly or indirectly ***control*** those management functions, and all ***persons*** whom you ***control*** in connection with those management functions. *[Used in: Part 1A, Items 7, 11, DRPs; Part 1B, Item 2]*

2. **Annual Updating Amendment:** Within 90 days after your firm's fiscal year end, your firm must file an "annual updating amendment," which is an amendment to your firm's Form ADV that reaffirms the eligibility information contained in Item 2 of Part 1A and updates the responses to any other item for which the information is no longer accurate. *[Used in: General Instructions; Part 1A Instructions, Introductory Text, Item 2; Part 2A, Instructions, Appendix 1 Instructions; Part 2B, Instructions]*

3. **Borrowings:** Borrowings include secured borrowings and unsecured borrowings, collectively. Secured borrowings are obligations for borrowed money in respect of which the borrower has posted collateral or other credit support and should include any reverse repos (i.e. any sale of securities coupled with an agreement to repurchase the same (or similar) securities at a later date at an agreed price). Unsecured borrowings are obligations for borrowed money in respect of which the borrower has not posted collateral or other credit support. *[Used in: Part 1A, Instructions, Item 5, Schedule D]*

4. **Brochure:** A written disclosure statement that you must provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2A. *[Used in: General Instructions; Used throughout Part 2]*

5. **Brochure Supplement:** A written disclosure statement containing information about certain of your ***supervised persons*** that your firm is required by Part 2B of Form ADV to provide to ***clients*** and prospective ***clients***. See SEC rule 204-3; Form ADV, Part 2B. *[Used in: General Instructions; Used throughout Part 2]*

6. **Charged:** Being accused of a crime in a formal complaint, information, or indictment (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs]*

7. **Client:** Any of your firm's investment advisory clients. This term includes clients from which your firm receives no compensation, such as family members of your *supervised persons*. If your firm also provides other services (e.g., accounting services), this term does not include clients that are not investment advisory clients. *[Used throughout Form ADV and Form ADV-W]*

8. **Commodity Derivative:** Exposures to commodities that you do not hold physically, whether held synthetically or through derivatives (whether cash or physically settled). *[Used in: Part 1A, Schedule D]*

9. **Control:** The power, directly or indirectly, to direct the management or policies of a ***person***, whether through ownership of securities, by contract, or otherwise.

   - Each of your firm's officers, partners, or directors exercising executive responsibility (or ***persons*** having similar status or functions) is presumed to control your firm.

   - A ***person*** is presumed to control a corporation if the ***person***: (i) directly or indirectly has the right to vote 25 percent or more of a class of the corporation's voting securities; or (ii) has the power to sell or direct the sale of 25 percent or more of a class of the corporation's voting securities.

   - A ***person*** is presumed to control a partnership if the ***person*** has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the partnership.

   - A ***person*** is presumed to control a limited liability company ("LLC") if the ***person***: (i) directly or indirectly has the right to vote 25 percent or more of a class of the interests of the LLC; (ii) has the right to receive upon dissolution, or has contributed, 25 percent or more of the capital of the LLC; or (iii) is an elected manager of the LLC.

   - A ***person*** is presumed to control a trust if the ***person*** is a trustee or ***managing agent*** of the trust.

   [Used in: General Instructions; Part 1A, Instructions, Items 2, 7, 10, 11, 12, Schedules A, B, C, D, R; DRPs]

10. **Credit Derivative**: Single name credit default swap, including loan credit default swap, credit default swap referencing a standardized basket of credit entities, including credit default swap indices and indices referencing leverage loans, and credit default swap referencing bespoke basket or tranche of collateralized debt obligations and collateralized loan obligations (including cash flow and synthetic) other than mortgage backed securities. *[Used in: Part 1A, Schedule D]*

11. **Custody:** Holding, directly or indirectly, ***client*** funds or securities, or having any authority to obtain possession of them. You have custody if a ***related person*** holds, directly or indirectly, ***client*** funds or securities, or has any authority to obtain possession of them, in connection with advisory services you provide to ***clients***. Custody includes:

    - Possession of ***client*** funds or securities (but not of checks drawn by clients and made payable to third parties) unless you receive them inadvertently and you return them to the sender promptly, but in any case within three business days of receiving them;

    - Any arrangement (including a general power of attorney) under which you are authorized or permitted to withdraw ***client*** funds or securities maintained with a custodian upon your instruction to the custodian; and

    - Any capacity (such as general partner of a limited partnership, managing member of a limited liability company or a comparable position for another type of pooled investment vehicle, or trustee of a trust) that gives you or your ***supervised person*** legal ownership of or access to ***client*** funds or securities.

    [Used in: Part 1A, Item 9; Part 1B, Instructions, Item 2; Part 2A, Items 15, 18]

12. **Discretionary Authority or Discretionary Basis:** Your firm has discretionary authority or manages assets on a discretionary basis if it has the authority to decide which securities to purchase and sell for the ***client***. Your firm also has discretionary authority if it has the authority to decide which investment advisers to retain on behalf of the ***client***. *[Used in: Part 1A, Instructions, Item 8; Part 1B, Instructions; Part 2A, Items 4, 16, 18; Part 2B, Instructions]*

13. **Employee:** This term includes an independent contractor who performs advisory functions on your behalf. *[Used in: Part 1A, Instructions, Items 1, 5, 11; Part 2B, Instructions]*

14. **Enjoined:** This term includes being subject to a mandatory injunction, prohibitory injunction, preliminary injunction, or a temporary restraining ***order***. *[Used in: Part 1A, Item 11; DRPs]*

15. **Equity Derivative:** Includes both listed equity derivative and derivative exposure to unlisted securities. Listed equity derivative includes all synthetic or derivative exposure to equities, including preferred equities, listed on a regular exchange. Listed equity derivative also includes a single stock future, equity index future, dividend swap, total return swap (contract for difference), warrant and right. Derivative exposure to unlisted equities includes all synthetic or derivative exposure to equities, including preferred equities, that are not listed on a regulated exchange. Derivative exposure to unlisted securities also

includes a single stock future, equity index future, dividend swap, total return swap (contract for difference), warrant and right. *[Used in: Part 1A, Schedule D]*

16. **Exempt Reporting Adviser:** An investment adviser that qualifies for the exemption from registration under section 203(l) of the Advisers Act because it is an adviser solely to one or more venture capital funds, or under rule 203(m)-1 of the Advisers Act because it is an adviser solely to ***private funds*** and has assets under management in the United States of less than $150 million. *[Used in: Throughout Part 1A; General Instructions; Form ADV-H; Form ADV-NR]*

17. **Felony:** For jurisdictions that do not differentiate between a felony and a ***misdemeanor***, a felony is an offense punishable by a sentence of at least one year imprisonment and/or a fine of at least $1,000. The term also includes a general court martial. *[Used in: Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

18. **Filing Adviser:** An investment adviser eligible to register with the SEC that files (and amends) a single ***umbrella registration*** on behalf of itself and each of its ***relying advisers***. *[Used in: General Instructions; Part 1A, Items 1, 2, 3, 10 and 11; Schedule R]*

19. **FINRA CRD** or **CRD:** The Web Central Registration Depository ("CRD") system operated by FINRA for the registration of broker-dealers and broker-dealer representatives. *[Used in: General Instructions, Part 1A, Item 1, Schedules A, B, C, D, R, DRPs; Form ADV-W, Item 1]*

20. **Foreign Exchange Derivative**: Any derivative whose underlying asset is a currency other than U.S. dollars or is an exchange rate. Cross-currency interest rate swaps should be included in foreign exchange derivatives and excluded from ***interest rate derivatives***. *[Used in: Part 1A, Schedule D]*

21. **Foreign Financial Regulatory Authority:** This term includes (1) a foreign securities authority; (2) another governmental body or foreign equivalent of a ***self-regulatory organization*** empowered by a foreign government to administer or enforce its laws relating to the regulation of ***investment-related*** activities; and (3) a foreign membership organization, a function of which is to regulate the participation of its members in the activities listed above. *[Used in: Part 1A, Items 1, 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

22. **Found:** This term includes adverse final actions, including consent decrees in which the respondent has neither admitted nor denied the findings, but does not include agreements, deficiency letters, examination reports, memoranda of understanding, letters of caution, admonishments, and similar informal resolutions of matters. *[Used in: Part 1A, Item 11; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

23. **Government Entity:** Any state or political subdivision of a state, including (i) any agency, authority, or instrumentality of the state or political subdivision; (ii) a plan or pool of assets ***controlled*** by the state or political subdivision or any agency, authority, or instrumentality thereof; and (iii) any officer, agent, or employee of the state or political subdivision or any agency, authority, or instrumentality thereof, acting in their official capacity. *[Used in: Part 1A, Item 5]*

24. **Gross Notional Value**: The gross nominal or notional value of all transactions that have been entered into but not yet settled as of the reporting date. For contracts with variable nominal or notional principal amounts, the basis for reporting is the nominal or notional principal amounts as of the reporting date. For options, use delta adjusted notional value. *[Used in: Part 1A, Schedule D]*

25. **High Net Worth Individual:** An individual who is a ***qualified client*** or who is a "qualified purchaser" as defined in section 2(a)(51)(A) of the Investment Company Act of 1940. *[Used in: Part 1A, Item 5; Schedule D]*

26. **Home State:** If your firm is registered with a ***state securities authority***, your firm's "home state" is the state where it maintains its ***principal office and place of business***. *[Used in: Part 1B, Instructions]*

27. **Impersonal Investment Advice:** Investment advisory services that do not purport to meet the objectives or needs of specific individuals or accounts. *[Used in: Part 1A, Instructions; Part 2A, Instructions; Part 2B, Instructions]*

28. **Independent Public Accountant:** A public accountant that meets the standards of independence described in rule 2-01(b) and (c) of Regulation S-X (17 CFR 210.2-01(b) and (c)). *[Used in: Item 9; Schedule D]*

29. **Interest Rate Derivative**: Any derivative whose underlying asset is the obligation to pay or the right to receive a given amount of money accruing interest at a given rate. Cross-currency interest rate swaps should be included in ***foreign exchange derivatives*** and excluded from interest rate derivatives. *[Used in: Part 1A, Schedule D]*

30. **Investment Adviser Representative:** *Any of your firm's* ***supervised persons*** *(except* those that provide only ***impersonal investment advice***) is an investment adviser representative, if

    - the ***supervised person*** regularly solicits, meets with, or otherwise communicates with your firm's ***clients***,

    - the ***supervised person*** has more than five ***clients*** who are natural persons and not ***high net worth individuals***, and

- more than ten percent of the ***supervised person's clients*** are natural persons and not ***high net worth individuals.***

NOTE: If your firm is registered with the ***state securities authorities*** and not the SEC, your firm may be subject to a different state definition of "investment adviser representative." Investment adviser representatives of SEC-registered advisers may be required to register in each state in which they have a place of business.

[Used in: General Instructions; Part 1A, Item 5; Part 2B, Item 1]

31. **Investment Grade**: A security is investment grade if it is sufficiently liquid that it can be sold at or near its carrying value within a reasonably short period of time and is subject to no greater than moderate credit risk. *[Used in: Part 1A, Schedule D]*

32. **Investment-Related:** Activities that pertain to securities, commodities, banking, insurance, or real estate (including, but not limited to, acting as or being associated with an investment adviser, broker-dealer, municipal securities dealer, government securities broker or dealer, issuer, investment company, futures sponsor, bank, or savings association). *[Used in: Part 1A, Items 7, 11, Schedule D, DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3, 4 and 7]*

33. **Involved:** Engaging in any act or omission, aiding, abetting, counseling, commanding, inducing, conspiring with or failing reasonably to supervise another in doing an act. *[Used in: Part 1A, Item 11; Part 2A, Items 9 and 19; Part 2B, Items 3 and 7]*

34. **Legal Entity Identifier:** A "legal entity identifier" assigned or recognized by the Global LEI Regulatory Oversight Committee (ROC) or the Global LEI Foundation (GLEIF). *[Used in: Part 1A, Item 1, Schedules D, R]*

35. **Management Persons:** Anyone with the power to exercise, directly or indirectly, a ***controlling*** influence over your firm's management or policies, or to determine the general investment advice given to the ***clients*** of your firm.

    Generally, all of the following are management persons:

    - Your firm's principal executive officers, such as your chief executive officer, chief financial officer, chief operations officer, chief legal officer, and chief compliance officer; your directors, general partners, or trustees; and other individuals with similar status or performing similar functions;

    - The members of your firm's investment committee or group that determines general investment advice to be given to ***clients***; and

- If your firm does not have an investment committee or group, the individuals who determine general investment advice provided to ***clients*** (if there are more than five people, you may limit your firm's response to their supervisors).

[Used in: Part 1B, Item 2; Part 2A, Items 9, 10 and 19]

36. **Managing Agent:** A managing agent of an investment adviser is any ***person***, including a trustee, who directs or manages (or who participates in directing or managing) the affairs of any unincorporated organization or association that is not a partnership. *[Used in: General Instructions; Form ADV-NR; Form ADV-W, Item 8]*

37. **Minor Rule Violation:** A violation of a ***self-regulatory organization*** rule that has been designated as "minor" pursuant to a plan approved by the SEC. A rule violation may be designated as "minor" under a plan if the sanction imposed consists of a fine of $2,500 or less, and if the sanctioned ***person*** does not contest the fine. (Check with the appropriate ***self-regulatory organization*** to determine if a particular rule violation has been designated as "minor" for these purposes.) *[Used in: Part 1A, Item 11]*

38. **Misdemeanor:** For jurisdictions that do not differentiate between a ***felony*** and a misdemeanor, a misdemeanor is an offense punishable by a sentence of less than one year imprisonment and/or a fine of less than $1,000. The term also includes a special court martial. *[Used in: Part 1A, Item 11; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

39. **Net Asset Value**: With respect to any ***client***, the gross assets of the ***client's*** accounts minus any outstanding indebtedness or other accrued but unpaid liabilities. *[Used in: Part 1A, Item 5]*

40. **Non-Investment Grade**: A security is non-investment grade if it is not an ***investment grade*** security. *[Used in: Part 1A, Schedule D]*

41. **Non-Resident:** (a) an individual who resides in any place not subject to the jurisdiction of the United States; (b) a corporation incorporated in or that has its ***principal office and place of business*** in any place not subject to the jurisdiction of the United States; and (c) a partnership or other unincorporated organization or association that is formed in or has its ***principal office and place of business*** in any place not subject to the jurisdiction of the United States. *[Used in: General Instructions; Form ADV-NR]*

42. **Notice Filing:** SEC-registered advisers may have to provide ***state securities authorities*** with copies of documents that are filed with the SEC. These filings are referred to as "notice filings." *[Used in: General Instructions; Part 1A, Item 2; Execution Page(s); Form ADV-W]*

43. **Order:** A written directive issued pursuant to statutory authority and procedures, including an order of denial, exemption, suspension, or revocation. Unless included in an order, this term does not include special stipulations, undertakings, or agreements relating to payments, limitations on activity or other restrictions. *[Used in: Part 1A, Items 2 and 11; Schedules D, R; DRPs; Part 2A, Item 9; Part 2B, Item 3]*

44. **Other derivative:** Any derivative that is not a ***commodity derivative, credit derivative, equity derivative, foreign exchange derivative*** or ***interest rate derivative***. *[Used in: Part 1A, Schedule D]*

45. **Parallel Managed Account:** With respect to any registered investment company or business development company, a parallel managed account is any managed account or other pool of assets that you advise and that pursues substantially the same investment objective and strategy and invests side by side in substantially the same positions as the identified investment company or business development company that you advise. *[Used in: Part 1A, Schedule D]*

46. **Performance-Based Fee:** An investment advisory fee based on a share of capital gains on, or capital appreciation of, ***client*** assets. A fee that is based upon a percentage of assets that you manage is not a performance-based fee. *[Used in: Part 1A, Item 5; Part 2A, Items 6 and 19]*

47. **Person:** A natural person (an individual) or a company. A company includes any partnership, corporation, trust, limited liability company ("LLC"), limited liability partnership ("LLP"), sole proprietorship, or other organization. *[Used throughout Form ADV and Form ADV-W]*

48. **Principal Office and Place of Business:** Your firm's executive office from which your firm's officers, partners, or managers direct, ***control***, and coordinate the activities of your firm. *[Used in: Part 1A, Instructions, Items 1 and 2; Schedules D, R; Form ADV-W, Item 1]*

49. **Private Fund:** An issuer that would be an investment company as defined in section 3 of the Investment Company Act of 1940 but for section 3(c)(1) or 3(c)(7) of that Act. *[Used in: Part 1A, Items 2, 5, 7, and 9; Schedule D; General Instructions; Part 1A, Instructions]*.

50. **Proceeding:** This term includes a formal administrative or civil action initiated by a governmental agency, ***self-regulatory organization*** or ***foreign financial regulatory authority***; a ***felony*** criminal indictment or information (or equivalent formal charge); or a ***misdemeanor*** criminal information (or equivalent formal charge). This term does not include other civil litigation, investigations, or arrests or similar charges effected in the absence of a formal criminal indictment or information (or equivalent formal charge). *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Item 9; Part 2B, Item 3]*

51. **Qualified Client**: A ***client*** that satisfies the definition of qualified client in SEC rule 205-3. *[Used in: Schedule D ; General Instructions]*

52. **Related Person:** Any ***advisory affiliate*** and any ***person*** that is under common ***control*** with your firm. *[Used in: Part 1A, Items 7, 8, 9; Schedule D; Form ADV-W, Item 3; Part 2A, Items 10, 11, 12, 14; Part 2A, Appendix 1, Item 6]*

53. **Relying Adviser:** An investment adviser eligible to register with the SEC that relies on a ***filing adviser*** to file (and amend) a single ***umbrella registration*** on its behalf. *[Used in: General Instructions; Part 1A, Items 1, 7, 11; Schedule D; Schedule R]*

54. **Self-Regulatory Organization** or **SRO:** Any national securities or commodities exchange, registered securities association, or registered clearing agency. For example, the Chicago Board of Trade ("CBOT"), FINRA and New York Stock Exchange ("NYSE") are self-regulatory organizations. *[Used in: Part 1A, Item 11; DRPs; Part 1B, Item 2; Part 2A, Items 9 and 19; Part 2B, Items 3 and 7]*

55. **Sovereign Bonds**: Any notes, bonds and debentures issued by a national government (including central government, other governments and central banks but excluding U.S. state and local governments), whether denominated in a local or foreign currency. *[Used in: Part 1A, Schedule D]*

56. **Sponsor:** A sponsor of a ***wrap fee program*** sponsors, organizes, or administers the program or selects, or provides advice to ***clients*** regarding the selection of, other investment advisers in the program. *[Used in: Part 1A, Item 5; Schedule D; Part 2A, Instructions, Appendix 1 Instructions]*

57. **State Securities Authority:** The securities commissioner or commission (or any agency, office or officer performing like functions) of any state of the United States, the District of Columbia, Puerto Rico, the Virgin Islands, or any other possession of the United States. *[Used throughout Form ADV]*

58. **Supervised Person:** Any of your officers, partners, directors (or other ***persons*** occupying a similar status or performing similar functions), or ***employees***, or any other ***person*** who provides investment advice on your behalf and is subject to your supervision or ***control***. *[Used throughout Part 2]*

59. **Umbrella Registration:** A single registration by a ***filing adviser*** and one or more ***relying advisers*** who collectively conduct a single advisory business and that meet the conditions set forth in General Instruction 5. *[Used in: General Instructions; Part 1A, Items 1, 2, 3, 7, 10 and 11; Schedule D; Schedule R]*

60. **United States person:** This term has the same meaning as in rule 203(m)-1 under the Advisers Act, which includes any natural person that is resident in the United States. *[Used in: Part 1A, Instructions; Item 5; Schedule D]*

61. **Wrap Brochure** or **Wrap Fee Program Brochure:** The written disclosure statement that ***sponsors*** of ***wrap fee programs*** must provide to each of their ***wrap fee program clients***. *[Used in: Part 2, General Instructions; Used throughout Part 2A, Appendix 1]*

62. **Wrap Fee Program:** Any advisory program under which a specified fee or fees not based directly upon transactions in a ***client's*** account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of ***client*** transactions. *[Used in: Part 1, Item 5; Schedule D; Part 2A, Instructions, Item 4, used throughout Appendix 1; Part 2B, Instructions]*

FORM ADV (Paper Version)

- **UNIFORM APPLICATION FOR INVESTMENT ADVISER REGISTRATION AND**
- **REPORT BY EXEMPT REPORTING ADVISERS**

PART 1A

WARNING: Complete this form truthfully. False statements or omissions may result in denial of your application, revocation of your registration, or criminal prosecution. You must keep this form updated by filing periodic amendments. See Form ADV General Instruction 4.

Check the box that indicates what you would like to do (check all that apply):

SEC or State Registration:
☐ Submit an initial application to register as an investment adviser with the SEC.
☐ Submit an initial application to register as an investment adviser with one or more states.
☐ Submit an *annual updating amendment* to your registration for your fiscal year ended _________.
☐ Submit an other-than-annual amendment to your registration.

SEC or State Report by *Exempt Reporting Advisers*:
☐ Submit an initial report to the SEC.
☐ Submit a report to one or more *state securities authorities*.
☐ Submit an *annual updating amendment* to your report for your fiscal year ended _________.
☐ Submit an other-than-annual amendment to your report.
☐ Submit a final report.

Item 1 Identifying Information

Responses to this Item tell us who you are, where you are doing business, and how we can contact you. If you are filing an *umbrella registration*, the information in Item 1 should be provided for the *filing adviser* only. General Instruction 5 provides information to assist you with filing an *umbrella registration*.

A. Your full legal name (if you are a sole proprietor, your last, first, and middle names):

____

B. (1) Name under which you primarily conduct your advisory business, if different from Item 1.A.

____

List on Section 1.B. of Schedule D any additional names under which you conduct your advisory business.

(2) If you are using this Form ADV to register more than one investment adviser under an *umbrella registration*, check this box ☐.

If you check this box, complete a Schedule R for each relying adviser.

C. If this filing is reporting a change in your legal name (Item 1.A.) or primary business name (Item 1.B.), enter the new name and specify whether the name change is of ☐ your legal name or ☐ your primary business name:

____

D. (1) If you are registered with the SEC as an investment adviser, your SEC file number: 801-__________

(2) If you report to the SEC as an *exempt reporting adviser*, your SEC file number: 802-__________

(3) If you have Central Index Key numbers assigned by the SEC ("CIK Number"), all of your CIK numbers: _______

E. If you have one or more numbers ("*CRD* Numbers") assigned by the *FINRA's CRD* system or by the IARD system, all of your *CRD* numbers: __________

If your firm does not have a CRD number, skip this Item 1.E. Do not provide the CRD number of one of your officers, employees, or affiliates.

F. *Principal Office and Place of Business*

(1) Address (do not use a P.O. Box):

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

List on Section 1.F. of Schedule D any office, other than your principal office and place of business, at which you conduct investment advisory business. If you are applying for registration, or are registered, with one or more state securities authorities, you must list all of your offices in the state or states to which you are applying for registration or with whom you are registered. If you are applying for SEC registration, if you are registered only with the SEC, or if you are reporting to the SEC as an exempt reporting adviser, list the largest twenty-five offices in terms of numbers of employees as of the end of your most recently completed fiscal year.

(2) Days of week that you normally conduct business at your *principal office and place of business*:

☐ Monday - Friday ☐ Other: ____________________

Normal business hours at this location: ____________________

(3) Telephone number at this location: ____________________
(area code) (telephone number)

(4) Facsimile number at this location, if any: ____________________
(area code) (facsimile number)

(5) What is the total number of offices, other than your *principal office and place of business*, at which you conduct investment advisory business as of the end of your most recently completed fiscal year?

____

G. Mailing address, if different from your *principal office and place of business* address:

(number and street)

(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

H. If you are a sole proprietor, state your full residence address, if different from your *principal office and place of business* address in Item 1.F.:

(number and street)

(city) (state/country) (zip+4/postal code)

I. Do you have one or more websites or websites for social media platforms used by your firm (including, but not limited to, Twitter, Facebook and LinkedIn)?

Yes ☐ No ☐

If "yes," list all firm website addresses on Section 1.I. of Schedule D. If a website address serves as a portal through which to access other information you have published on the web, you may list the portal without listing addresses for all of the other information. Some advisers may need to list more than one portal address. Do not provide individual electronic mail (e-mail) addresses or social media websites of employees in response to this Item.

J. Chief Compliance Officer

(1) Provide the name and contact information of your Chief Compliance Officer: If you are an *exempt reporting adviser*, you must provide the contact information for your Chief Compliance Officer, if you have one. If not, you must complete Item 1.K. below.

(name)

(other titles, if any)

(area code) (telephone number) (area code) (facsimile number, if any)

(number and street)

(city) (state/country) (zip+4/postal code)

(electronic mail (e-mail) address, if Chief Compliance Officer has one)

(2) If your Chief Compliance Officer is compensated or employed by any *person* other than you or a *related person* for providing chief compliance officer services, provide the *person's* name and IRS Employer Identification Number (if any):________________.

K. Additional Regulatory Contact Person: If a person other than the Chief Compliance Officer is authorized to receive information and respond to questions about this Form ADV, you may provide that information here.

(name)

(titles)

(area code) (telephone number) (area code) (facsimile number, if any)

(number and street)

(city) (state/country) (zip+4/postal code)

(electronic mail (e-mail) address, if contact person has one)

L. Do you maintain some or all of the books and records you are required to keep under Section 204 of the Advisers Act, or similar state law, somewhere other than your *principal office and place of business*?

Yes ☐ No ☐

If "yes," complete Section 1.L. of Schedule D.

M. Are you registered with a *foreign financial regulatory authority*? Yes ☐ No ☐

Answer "no" if you are not registered with a foreign financial regulatory authority, even if you have an affiliate that is registered with a foreign financial regulatory authority. If "yes," complete Section 1.M. of Schedule D.

N. Are you a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934?

Yes ☐ No ☐

O. Did you have $1 billion or more in assets on the last day of your most recent fiscal year?

Yes ☐ No ☐

If yes, what is the approximate amount of your assets:

$1 billion to less than $10 billion ☐

$10 billion to less than $50 billion ☐

$50 billion or more ☐

For purposes of Item 1.O. only, "assets" refers to your total assets, rather than the assets you manage on behalf of clients. Determine your total assets using the total assets shown on the balance sheet for your most recent fiscal year end.

P. Provide your *Legal Entity Identifier* if you have one: ______________________________

A *legal entity identifier* is a unique number that companies use to identify each other in the financial marketplace. You may not have a *legal entity identifier*.

Item 2

SEC Registration

Responses to this Item help us (and you) determine whether you are eligible to register with the SEC. Complete this Item 2.A. only if you are applying for SEC registration or submitting an *annual updating amendment* to your SEC registration. If you are filing an *umbrella registration*, the information in Item 2 should be provided for the *filing adviser* only.

A. To register (or remain registered) with the SEC, you must check **at least one** of the Items 2.A.(1) through 2.A.(12), below. If you are submitting an *annual updating amendment* to your SEC registration and you are no longer eligible to register with the SEC, check Item 2.A.(13). Part 1A Instruction 2 provides information to help you determine whether you may affirmatively respond to each of these items.

You (the adviser):

☐ (1) are a **large advisory firm** that either:

(a) has regulatory assets under management of $100 million (in U.S. dollars) or more, or

(b) has regulatory assets under management of $90 million (in U.S. dollars) or more at the time of filing its most recent *annual updating amendment* and is registered with the SEC;

☐ (2) are a **mid-sized advisory firm** that has regulatory assets under management of $25 million (in U.S. dollars) or more but less than $100 million (in U.S. dollars) and you are either:

(a) not required to be registered as an adviser with the *state securities authority* of the state where you maintain your *principal office and place of business*, or

(b) not subject to examination by the *state securities authority* of the state where you maintain your *principal office and place of business*;

*Click **HERE** for a list of states in which an investment adviser, if registered, would not be subject to examination by the state securities authority.*

☐ (3) have your *principal office and place of business* **in Wyoming** (which does not regulate advisers);

☐ (4) have your *principal office and place of business* **outside the United States**;

☐ (5) are **an investment adviser (or sub-adviser) to an investment company** registered under the Investment Company Act of 1940;

☐ (6) are **an investment adviser to a company which has elected to be a business development company** pursuant to section 54 of the Investment Company Act of 1940 and has not withdrawn the election, and you have at least $25 million of regulatory assets under management;

☐ (7) are a **pension consultant** with respect to assets of plans having an aggregate value of at least $200,000,000 that qualifies for the exemption in rule 203A-2(a);

☐ (8) are a **related adviser** under rule 203A-2(b) that *controls*, is *controlled* by, or is under common *control* with, an investment adviser that is registered with the SEC, and your *principal office and place of business* is the same as the registered adviser;

If you check this box, complete Section 2.A.(8) of Schedule D.

☐ (9) are an **adviser** relying on rule 203A-2(c) because you **expect to be eligible for SEC registration within 120 days**;

If you check this box, complete Section 2.A.(9) of Schedule D.

☐ (10) are a **multi-state adviser** that is required to register in 15 or more states and is relying on rule 203A-2(d);

If you check this box, complete Section 2.A.(10) of Schedule D.

☐ (11) are an **Internet adviser** relying on rule 203A-2(e);

☐ (12) have **received an SEC *order*** exempting you from the prohibition against registration with the SEC;

If you check this box, complete Section 2.A.(12) of Schedule D.

☐ (13) are **no longer eligible** to remain registered with the SEC.

SEC Reporting by *Exempt Reporting Advisers*

B. Complete this Item 2.B. only if you are reporting to the SEC as an *exempt reporting adviser*. Check all that apply. You:

☐ (1) qualify for the exemption from registration as an adviser solely to one or more venture capital funds;

☐ (2) qualify for the exemption from registration because you act solely as an adviser to *private funds* and have assets under management in the United States of less than $150 million;

☐ (3) act solely as an adviser to *private funds* but you are no longer eligible to check box 2.B.(2) because you have assets under management in the United States of $150 million or more.

If you check box (2) or (3), complete Section 2.B. of Schedule D.

State Securities Authority Notice Filings and State Reporting by *Exempt Reporting Advisers*

C. Under state laws, SEC-registered advisers may be required to provide to *state securities authorities* a copy of the Form ADV and any amendments they file with the SEC. These are called *notice filings*. In addition, *exempt reporting advisers* may be required to provide *state securities authorities* with a copy of reports and any amendments they file with the SEC. If this is an initial application or report, check the box(es) next to the state(s) that you would like to receive notice of this and all subsequent filings or reports you submit to the SEC. If this is an amendment to direct your *notice filings* or reports to additional state(s), check the box(es) next to the state(s) that you would like to receive notice of this and all subsequent filings or reports you submit to the SEC. If this is an amendment to your registration to stop your *notice filings* or reports from going to state(s) that currently receive them, uncheck the box(es) next to those state(s).

☐ AL	☐ CT	☐ HI	☐ KY	☐ MN	☐ NH	☐ OH	☐ SC	☐ VI
☐ AK	☐ DE	☐ ID	☐ LA	☐ MS	☐ NJ	☐ OK	☐ SD	☐ VA
☐ AZ	☐ DC	☐ IL	☐ ME	☐ MO	☐ NM	☐ OR	☐ TN	☐ WA
☐ AR	☐ FL	☐ IN	☐ MD	☐ MT	☐ NY	☐ PA	☐ TX	☐ WV
☐ CA	☐ GA	☐ IA	☐ MA	☐ NE	☐ NC	☐ PR	☐ UT	☐ WI
☐ CO	☐ GU	☐ KS	☐ MI	☐ NV	☐ ND	☐ RI	☐ VT	

If you are amending your registration to stop your notice filings or reports from going to a state that currently receives them and you do not want to pay that state's notice filing or report filing fee for the coming year, your amendment must be filed before the end of the year (December 31).

Item 3 Form of Organization

If you are filing an *umbrella registration*, the information in Item 3 should be provided for the *filing adviser* only.

A. How are you organized?

☐ Corporation ☐ Sole Proprietorship ☐ Limited Liability Partnership (LLP)
☐ Partnership ☐ Limited Liability Company (LLC) ☐ Limited Partnership (LP)
☐ Other (specify):____

If you are changing your response to this Item, see Part 1A Instruction 4.

B. In what month does your fiscal year end each year? ________________

C. Under the laws of what state or country are you organized? ____________________

If you are a partnership, provide the name of the state or country under whose laws your partnership was formed. If you are a sole proprietor, provide the name of the state or country where you reside.

If you are changing your response to this Item, see Part 1A Instruction 4.

Item 4 Successions

A. Are you, at the time of this filing, succeeding to the business of a registered investment adviser, including, for example, a change of your structure or legal status (*e.g.*, form of organization or state of incorporation)?

☐ Yes ☐ No

If "yes," complete Item 4.B. and Section 4 of Schedule D.

B. Date of Succession: ____________
(mm/dd/yyyy)

If you have already reported this succession on a previous Form ADV filing, do not report the succession again. Instead, check "No." See Part 1A Instruction 4.

Item 5 Information About Your Advisory Business

Responses to this Item help us understand your business, assist us in preparing for on-site examinations, and provide us with data we use when making regulatory policy. Part 1A Instruction 5.a. provides additional guidance to newly formed advisers for completing this Item 5.

Employees

If you are organized as a sole proprietorship, include yourself as an employee in your responses to Item 5.A and Items 5.B.(1), (2), (3), (4), and (5). If an employee performs more than one function, you should count that employee in each of your responses to Items 5.B.(1), (2), (3), (4) and (5).

A. Approximately how many *employees* do you have? Include full- and part-time *employees* but do not include any clerical workers.

____

B. (1) Approximately how many of the *employees* reported in 5.A. perform investment advisory functions (including research)?

____

(2) Approximately how many of the *employees* reported in 5.A. are registered representatives of a broker-dealer?

____

(3) Approximately how many of the *employees* reported in 5.A. are registered with one or more *state securities authorities* as *investment adviser representatives*?

____

(4) Approximately how many of the *employees* reported in 5.A. are registered with one or more *state securities authorities* as *investment adviser representatives* for an investment adviser other than you?

____

(5) Approximately how many of the *employees* reported in 5.A. are licensed agents of an insurance company or agency?

____

(6) Approximately how many firms or other *persons* solicit advisory *clients* on your behalf?

____

In your response to Item 5.B.(6), do not count any of your employees and count a firm only once – do not count each of the firm's employees that solicit on your behalf.

Clients

In your responses to Items 5.C. and 5.D. do not include as "clients" the investors in a private fund you advise, unless you have a separate advisory relationship with those investors.

C. (1) To approximately how many *clients* for whom you do not have regulatory assets under management did you provide investment advisory services during your most recently completed fiscal year?

______

(2) Approximately what percentage of your *clients* are non-*United States persons*? ______%

D. *For purposes of this Item 5.D., the category "individuals" includes trusts, estates, and 401(k) plans and IRAs of individuals and their family members, but does not include businesses organized as sole proprietorships.*
The category "business development companies" consists of companies that have made an election pursuant to section 54 of the Investment Company Act of 1940. Unless you provide advisory services pursuant to an investment advisory contract to an investment company registered under the Investment Company Act of 1940, do not answer (d)(1) or (d)(2) below.

Indicate the approximate number of your *clients* and amount of your total regulatory assets under management (reported in Item 5.F. below) attributable to each of the following type of *client*. The aggregate amount of regulatory assets under management reported in Item 5.D.(2) should equal the total amount of regulatory assets under management reported in Item 5.F.(2) below.

Type of *Client*	(1) Number of *Client*(s)	(2) Amount of Regulatory Assets under Management
(a) Individuals (other than *high net worth individuals*)		
(b) *High net worth individuals*		
(c) Banking or thrift institutions		
(d) Investment companies		
(e) Business development companies		
(f) Pooled investment vehicles (other than investment companies)		
(g) Pension and profit sharing plans (but not the plan participants or government pension plans)		
(h) Charitable organizations		
(i) Corporations or other businesses not listed above		
(j) State or municipal *government entities* (including government pension plans)		
(k) Other investment advisers		
(l) Insurance companies		
(m) Sovereign wealth funds and foreign official institutions		
(n) Other: ______		

Compensation Arrangements

E. You are compensated for your investment advisory services by (check all that apply):

☐ (1) A percentage of assets under your management
☐ (2) Hourly charges
☐ (3) Subscription fees (for a newsletter or periodical)
☐ (4) Fixed fees (other than subscription fees)
☐ (5) Commissions
☐ (6) *Performance-based fees*
☐ (7) Other (specify): ____

Regulatory Assets Under Management

F. (1) Do you provide continuous and regular supervisory or management services to securities portfolios? ☐ Yes ☐ No

(2) If yes, what is the amount of your regulatory assets under management and total number of accounts?

		U.S. Dollar Amount		Total Number of Accounts
Discretionary:	(a)	$______________.00	(d)	______________
Non-Discretionary:	(b)	$______________.00	(e)	______________
Total:	(c)	$______________.00	(f)	______________

Part 1A Instruction 5.b. explains how to calculate your regulatory assets under management. You must follow these instructions carefully when completing this Item.

(3) What is the approximate amount of your total regulatory assets under management (reported in Item 5.F.(2)(c) above) attributable to non-U.S. *clients*? ____________

Advisory Activities

G. What type(s) of advisory services do you provide? Check all that apply.

☐ (1) Financial planning services
☐ (2) Portfolio management for individuals and/or small businesses
☐ (3) Portfolio management for investment companies (as well as "business development companies" that have made an election pursuant to section 54 of the Investment Company Act of 1940)
☐ (4) Portfolio management for pooled investment vehicles (other than investment companies)
☐ (5) Portfolio management for businesses (other than small businesses) or institutional *clients* (other than registered investment companies and other pooled investment vehicles)
☐ (6) Pension consulting services
☐ (7) Selection of other advisers (including *private fund* managers)
☐ (8) Publication of periodicals or newsletters
☐ (9) Security ratings or pricing services
☐ (10) Market timing services
☐ (11) Educational seminars/workshops
☐ (12) Other (specify): ____

Do not check Item 5.G.(3) unless you provide advisory services pursuant to an investment advisory contract to an investment company registered under the Investment Company Act of 1940, including as a subadviser. If you check Item 5.G.(3), report the 811 or 814 number of the investment company or investment companies to which you provide advice in Section 5.G.(3) of Schedule D.

H. If you provide financial planning services, to how many *clients* did you provide these services during your last fiscal year?

☐ 0 ☐ 1-10 ☐ 11-25 ☐ 26-50 ☐ 51-100 ☐ 101-250 ☐ 251 – 500
☐ More than 500 If more than 500, how many? ______ (round to the nearest 500)

In your responses to this Item 5.H., do not include as "clients" the investors in a private fund you advise, unless you have a separate advisory relationship with those investors.

I. (1) Do you participate in a *wrap fee program*? ☐ Yes ☐ No.

(2) If you participate in a *wrap fee program*, what is the amount of your regulatory assets under management attributable to acting as:

(a) *sponsor* to a *wrap fee program* $_____

(b) a portfolio manager for a *wrap fee program*? $_____

If you are a portfolio manager for a wrap fee program, list the names of the programs, their sponsors and related information in Section 5.I.(2) of Schedule D.

If your involvement in a wrap fee program is limited to recommending wrap fee programs to your clients, or you advise a mutual fund that is offered through a wrap fee program, do not check Item 5.I.(1) or enter any amounts in response to Item 5.I(2).

J. (1) In response to Item 4.B. of Part 2A of Form ADV, do you indicate that you provide investment advice only with respect to limited types of investments? ☐ Yes ☐ No

(2) Do you report *client* assets in Item 4.E of Part 2A that are computed using a different method than the method used to compute your regulatory assets under management? ☐ Yes ☐ No

K. Separately Managed Account *Clients*

(1) Do you have regulatory assets under management attributable to *clients* other than those listed in Item 5.D.(2)(d)-(f) (separately managed account *clients*)? ☐ Yes ☐ No

If yes, complete Section 5.K.(1) of Schedule D.

(2) Do you engage in *borrowing* transactions on behalf of any of the separately managed account *clients* that you advise? ☐ Yes ☐ No

If yes, complete Section 5.K.(2) of Schedule D.

(3) Do you engage in derivative transactions on behalf of any of the separately managed account *clients* that you advise? ☐ Yes ☐ No

If yes, complete Section 5.K.(2) of Schedule D.

(4) After subtracting the amounts in Item 5.D.(2)(d)-(f) above from your total regulatory assets under management, does any custodian hold ten percent or more of this remaining amount of regulatory assets under management?

☐ Yes ☐ No

If yes, complete Section 5.K.(3) of Schedule D for each custodian.

Item 6 Other Business Activities

In this Item, we request information about your firm's other business activities.

A. You are actively engaged in business as a (check all that apply):

☐ (1) broker-dealer (registered or unregistered)
☐ (2) registered representative of a broker-dealer
☐ (3) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
☐ (4) futures commission merchant
☐ (5) real estate broker, dealer, or agent
☐ (6) insurance broker or agent
☐ (7) bank (including a separately identifiable department or division of a bank)
☐ (8) trust company
☐ (9) registered municipal advisor
☐ (10) registered security-based swap dealer
☐ (11) major security-based swap participant
☐ (12) accountant or accounting firm
☐ (13) lawyer or law firm
☐ (14) other financial product salesperson (specify): ____________________

If you engage in other business using a name that is different from the names reported in Items 1.A. or 1.B.(1), complete Section 6.A. of Schedule D.

B. (1) Are you actively engaged in any other business not listed in Item 6.A. (other than giving investment advice)? ☐ Yes ☐ No

(2) If yes, is this other business your primary business? ☐ Yes ☐ No

If "yes," describe this other business on Section 6.B.(2) of Schedule D, and if you engage in this business under a different name, provide that name.

(3) Do you sell products or provide services other than investment advice to your advisory *clients*? ☐ Yes ☐ No

If "yes," describe this other business on Section 6.B.(3) of Schedule D, and if you engage in this business under a different name, provide that name.

Item 7 Financial Industry Affiliations and *Private Fund* Reporting

In this Item, we request information about your financial industry affiliations and activities. This information identifies areas in which conflicts of interest may occur between you and your *clients*.

A. This part of Item 7 requires you to provide information about you and your *related persons*, including foreign affiliates. Your *related persons* are all of your *advisory affiliates* and any *person* that is under common *control* with you.

You have a *related person* that is a (check all that apply):

☐ (1) broker-dealer, municipal securities dealer, or government securities broker or dealer (registered or unregistered)
☐ (2) other investment adviser (including financial planners)
☐ (3) registered municipal advisor
☐ (4) registered security-based swap dealer
☐ (5) major security-based swap participant
☐ (6) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
☐ (7) futures commission merchant
☐ (8) banking or thrift institution
☐ (9) trust company
☐ (10) accountant or accounting firm
☐ (11) lawyer or law firm
☐ (12) insurance company or agency
☐ (13) pension consultant
☐ (14) real estate broker or dealer
☐ (15) sponsor or syndicator of limited partnerships (or equivalent), excluding pooled investment vehicles
☐ (16) sponsor, general partner, managing member (or equivalent) of pooled investment vehicles

Note that Item 7.A should not be used to disclose that some of your employees perform investment advisory functions or are registered representatives of a broker-dealer. The number of your firm's employees who perform investment advisory functions should be disclosed under Item 5.B(1). The number of your firm's employees who are registered representatives of a broker-dealer should be disclosed under Item 5.B(2).

Note that if you are filing an umbrella registration, you should not check Item 7.A.(2) with respect to your relying advisers, and you do not have to complete Section 7.A. in Schedule D for your relying advisers. You should complete a Schedule R for each relying adviser.

For each related person, including foreign affiliates that may not be registered or required to be registered in the United States, complete Section 7.A. of Schedule D.

You do not need to complete Section 7.A. of Schedule D for any related person if: (1) you have no business dealings with the related person in connection with advisory services you provide to your clients; (2) you do not conduct shared operations with the related person; (3) you do not refer clients or business to the related person, and the related person does not refer prospective clients or business to you; (4) you do not share supervised persons or premises with the related person; and (5) you have no reason to believe that your relationship with the related person otherwise creates a conflict of interest with your clients.

You must complete Section 7.A. of Schedule D for each related person acting as qualified custodian in connection with advisory services you provide to your clients (other than any mutual fund transfer agent *pursuant to rule 206(4)-2(b)(1)), regardless of whether you have determined the related person to be operationally independent under rule 206(4)-2 of the Advisers Act.*

B. Are you an adviser to any *private fund*? ☐ Yes ☐ No

If "yes," then for each private fund that you advise, you must complete a Section 7.B.(1) of Schedule D, except in certain circumstances described in the next sentence and in Instruction 6 of the Instructions to Part 1A. If you are registered or applying for registration with the SEC or reporting as an SEC exempt reporting adviser, and another SEC-registered adviser or SEC exempt reporting adviser reports this information with respect to any such private fund in Section 7.B.(1) of Schedule D of its Form ADV (e.g., if you are a subadviser), do not complete Section 7.B.(1) of Schedule D with respect to that private fund. You must, instead, complete Section 7.B.(2) of Schedule D.

In either case, if you seek to preserve the anonymity of a private fund client by maintaining its identity in your books and records in numerical or alphabetical code, or similar designation, pursuant to rule 204-2(d), you may identify the private fund in Section 7.B.(1) or 7.B.(2) of Schedule D using the same code or designation in place of the fund's name.

Item 8 Participation or Interest in *Client* Transactions

In this Item, we request information about your participation and interest in your *clients'* transactions. This information identifies additional areas in which conflicts of interest may occur between you and your *clients*. Your responses to these questions should be based on the types of participation and interest that you expect to engage in during the next year.

Like Item 7, Item 8 requires you to provide information about you and your *related persons*, including foreign affiliates.

Proprietary Interest in *Client* Transactions

A. Do you or any *related person*:	Yes	No
(1) buy securities for yourself from advisory *clients*, or sell securities you own to advisory *clients* (principal transactions)?	☐	☐
(2) buy or sell for yourself securities (other than shares of mutual funds) that you also recommend to advisory *clients*?	☐	☐
(3) recommend securities (or other investment products) to advisory *clients* in which you or any *related person* has some other proprietary (ownership) interest (other than those mentioned in Items 8.A.(1) or (2))?	☐	☐

Sales Interest in *Client* Transactions

B. Do you or any *related person*:	Yes	No
(1) as a broker-dealer or registered representative of a broker-dealer, execute securities trades for brokerage customers in which advisory *client* securities are sold to or bought from the brokerage customer (agency cross transactions)?	☐	☐

(2) recommend to advisory *clients,* or act as a purchaser representative for advisory *clients* with respect to, the purchase of securities for which you or any *related person* serves as underwriter or general or managing partner? ☐ ☐

(3) recommend purchase or sale of securities to advisory *clients* for which you or any *related person* has any other sales interest (other than the receipt of sales commissions as a broker or registered representative of a broker-dealer)? ☐ ☐

Investment or Brokerage Discretion

	Yes	No
C. Do you or any *related person* have *discretionary authority* to determine the:		
(1) securities to be bought or sold for a *client's* account?	☐	☐
(2) amount of securities to be bought or sold for a *client's* account?	☐	☐
(3) broker or dealer to be used for a purchase or sale of securities for a *client's* account?	☐	☐
(4) commission rates to be paid to a broker or dealer for a *client's* securities transactions?	☐	☐

	Yes	No
D. If you answer "yes" to C.(3) above, are any of the brokers or dealers *related persons*?	☐	☐
E. Do you or any *related person* recommend brokers or dealers to *clients*?	☐	☐
F. If you answer "yes" to E above, are any of the brokers or dealers *related persons*?	☐	☐
G. (1) Do you or any *related person* receive research or other products or services other than execution from a broker-dealer or a third party ("soft dollar benefits") in connection with *client* securities transactions?	☐	☐
(2) If "yes" to G.(1) above, are all the "soft dollar benefits" you or any *related persons* receive eligible "research or brokerage services" under section 28(e) of the Securities Exchange Act of 1934?	☐	☐
H. (1) Do you or any *related person*, directly or indirectly, compensate any *person* that is not an *employee* for *client* referrals?	☐	☐
(2) Do you or any *related person*, directly or indirectly, provide any *employee* compensation that is specifically related to obtaining *clients* for the firm (cash or non-cash compensation in addition to the *employee*'s regular salary)?	☐	☐
I. Do you or any *related person*, including any *employee*, directly or indirectly, receive compensation from any *person* (other than you or any *related* person) for *client* referrals?	☐	☐

In your response to Item 8.I., do not include the regular salary you pay to an employee.

In responding to Items 8.H and 8.I., consider all cash and non-cash compensation that you or a related person gave to (in answering Item 8.H) or received from (in answering Item 8.I) any person in exchange for client referrals, including any bonus that is based, at least in part, on the number or amount of client referrals.

Item 9 Custody

In this Item, we ask you whether you or a *related person* has *custody* of *client* (other than *clients* that are investment companies registered under the Investment Company Act of 1940) assets and about your custodial practices.

A. (1) Do you have *custody* of any advisory *clients'*:

	Yes	No
(a) cash or bank accounts?	☐	☐
(b) securities?	☐	☐

If you are registering or registered with the SEC, answer "No" to Item 9.A.(1)(a) and (b) if you have custody solely because (i) you deduct your advisory fees directly from your clients' accounts, or (ii) a related person has custody of client assets in connection with advisory services you provide to clients, but you have overcome the presumption that you are not operationally independent (pursuant to Advisers Act rule 206(4)-(2)(d)(5)) from the related person.

(2) If you checked "yes" to Item 9.A.(1)(a) or (b), what is the approximate amount of *client* funds and securities and total number of *clients* for which you have *custody*:

U.S. Dollar Amount	Total Number of *Clients*
(a) $______________	(b) ______________

If you are registering or registered with the SEC and you have custody solely because you deduct your advisory fees directly from your clients' accounts, do not include the amount of those assets and the number of those clients in your response to Item 9.A.(2). If your related person has custody of client assets in connection with advisory services you provide to clients, do not include the amount of those assets and the number of those clients in your response to Item 9.A.(2). Instead, include that information in your response to Item 9.B.(2).

B. (1) In connection with advisory services you provide to *clients*, do any of your *related persons* have *custody* of any of your advisory *clients'*:

	Yes	No
(a) cash or bank accounts?	☐	☐
(b) securities?	☐	☐

You are required to answer this item regardless of how you answered Item 9.A.(1)(a) or (b).

(2) If you checked "yes" to Item 9.B.(1)(a) or (b), what is the approximate amount of *client* funds and securities and total number of *clients* for which your *related persons* have *custody*:

U.S. Dollar Amount	Total Number of *Clients*
(a) $______________	(b) ______________

C. If you or your *related persons* have *custody* of *client* funds or securities in connection with advisory services you provide to *clients*, check all the following that apply:

☐ (1) A qualified custodian(s) sends account statements at least quarterly to the investors in the pooled investment vehicle(s) you manage.

☐ (2) An *independent public accountant* audits annually the pooled investment vehicle(s) that you manage and the audited financial statements are distributed to the investors in the pools.

☐ (3) An *independent public accountant* conducts an annual surprise examination of *client* funds and securities.

☐ (4) An *independent public accountant* prepares an internal control report with respect to custodial services when you or your *related persons* are qualified custodians for *client* funds and securities.

If you checked Item 9.C.(2), C.(3) or C.(4), list in Section 9.C. of Schedule D the accountants that are engaged to perform the audit or examination or prepare an internal control report. (If you checked Item 9.C.(2), you do not have to list auditor information in Section 9.C. of Schedule D if you already provided this information with respect to the private funds you advise in Section 7.B.(1) of Schedule D).

D. Do you or your *related person(s)* act as qualified custodians for your *clients* in connection with advisory services you provide to *clients*?

	Yes	No
(1) you act as a qualified custodian	☐	☐
(2) your *related person(s)* act as qualified custodian(s)	☐	☐

If you checked "yes" to Item 9.D.(2), all related persons that act as qualified custodians (other than any mutual fund transfer agent pursuant to rule 206(4)-2(b)(1)) must be identified in Section 7.A. of Schedule D, regardless of whether you have determined the related person to be operationally independent under rule 206(4)-2 of the Advisers Act.

E. If you are filing your *annual updating amendment* and you were subject to a surprise examination by an *independent public accountant* during your last fiscal year, provide the date (MM/YYYY) the examination commenced: ________

F. If you or your *related persons* have *custody* of *client* funds or securities, how many *persons*, including, but not limited to, you and your *related persons*, act as qualified custodians for your *clients* in connection with advisory services you provide to *clients*? ________

Item 10 Control Persons

In this Item, we ask you to identify every *person* that, directly or indirectly, *controls* you. If you are filing an *umbrella registration*, the information in Item 10 should be provided for the *filing adviser* only.

If you are submitting an initial application or report, you must complete Schedule A and Schedule B. Schedule A asks for information about your direct owners and executive officers. Schedule B asks for information about your indirect owners. If this is an amendment and you are updating information you reported on either Schedule A or Schedule B (or both) that you filed with your initial application or report, you must complete Schedule C.

A. Does any *person* not named in Item 1.A. or Schedules A, B, or C, directly or indirectly, *control* your management or policies? ☐ Yes ☐ No

If yes, complete Section 10.A. of Schedule D.

B. If any *person* named in Schedules A, B, or C or in Section 10.A. of Schedule D is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934, please complete Section 10.B. of Schedule D.

Item 11 Disclosure Information

In this Item, we ask for information about your disciplinary history and the disciplinary history of all your *advisory affiliates*. We use this information to determine whether to grant your application for registration, to decide whether to revoke your registration or to place limitations on your activities as an investment adviser, and to identify potential problem areas to focus on during our on-site examinations. One event may result in "yes" answers to more than one of the questions below. In accordance with General Instruction 5 to Form ADV, "you" and "your" includes the *filing adviser* and all *relying advisers* under an *umbrella registration.*

Your *advisory affiliates* are: (1) all of your current *employees* (other than *employees* performing only clerical, administrative, support or similar functions); (2) all of your officers, partners, or directors (or any *person* performing similar functions); and (3) all *persons* directly or indirectly *controlling* you or *controlled* by you. If you are a "separately identifiable department or division" (SID) of a bank, see the Glossary of Terms to determine who your *advisory affiliates* are.

If you are registered or registering with the SEC or if you are an exempt reporting adviser, you may limit your disclosure of any event listed in Item 11 to ten years following the date of the event. If you are registered or registering with a state, you must respond to the questions as posed; you may, therefore, limit your disclosure to ten years following the date of an event only in responding to Items 11.A.(1), 11.A.(2), 11.B.(1), 11.B.(2), 11.D.(4), and 11.H(1)(a). For purposes of calculating this ten-year period, the date of an event is the date the final order, judgment, or decree was entered, or the date any rights of appeal from preliminary orders, judgments, or decrees lapsed.

You must complete the appropriate Disclosure Reporting Page ("DRP") for "yes" answers to the questions in this Item 11.

	Yes	No
Do any of the events below involve you or any of your *supervised persons?*	☐	☐

<u>For "yes" answers to the following questions, complete a Criminal Action DRP:</u>

	Yes	No
A. In the past ten years, have you or any *advisory affiliate*:		
(1) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign, or military court to any *felony*?	☐	☐
(2) been *charged* with any *felony*?	☐	☐

If you are registered or registering with the SEC, or if you are reporting as an exempt reporting adviser, you may limit your response to Item 11.A.(2) to charges that are currently pending.

B. In the past ten years, have you or any *advisory affiliate*:

(1) been convicted of or pled guilty or nolo contendere ("no contest") in a domestic, foreign, or military court to a *misdemeanor* involving: investments or an *investment-related* business, or any fraud, false statements, or omissions, wrongful taking of property, bribery, perjury, forgery, counterfeiting, extortion, or a conspiracy to commit any of these offenses? ☐ ☐

(2) been *charged* with a *misdemeanor* listed in Item 11.B.(1)? ☐ ☐

If you are registered or registering with the SEC, or if you are reporting as an exempt reporting adviser, you may limit your response to Item 11.B.(2) to charges that are currently pending.

For "yes" answers to the following questions, complete a Regulatory Action DRP:

Yes No

C. Has the SEC or the Commodity Futures Trading Commission (CFTC) ever:

(1) *found* you or any *advisory affiliate* to have made a false statement or omission? ☐ ☐

(2) *found* you or any *advisory affiliate* to have been *involved* in a violation of SEC or CFTC regulations or statutes? ☐ ☐

(3) *found* you or any *advisory affiliate* to have been a cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted? ☐ ☐

(4) entered an *order* against you or any *advisory affiliate* in connection with *investment-related* activity? ☐ ☐

(5) imposed a civil money penalty on you or any *advisory affiliate*, or *ordered* you or any *advisory affiliate* to cease and desist from any activity? ☐ ☐

D. Has any other federal regulatory agency, any state regulatory agency, or any *foreign financial regulatory authority*:

(1) ever *found* you or any *advisory affiliate* to have made a false statement or omission, or been dishonest, unfair, or unethical? ☐ ☐

(2) ever *found* you or any *advisory affiliate* to have been *involved* in a violation of *investment-related* regulations or statutes? ☐ ☐

Yes No

(3) ever *found* you or any *advisory affiliate* to have been a cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted? ☐ ☐

(4) in the past ten years, entered an *order* against you or any *advisory affiliate* in connection with an *investment-related* activity? ☐ ☐

(5) ever denied, suspended, or revoked your or any *advisory affiliate's* registration or license, or otherwise prevented you or any *advisory affiliate*, by *order*, from associating with an *investment-related* business or restricted your or any

advisory affiliate's activity? ☐ ☐

E. Has any *self-regulatory organization* or commodities exchange ever:

(1) *found* you or any *advisory affiliate* to have made a false statement or omission? ☐ ☐

(2) *found* you or any *advisory affiliate* to have been *involved* in a violation of its rules (other than a violation designated as a "*minor rule violation*" under a plan approved by the SEC)? ☐ ☐

(3) *found* you or any *advisory affiliate* to have been the cause of an *investment-related* business having its authorization to do business denied, suspended, revoked, or restricted? ☐ ☐

(4) disciplined you or any *advisory affiliate* by expelling or suspending you or the *advisory affiliate* from membership, barring or suspending you or the *advisory affiliate* from association with other members, or otherwise restricting your or the *advisory affiliate's* activities? ☐ ☐

F. Has an authorization to act as an attorney, accountant, or federal contractor granted to you or any *advisory affiliate* ever been revoked or suspended? ☐ ☐

G. Are you or any *advisory affiliate* now the subject of any regulatory *proceeding* that could result in a "yes" answer to any part of Item 11.C., 11.D., or 11.E.? ☐ ☐

For "yes" answers to the following questions, complete a Civil Judicial Action DRP:

Yes No

H. (1) Has any domestic or foreign court:

(a) in the past ten years, *enjoined* you or any *advisory affiliate* in connection with any *investment-related* activity? ☐ ☐

(b) ever *found* that you or any *advisory affiliate* were *involved* in a violation of *investment-related* statutes or regulations? ☐ ☐

(c) ever dismissed, pursuant to a settlement agreement, an *investment-related* civil action brought against you or any *advisory affiliate* by a state or *foreign financial regulatory authority*? ☐ ☐

(2) Are you or any *advisory affiliate* now the subject of any civil *proceeding* that could result in a "yes" answer to any part of Item 11.H(1)? ☐ ☐

Item 12 Small Businesses

The SEC is required by the Regulatory Flexibility Act to consider the effect of its regulations on small entities. In order to do this, we need to determine whether you meet the definition of "small business" or "small organization" under rule 0-7.

Answer this Item 12 only if you are registered or registering with the SEC and you indicated in response to Item 5.F.(2)(c) that you have regulatory assets under management of less than $25 million. You are not required to answer this Item 12 if you are filing for initial registration as a state adviser, amending a current state registration, or switching from SEC to state registration.

For purposes of this Item 12 only:

- Total Assets refers to the total assets of a firm, rather than the assets managed on behalf of *clients*. In determining your or another *person's* total assets, you may use the total assets shown on a current balance sheet (but use total assets reported on a consolidated balance sheet with subsidiaries included, if that amount is larger).

- *Control* means the power to direct or cause the direction of the management or policies of a *person*, whether through ownership of securities, by contract, or otherwise. Any *person* that directly or indirectly has the right to vote 25 percent or more of the voting securities, or is entitled to 25 percent or more of the profits, of another *person* is presumed to *control* the other *person*.

	Yes	No
A. Did you have total assets of $5 million or more on the last day of your most recent fiscal year?	☐	☐

If "yes," you do not need to answer Items 12.B. and 12.C.

B. Do you:

(1) *control* another investment adviser that had regulatory assets under management (calculated in response to Item 5.F.(2)(c) of Form ADV) of $25 million or more on the last day of its most recent fiscal year?	☐	☐
(2) *control* another *person* (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year?	☐	☐

C. Are you:

(1) *controlled* by or under common *control* with another investment adviser that had regulatory assets under management (calculated in response to Item 5.F.(2)(c) of Form ADV) of $25 million or more on the last day of its most recent fiscal year?	☐	☐
(2) *controlled* by or under common *control* with another *person* (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year?	☐	☐

FORM ADV Schedule A	Your Name________________ Date________________	SEC File No.________________ *CRD* No.________________

Direct Owners and Executive Officers

1. Complete Schedule A only if you are submitting an initial application or report. Schedule A asks for information about your direct owners and executive officers. Use Schedule C to amend this information.

2. Direct Owners and Executive Officers. List below the names of:

   (a) each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, Chief Compliance Officer (Chief Compliance Officer is required if you are registered or applying for registration and cannot be more than one individual), director and any other individuals with similar status or functions;

   (b) if you are organized as a corporation, each shareholder that is a direct owner of 5% or more of a class of your voting securities, unless you are a public reporting company (a company subject to Section 12 or 15(d) of the Exchange Act);

   Direct owners include any *person* that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 5% or more of a class of your voting securities. For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (c) if you are organized as a partnership, <u>all</u> general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of your capital;

   (d) in the case of a trust that directly owns 5% or more of a class of your voting securities, or that has the right to receive upon dissolution, or has contributed, 5% or more of your capital, the trust and each trustee; and

   (e) if you are organized as a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of your capital, and (ii) if managed by elected managers, all elected managers.

3. Do you have any indirect owners to be reported on Schedule B? ☐ Yes ☐ No

4. In the DE/FE/I column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "I" if the owner or executive officer is an individual.

5. Complete the Title or Status column by entering board/management titles; status as partner, trustee, sole proprietor, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

6. Ownership codes are:

NA - less than 5%	B - 10% but less than 25%	D - 50% but less than 75%
A - 5% but less than 10%	C - 25% but less than 50%	E - 75% or more

7. (a) In the *Control Person* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form ADV, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.
   (b) In the PR column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Exchange Act.
   (c) Complete each column.

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Title or Status	Date Title or Status Acquired MM	YYYY	Ownership Code	*Control Person*	PR	*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.

RM ADV nedule B	Your Name__________ Date__________	SEC File No.__________ *CRD* No.__________

Indirect Owners

1. Complete Schedule B only if you are submitting an initial application or report. Schedule B asks for information about your indirect owners; you must first complete Schedule A, which asks for information about your direct owners. Use Schedule C to amend this information.

2. Indirect Owners. With respect to each owner listed on Schedule A (except individual owners), list below:

   (a) in the case of an owner that is a corporation, each of its shareholders that beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 25% or more of a class of a voting security of that corporation;

   For purposes of this Schedule, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

   (b) in the case of an owner that is a partnership, <u>all</u> general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 25% or more of the partnership's capital;

   (c) in the case of an owner that is a trust, the trust and each trustee; and

   (d) in the case of an owner that is a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 25% or more of the LLC's capital, and (ii) if managed by elected managers, all elected managers.

3. Continue up the chain of ownership listing all 25% owners at each level. Once a public reporting company (a company subject to Sections 12 or 15(d) of the Exchange Act) is reached, no further ownership information need be given.

In the DE/FE/I column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "I" if the owner is an individual.

5. Complete the Status column by entering the owner's status as partner, trustee, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

6. Ownership codes are: C - 25% but less than 50% D - 50% but less than 75% E - 75% or more F - Other (general partner, trustee, or elected manager)

7. (a) In the *Control Person* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form ADV, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.
   (b) In the PR column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Exchange Act.
   (c) Complete each column.

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Entity in Which Interest is Owned	Status	Date Status Acquired MM	YYYY	Ownership Code	*Control Person*	PR	*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.

FORM ADV Schedule C	Your Name____________ Date____________	SEC File No.____________ *CRD* No.____________

Amendments to Schedules A and B

1. Use Schedule C only to amend information requested on either Schedule A or Schedule B. Refer to Schedule A and Schedule B for specific instructions for completing this Schedule C. Complete each column.

2. In the Type of Amendment column, indicate "A" (addition), "D" (deletion), or "C" (change in information about the same *person*).

3. Ownership codes are:
   NA - less than 5%
   A - 5% but less than 10%
   B - 10% but less than 25%
   C - 25% but less than 50%
   D - 50% but less than 75%
   E - 75% or more
   G - Other (general partner, trustee, or elected member)

4. List below all changes to Schedule A (Direct Owners and Executive Officers):

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Type of Amendment	Title or Status	Date Title or Status Acquired MM/YYYY	Ownership Code	*Control Person*	PR	*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.

5. List below all changes to Schedule B (Indirect Owners):

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Type of Amendment	Title or Status	Date Title or Status Acquired MM/YYYY	Ownership Code	*Control Person*	PR	*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax No. or Employer ID No.

FORM ADV Schedule D Page 1 of 17	Your Name__________ Date__________	*CRD* Number__________ SEC 801- or 802 Number__________

ain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. ort only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

SECTION 1.B. Other Business Names

List your other business names and the jurisdictions in which you use them. You must complete a separate Schedule D Section 1.B. for each business name.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name ____________________ Jurisdictions ________________

SECTION 1.F. Other Offices

Complete the following information for each office, other than your *principal office and place of business*, at which you conduct investment advisory business. You must complete a separate Schedule D Section 1.F. for each location. If you are applying for SEC registration, if you are registered only with the SEC, or if you are an *exempt reporting adviser*, list only the largest twenty-five offices (in terms of numbers of *employees*).

Check only one box: ☐ Add ☐ Delete

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

________________ ________________
.a code) (telephone number) (area code) (facsimile number, if any)

If this office location is also required to be registered with FINRA or a *state securities authority* as a branch office location for a broker-dealer or investment adviser on the Uniform Branch Office Registration Form (Form BR), please provide the *CRD* Branch Number here:

How many *employees* perform investment advisory functions from this office location? ________

Are other business activities conducted at this office location? (check all that apply)

- ☐ (1) Broker-dealer (registered or unregistered)
- ☐ (2) Bank (including a separately identifiable department or division of a bank)
- ☐ (3) Insurance broker or agent
- ☐ (4) Commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
- ☐ (5) Registered municipal advisor
- ☐ (6) Accountant or accounting firm
- ☐ (7) Lawyer or law firm

Describe any other *investment-related* business activities conducted from this office location:

____

SECTION 1.I. Website Addresses

your website addresses, including website addresses for social media platforms (including, but not limited to, Twitter, Facebook and/or .cedIn). You must complete a separate Schedule D Section 1.I. for each website or social media website address.

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

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Check only one box: ☐ Add ☐ Delete

Website Address/Social Media Website Address: ________________________

SECTION 1.L. Location of Books and Records

Complete the following information for each location at which you keep your books and records, other than your *principal office and place of business*. You must complete a separate Schedule D Section 1.L. for each location.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of entity where books and records are kept: ________________________

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

________________________ ________________________
(area code) (telephone number) (area code) (facsimile number, if any)

This is (check one): ☐ one of your branch offices or affiliates.
☐ a third-party unaffiliated recordkeeper.
☐ other.

Briefly describe the books and records kept at this location. ________________________

____

SECTION 1.M. Registration with *Foreign Financial Regulatory Authorities*

List the name and country, in English, of each *foreign financial regulatory authority* with which you are registered. You must complete a separate Schedule D Section 1.M. for each *foreign financial regulatory authority* with whom you are registered.

Check only one box: ☐ Add ☐ Delete

Name of *Foreign Financial Regulatory Authority* ________________________
Name of Country ________________________

SECTION 2.A.(8) Related Adviser

If you are relying on the exemption in rule 203A-2(b) from the prohibition on registration because you *control*, are *controlled* by, or are under common *control* with an investment adviser that is registered with the SEC and your *principal office and place of business* is the same as that of the registered adviser, provide the following information:

Name of Registered Investment Adviser ________________________
CRD Number of Registered Investment Adviser ________________________
SEC Number of Registered Investment Adviser 801-________________________

SECTION 2.A.(9) Investment Adviser Expecting to be Eligible for Commission Registration within 120 Days

If you are relying on rule 203A-2(c), the exemption from the prohibition on registration available to an adviser that expects to be eligible for SEC registration within 120 days, you are required to make certain representations about your eligibility for SEC registration. By checking the appropriate boxes, you will be deemed to have made the required representations. You must make both of these representations:

☐ I am not registered or required to be registered with the SEC or a *state securities authority* and I have a reasonable expectation that I will be eligible to register with the SEC within 120 days after the date my registration with the SEC becomes effective.

...ain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. ...eport only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

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☐ I undertake to withdraw from SEC registration if, on the 120th day after my registration with the SEC becomes effective, I would be prohibited by Section 203A(a) of the Advisers Act from registering with the SEC.

SECTION 2.A.(10) Multi-State Adviser

If you are relying on rule 203A-2(d), the multi-state adviser exemption from the prohibition on registration, you are required to make certain representations about your eligibility for SEC registration. By checking the appropriate boxes, you will be deemed to have made the required representations.

If you are applying for registration as an investment adviser with the SEC, you must make both of these representations:

☐ I have reviewed the applicable state and federal laws and have concluded that I am required by the laws of 15 or more states to register as an investment adviser with the *state securities authorities* in those states.

☐ I undertake to withdraw from SEC registration if I file an amendment to this registration indicating that I would be required by the laws of fewer than 15 states to register as an investment adviser with the *state securities authorities* of those states.

If you are submitting your *annual updating amendment*, you must make this representation:

☐ Within 90 days prior to the date of filing this amendment, I have reviewed the applicable state and federal laws and have concluded that I am required by the laws of at least 15 states to register as an investment adviser with the *state securities authorities* in those states.

SECTION 2.A.(12) SEC Exemptive *Order*

...ou are relying upon an SEC *order* exempting you from the prohibition on registration, provide the following information:

Application Number: 803-____________ Date of *order*: ____________
(mm/dd/yyyy)

SECTION 2.B. *Private Fund* Assets

If you check Item 2.B.(2) or (3), what is the amount of the *private fund* assets that you manage? ____________.

NOTE: "*Private fund* assets" has the same meaning here as it has under rule 203(m)-1. If you are an investment adviser with its *principal office and place of business* outside of the United States only include *private fund* assets that you manage at a place of business in the United States.

SECTION 4 Successions

Complete the following information if you are succeeding to the business of a currently registered investment adviser, including a change of your structure or legal status (*e.g.*, form of organization or state of incorporation). If you acquired more than one firm in the succession you are reporting on this Form ADV, you must complete a separate Schedule D Section 4 for each acquired firm. See Part 1A Instruction 4.

Name of Acquired Firm ________________________________

Acquired Firm's SEC File No. (if any) 801-____________ Acquired Firm's *CRD* Number ____________

SECTION 5.G.(3) Advisers to Registered Investment Companies and Business Development Companies

If you check Item 5.G (3), what is the SEC file number (811 or 814 number) of each of the registered investment companies and business development companies to which you act as an adviser pursuant to an advisory contract? You must complete a separate Schedule D Section 5.G.(3) for each registered investment company and business development company to which you act as an adviser.

...ck only one box: ☐ Add ☐ Delete

SEC File Number 811- or 814-____________

FORM ADV Schedule D Page 4 of 17	Your Name ______ Date ______	*CRD* Number ______ SEC 801- or 802 Number ______

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

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Provide the regulatory assets under management of all *parallel managed accounts* related to a registered investment company or business development company that you advise.

$______________

SECTION 5.I.(2) *Wrap Fee Programs*

If you are a portfolio manager for one or more *wrap fee programs*, list the name of each program and its *sponsor*. You must complete a separate Schedule D Section 5.I.(2) for each *wrap fee program* for which you are a portfolio manager.

Check only one box: ☐ Add ☐ Delete ☐ Amend

Name of *Wrap Fee Program* ______________________________

Name of *Sponsor* ______________________________

Sponsor's SEC File Number (if any) (*e.g.*, 801-, 8-, 866-, 802-) ______________

Sponsor's CRD Number (if any): ______________

SECTION 5.K.(1) Separately Managed Accounts

After subtracting the amounts reported in Item 5.D.(2)(d)-(f) from your total regulatory assets under management, indicate the approximate percentage of this remaining amount attributable to each of the following categories of assets. If the remaining amount is at least $10 billion in regulatory assets under management, complete Question (a). If the remaining amount is less than $10 billion in regulatory assets under management, complete Question (b). End of year refers to the date used to calculate your regulatory assets under management for purposes of your *annual updating amendment*. Mid-year is the date six months before the end of year date. Each column should add up to 100%.

(a)

Asset Type		Mid-year	End of year
(i)	Exchange-Traded Equity Securities	___%	
(ii)	U.S. Government /Agency Bonds		
(iii)	U.S. State and Local Bonds		
(iv)	*Sovereign Bonds*		
(v)	Corporate Bonds – *Investment Grade*		
(vi)	Corporate Bonds – *Non-Investment Grade*		
(vii)	Derivatives		
(viii)	Securities Issued by Registered Investment Companies or Business Development Companies		
(ix)	Securities Issued by Pooled Investment Vehicles (other than Registered Investment Companies)		
(x)	Other		

Generally describe any assets included in “Other”: ______________________________

ain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. ,ort only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

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(b)

Asset Type		End of year
(i)	Exchange-Traded Equity Securities	___%
(ii)	U.S. Government /Agency Bonds	
(iii)	U.S. State and Local Bonds	
(iv)	*Sovereign Bonds*	
(v)	Corporate Bonds – *Investment Grade*	
(vi)	Corporate Bonds – *Non-Investment Grade*	
(vii)	Derivatives	
(viii)	Securities Issued by Registered Investment Companies or Business Development Companies	
(ix)	Securities Issued by Pooled Investment Vehicles (other than Registered Investment Companies)	
(x)	Other	

ᴗenerally describe any assets included in "Other":______

Section 5.K.(2). Separately Managed Accounts – Use of *Borrowings* and Derivatives. If your regulatory assets under management attributable to separately managed accounts are at least $10 billion, you should complete Question (a). If your regulatory assets under management attributable to separately managed accounts are at least $150 million but less than $10 billion, you should complete Question (b).

(a)

In the table below, provide the following information regarding the separately managed accounts you advise. If you are a subadviser to a separately managed account, you should only provide information with respect to the portion of the account that you subadvise. End of year refers to the date used to calculate your regulatory assets under management for purposes of your *annual updating amendment*. Mid-year is the date six months before the end of year date.

In column 1, indicate the number of separately managed accounts you advise according to *net asset value* and gross notional exposure. For this purpose, the gross notional exposure of an account is the percentage obtained by dividing (i) the sum of (a) the dollar amount of any *borrowings* and (b) the *gross notional value* of all derivatives, by (ii) the *net asset value* of the account.

In column 2, provide the weighted average amount of *borrowings* (as a percentage of net assets) for the accounts included in column 1.

In column 3, provide the weighted average *gross notional value* of derivatives (aggregate *gross notional value* of derivatives divided by the aggregate *net asset value* of the accounts included in column 1) with respect to each category of derivatives specified in 3(a) through (f).

You do not need to complete the table with respect to any separately managed accounts with a *net asset value* of less than $10,000,000.

Your Name________________ *CRD* Number________________
Date________________ SEC 801- or 802 Number________________

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(i) Mid-Year

Net asset value **of account**	**Gross notional exposure**	**1 Number of accounts**	**2 Average *borrowings***	**3 Average Derivative Exposures**					
				(a) *Interest Rate Derivative*	(b) *Foreign Exchange Derivative*	(c) *Credit Derivative*	(d) *Equity Derivative*	(e) *Commodity Derivative*	(f) *Other Derivative*
$10,000,000-249,999,999	**Less than 10%**								
	10-99%								
	100-199%								
	200% or more								
$250,000,000-999,999,999	**Less than 10%**								
	10-99%								
	100-199%								
	200% or more								
$1,000,000,000-or greater	**Less than 10%**								
	10-99%								
	100-199%								
	200% or more								

Optional: Use the space below to provide a narrative description of the strategies and/or manner in which *borrowings* and derivatives are used in the management of the separately managed accounts that you advise.

(ii) End of Year

Net asset value **of account**	**Gross notional exposure**	**1 Number of accounts**	**2 Average *borrowings***	**3 Average Derivative Exposures**					
				(a) *Interest Rate Derivative*	(b) *Foreign Exchange Derivative*	(c) *Credit Derivative*	(d) *Equity Derivative*	(e) *Commodity Derivative*	(f) *Other Derivative*
$10,000,000-249,999,999	**Less than 10%**								
	10-99%								
	100-199%								
	200% or more								
$250,000,000-999,999,999	**Less than 10%**								
	10-99%								
	100-199%								
	200% or more								
$1,000,000,000-or greater	**Less than 10%**								
	10-99%								
	100-199%								
	200% or more								

Optional: Use the space below to provide a narrative description of the strategies and/or manner in which *borrowings* and derivatives are used in the management of the separately managed accounts that you advise.

Your Name____________________ *CRD* Number____________________
Date____________________ SEC 801- or 802 Number____________________

ıin items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. ...port only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

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(b)

In the table below, provide the following information regarding the separately managed accounts you advise as of the date used to calculate your regulatory assets under management for purposes of your *annual updating amendment*. If you are a subadviser to a separately managed account, you should only provide information with respect to the portion of the account that you subadvise.

In column 1, indicate the number of separately managed accounts you advise according to *net asset value* and gross notional exposure. For purposes of this item, the gross notional exposure of an account is the percentage obtained by dividing (i) the sum of (a) the dollar amount of any *borrowings* and (b) the *gross notional value* of all derivatives, by (ii) the *net asset value* of the account.

In column 2, provide the weighted average amount of *borrowings* (as a percentage of *net asset value*) for the accounts included in column 1.

You do not need to complete the table with respect to any separately managed accounts with a *net asset value* of less than $10,000,000.

***Net asset value* of account**	**Gross notional exposure**	**1 Number of accounts**	**2 Average *borrowings***
$10,000,000-249,999,999	**Less than 10%**		
	10-99%		
	100-199%		
	200% or more		
ı,000,000-999,999	**Less than 10%**		
	10-99%		
	100-199%		
	200% or more		
$1,000,000,000-or greater	**Less than 10%**		
	10-99%		
	100-199%		
	200% or more		

Optional: Use the space below to provide a narrative description of the strategies and/or manner in which *borrowings* and derivatives are used in the management of the separately managed accounts that you advise.

____
____
____

SECTION 5.K.(3) Custodians for Separately Managed Accounts

Complete a separate Schedule D Section 5.K.(3) for each custodian that holds ten percent or more of your separately managed account *client* regulatory assets under management.

(a) Legal name of custodian: ________________________

(b) Primary business name of custodian: ________________________

(c) The location(s) of the custodian's office(s) responsible for *custody* of the assets (city, state and country): ____________

(d) Is the custodian a *related person* of your firm? ☐ Yes ☐ No

(e) If the custodian is a broker-dealer, provide its SEC registration number (if any) 8-____________

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(f) If the custodian is not a broker-dealer, or is a broker-dealer but does not have an SEC registration number, provide its *legal entity identifier* (if any)____________

(g) What amount of your regulatory assets under management attributable to separately managed accounts is held at the custodian?__________

SECTION 6.A. Names of Your Other Businesses

If you are actively engaged in other business using a different name, provide that name and the other line(s) of business.

☐ Add ☐ Delete ☐ Amend

Other Business Name: ____________________

Other line(s) of business in which you engage using this name: (check all that apply)

- ☐ (1) broker-dealer (registered or unregistered)
- ☐ (2) registered representative of a broker-dealer
- ☐ (3) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
- ☐ (4) futures commission merchant
- ☐ (5) real estate broker, dealer, or agent
- ☐ (6) insurance broker or agent
- ☐ (7) bank (including a separately identifiable department or division of a bank)
- ☐ (8) trust company
- ☐ (9) registered municipal advisor
- ☐ (10) registered security-based swap dealer
- ☐ (11) major security-based swap participant
- ☐ (12) accountant or accounting firm
- ☐ (13) lawyer or law firm
- ☐ (14) other financial product salesperson (specify): ____________________

SECTION 6.B.(2) Description of Primary Business

Describe your primary business (not your investment advisory business):

____

If you engage in that business under a different name, provide that name:

____

SECTION 6.B.(3) Description of Other Products and Services

Describe other products or services you sell to your *client*. You may omit products and services that you listed in Section 6.B.2. above.

____

If you engage in that business under a different name, provide that name:

____

FORM ADV Schedule D Page 9 of 17	Your Name________________ Date________________	*CRD* Number________________ SEC 801- or 802 Number________________

ain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. ,ort only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

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SECTION 7.A. Financial Industry Affiliations

Complete a separate Schedule D Section 7.A. for each *related person* listed in Item 7.A.

Check only one box: ☐ Add ☐ Delete ☐ Amend

1. Legal Name of *Related Person*: ________________________________
2. Primary Business Name of *Related Person*: ________________________________
3. *Related Person*'s SEC File Number (if any) (*e.g.*, 801-, 8-, 866-, 802-) ____________
4. *Related Person's* (a) *CRD* Number (if any): __________ (b) CIK Number(s) (if any): __________
5. *Related Person* is: (check all that apply)

   ☐ (a) broker-dealer, municipal securities dealer, or government securities broker or dealer
   ☐ (b) other investment adviser (including financial planners)
   ☐ (c) registered municipal advisor
   ☐ (d) registered security-based swap dealer
   ☐ (e) major security-based swap participant
   ☐ (f) commodity pool operator or commodity trading advisor (whether registered or exempt from registration)
   ☐ (g) futures commission merchant
   ☐ (h) banking or thrift institution
   ☐ (i) trust company
   ☐ (j) accountant or accounting firm
   ☐ (k) lawyer or law firm
   ☐ (l) insurance company or agency
   ☐ (m) pension consultant
   ☐ (n) real estate broker or dealer
   ☐ (o) sponsor or syndicator of limited partnerships (or equivalent), excluding pooled investment vehicles
   ☐ (p) sponsor, general partner, managing member (or equivalent) of pooled investment vehicles

6. Do you *control* or are you *controlled* by the *related person*? ☐ Yes ☐ No
7. Are you and the *related person* under common *control*? ☐ Yes ☐ No
8. (a) Does the *related person* act as a qualified custodian for your *clients* in connection with advisory services you provide to *clients*? ☐ Yes ☐ No

   (b) If you are registering or registered with the SEC and you have answered "yes" to question 8.(a) above, have you overcome the presumption that you are not operationally independent (pursuant to rule 206(4)-(2)(d)(5)) from the *related person* and thus are not required to obtain a surprise examination for your *clients'* funds or securities that are maintained at the *related person*? ☐ Yes ☐ No

   (c) If you have answered "yes" to question 8.(a) above, provide the location of the *related person*'s office responsible for *custody* of your *clients'* assets:

   ____
   (number and street)

   ____
   (city) (state/country) (zip+4/postal code)

9. (a) If the *related person* is an investment adviser, is it exempt from registration? ☐ Yes ☐ No

   (b) If the answer is yes, under what exemption? ______

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This is an ☐ INITIAL or ☐ AMENDED Schedule D

10. (a) Is the *related person* registered with a *foreign financial regulatory authority?* ☐ Yes ☐ No

    (b) If the answer is yes, list the name and country, in English, of each *foreign financial regulatory authority* with which the *related person* is registered. ________________________

11. Do you and the *related person* share any *supervised persons*? ☐ Yes ☐ No

12. Do you and the *related person* share the same physical location? ☐ Yes ☐ No

---

SECTION 7.B.(1) *Private Fund* Reporting

Check only one box: ☐ Add ☐ Delete ☐ Amend

A. PRIVATE FUND

Information About the *Private Fund*

1. (a) Name of the *private fund*: __________________

   (b) *Private fund* identification number: __________________

2. Under the laws of what state or country is the *private fund* organized: _______________________

3. Name(s) of General Partner, Manager, Trustee, or Directors (or *persons* serving in a similar capacity):

   (a) Check only one box: ☐ Add ☐ Delete ☐ Amend

   (b) If filing an *umbrella registration*, identify the *filing adviser* or *relying adviser* that sponsors or manages this *private fund*.

   ____

4. The *private fund* (check all that apply; you must check at least one):

   ☐ (1) qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the Investment Company Act of 1940

   ☐ (2) qualifies for the exclusion from the definition of investment company under section 3(c)(7) of the Investment Company Act of 1940

5. List the name and country, in English, of each *foreign financial regulatory authority* with which the *private fund* is registered.

   Check only one box: ☐ Add ☐ Delete ☐ Amend

   English Name of *Foreign Financial Regulatory Authority* ______________ Name of Country ______________

6. (a) Is this a "master fund" in a master-feeder arrangement? ☐ Yes ☐ No

   (b) If yes, what is the name and *private fund* identification number (if any) of the feeder funds investing in this *private fund*?

   Check only one box: ☐ Add ☐ Delete ☐ Amend

   ________ ________

   (c) Is this a "feeder fund" in a master-feeder arrangement? ☐ Yes ☐ No

...ain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. ...port only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

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(d) If yes, what is the name and *private fund* identification number (if any) of the master fund in which this *private fund* invests?

Check only one box: ☐ Add ☐ Delete ☐ Amend

________ ________

NOTE: You must complete question 6 for each master-feeder arrangement regardless of whether you are filing a single Schedule D, Section 7.B.(1) for the master-feeder arrangement or reporting on the funds separately.

7. If you are filing a single Schedule D, Section 7.B.(1) for a master-feeder arrangement according to the instructions to this Section 7.B.(1), for each of the feeder funds answer the following questions:

Check only one box: ☐ Add ☐ Delete ☐ Amend

(a) Name of the *private fund*: ____________

(b) *Private fund* identification number: ________________

(c) Under the laws of what state or country is the *private fund* organized: ____________________

(d) Name(s) of General Partner, Manager, Trustee, or Directors (or *persons* serving in a similar capacity):

(1) Check only one box: ☐ Add ☐ Delete ☐ Amend

____

(2) If filing an *umbrella registration*, identify the *filing adviser* or *relying adviser* that sponsors or manages this *private fund*.

____

(e) The *private fund* (check all that apply; you must check at least one):

☐ (1) qualifies for the exclusion from the definition of investment company under section 3(c)(1) of the Investment Company Act of 1940

☐ (2) qualifies for the exclusion from the definition of investment company under section 3(c)(7) of the Investment Company Act of 1940

(f) List the name and country, in English, of each *foreign financial regulatory authority* with which the *private fund* is registered.

Check only one box: ☐ Add ☐ Delete ☐ Amend

English Name of *Foreign Financial Regulatory Authority* ________________ Name of Country ________________

NOTE: For purposes of questions 6 and 7, in a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund"). A fund would also be a "feeder fund" investing in a "master fund" for purposes of this question if it issued multiple classes (or series) of shares or interests, and each class (or series) invests substantially all of its assets in a single master fund.

8. (a) Is this *private fund* a "fund of funds"? ☐ Yes ☐ No

NOTE: For purposes of this question only, answer "yes" if the fund invests 10 percent or more of its total assets in other pooled investment vehicles, regardless of whether they are also *private funds* or registered investment companies.

(b) If yes, does the *private fund* invest in funds managed by you or by a *related person?* ☐ Yes ☐ No

Your Name___________________
Date___________________

CRD Number___________________
SEC 801- or 802 Number___________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

9. During your last fiscal year, did the *private fund* invest in securities issued by investment companies registered under the Investment Company Act of 1940 (other than "money market funds," to the extent provided in Instruction 6.e.)? ☐ Yes ☐ No

10. What type of fund is the *private fund*?

☐ hedge fund ☐ liquidity fund ☐ private equity fund ☐ real estate fund ☐ securitized asset fund ☐ venture capital fund

☐Other *private fund*: __________

NOTE: For definitions of these fund types, please see Instruction 6 of the Instructions to Part 1A.

11. Current gross asset value of the *private fund*: $_____

Ownership

12. Minimum investment commitment required of an investor in the *private fund*: $____________

NOTE: Report the amount routinely required of investors who are not your *related persons* (even if different from the amount set forth in the organizational documents of the fund).

13. Approximate number of the *private fund*'s beneficial owners: ____

14. What is the approximate percentage of the *private fund* beneficially owned by you and your *related persons*:

_____ %

15. What is the approximate percentage of the *private fund* beneficially owned (in the aggregate) by:

a. Funds of funds:

_____ %

b. *Qualified clients*

_____ %

16. What is the approximate percentage of the *private fund* beneficially owned by *non-United States persons*:

_____ %

Your Advisory Services

17. (a) Are you a subadviser to this *private fund*? ☐ Yes ☐ No

(b) If the answer to question 17(a) is "yes," provide the name and SEC file number, if any, of the adviser of the *private fund*. If the answer to question 17(a) is "no," leave this question blank. ____________

18. (a) Do any other investment advisers advise the *private fund*? ☐ Yes ☐ No

(b) If the answer to question 18(a) is "yes," provide the name and SEC file number, if any, of the other advisers to the *private fund*. If t answer to question 18(a) is "no," leave this question blank.

Your Name________________ Date________________

CRD Number________________
SEC 801- or 802 Number________________

ain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. ...eport only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

Check only one box: ☐ Add ☐ Delete ☐ Amend

____________ ____________

19. Are your *clients* solicited to invest in the *private fund*? ☐ Yes ☐ No
NOTE: For purposes of this question, do not consider feeder funds of the private fund.

20. Approximately what percentage of your *clients* has invested in the *private fund*? _____%

Private Offering

21. Has the *private fund* ever relied on an exemption from registration of its securities under Regulation D of the Securities Act of 1933?
☐ Yes ☐ No

22. If yes, provide the *private fund*'s Form D file number (if any):

Check only one box: ☐ Add ☐ Delete ☐ Amend

021-______________

B. SERVICE PROVIDERS

☐ Check this box if you are filing this Form ADV through the IARD system and want the IARD system to create a new Schedule D, Section 7.B.(1) with the same service provider information you have given here in Questions 23 - 28 for a new *private fund* for which you are required to complete Section 7.B.(1) If you check the box, the system will pre-fill those fields for you, but you will be able to manually edit the information after it is pre-filled and before you submit your filing.

Auditors

23. (a) (1) Are the *private fund*'s financial statements subject to an annual audit? ☐ Yes ☐ No

(2) If the answer to 23(a)(1) is yes, are the financial statements prepared in accordance with U.S. GAAP? ☐ Yes ☐ No

If the answer to 23(a)(1) is "yes," respond to questions (b) through (h) below. If the *private fund* uses more than one auditing firm, you must complete questions (b) through (h) separately for each auditing firm.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Name of the auditing firm: ________________________________

(c) The location of the auditing firm's office responsible for the *private fund's* audit (city, state and country): ______________

(d) Is the auditing firm an *independent public accountant*? ☐ Yes ☐ No

(e) Is the auditing firm registered with the Public Company Accounting Oversight Board? ☐ Yes ☐ No

If yes, Public Company Accounting Oversight Board Registration Number: ________________

(f) If "yes" to (e) above, is the auditing firm subject to regular inspection by the Public Company Accounting Oversight Board in accordance with its rules? ☐ Yes ☐ No

(g) Are the *private fund*'s audited financial statements for the most recently completed fiscal year distributed to the *private fund*'s investors? ☐ Yes ☐ No

(h) Do all of the reports prepared by the auditing firm for the *private fund* since your last <u>*annual*</u> *updating amendment* contain unqualified opinions? ☐ Yes ☐ No ☐ Report Not

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

Yet Received

If you check "Report Not Yet Received," you must promptly file an amendment to your Form ADV to update your response when the report is available.

Prime Broker

24. (a) Does the *private fund* use one or more prime brokers? ☐ Yes ☐ No

If the answer to 24(a) is "yes," respond to questions (b) through (e) below for each prime broker the *private fund* uses. If the *private fund* uses more than one prime broker, you must complete questions (b) through (e) separately for each prime broker.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Name of the prime broker: __________

(c) If the prime broker is registered with the SEC, its registration number: 8-_____________

(d) Location of prime broker's office used principally by the *private fund* (city, state and country): ______________________________

(e) Does this prime broker act as custodian for some or all of the *private fund*'s assets? ☐ Yes ☐ No

Custodian

25. (a) Does the *private fund* use any custodians (including the prime brokers listed above) to hold some or all of its assets? ☐ Yes ☐ No

If the answer to 25(a) is "yes," respond to questions (b) through (f) below for each custodian the *private fund* uses. If the *private fun'* uses more than one custodian, you must complete questions (b) through (g) separately for each custodian.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Legal name of custodian: ______________________________

(c) Primary business name of custodian: ______________________________

(d) The location of the custodian's office responsible for *custody* of the *private fund*'s assets (city, state and country): ______________

(e) Is the custodian a *related person* of your firm? ☐ Yes ☐ No

(f) If the custodian is a broker-dealer, provide its SEC registration number (if any) 8-______________

(g) If the custodian is not a broker-dealer, or is a broker-dealer but does not have an SEC registration number, provide its *legal entity identifier* (if any)____

Administrator

26. (a) Does the *private fund* use an administrator other than your firm? ☐ Yes ☐ No

If the answer to 26(a) is "yes," respond to questions (b) through (f) below. If the *private fund* uses more than one administrator, you must complete questions (b) through (f) separately for each administrator.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Name of administrator: ______________________________

(c) Location of administrator (city, state and country): ______________________________

(d) Is the administrator a *related person* of your firm? ☐ Yes ☐ No ain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. ..eport only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

(e) Does the administrator prepare and send investor account statements to the *private fund*'s investors?

☐ Yes (provided to all investors) ☐ Some (provided to some but not all investors) ☐ No (provided to no investors)

(f) If the answer to 26(e) is "no" or "some," who sends the investor account statements to the (rest of the) *private fund*'s investors? If investor account statements are not sent to the (rest of the) *private fund*'s investors, respond "not applicable."

____________________.

27. During your last fiscal year, what percentage of the *private fund*'s assets (by value) was valued by a *person*, such as an administrator, that is not your *related person*?

________%

Include only those assets where (i) such person carried out the valuation procedure established for that asset, if any, including obtaining any relevant quotes, and (ii) the valuation used for purposes of investor subscriptions, redemptions or distributions, and fee calculations (including allocations) was the valuation determined by such person.

Marketers

28. (a) Does the *private fund* use the services of someone other than you or your *employees* for marketing purposes? ☐ Yes ☐ No

You must answer "yes" whether the *person* acts as a placement agent, consultant, finder, introducer, municipal advisor or other solicitor, or similar *person*. If the answer to 28(a) is "yes", respond to questions (b) through (g) below for each such marketer the *private fund* uses. If the *private fund* uses more than one marketer, you must complete questions (b) through (g) separately for each marketer.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(b) Is the marketer a *related person* of your firm? ☐ Yes ☐ No

(c) Name of the marketer: ____________________

(d) If the marketer is registered with the SEC, its file number (*e.g.*, 801-, 8-, or 866-): ________ and *CRD* Number (if any) ________

(e) Location of the marketer's office used principally by the *private fund* (city, state and country):

____

(f) Does the marketer market the *private fund* through one or more websites? ☐ Yes ☐ No

(g) If the answer to 28(f) is "yes," list the website address(es): ________

SECTION 7.B.(2) *Private Fund* Reporting

(1) Name of the *private fund* ________________

(2) *Private fund* identification number ________

Name and SEC File number of adviser that provides information about this *private fund* in Section 7.B.(1) of Schedule D of its Form ADV filing ________________, 801- ________ or 802-________

(4) Are your *clients* solicited to invest in this *private fund*? ☐ Yes ☐ No

Your Name ____________________ CRD Number ____________________
Date ____________________ SEC 801- or 802 Number ____________________

Certain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

In answering this question, disregard feeder funds' investment in a master fund. For purposes of this question, in a master-feeder arrangement, one or more funds ("feeder funds") invest all or substantially all of their assets in a single fund ("master fund"). A fund would also be a "feeder fund" investing in a "master fund" for purposes of this question if it issued multiple classes (or series) of shares or interests, and each class (or series) invests substantially all of its assets in a single master fund.

SECTION 9.C. *Independent Public Accountant*

You must complete the following information for each *independent public accountant* engaged to perform a surprise examination, perform an audit of a pooled investment vehicle that you manage, or prepare an internal control report. You must complete a separate Schedule D Section 9.C. for each *independent public accountant*.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Name of the *independent public accountant*: ______________________________

(2) The location of the *independent public accountant*'s office responsible for the services provided:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

(3) Is the *independent public accountant* registered with the Public Company Accounting Oversight Board? ☐ Yes ☐ No

If yes, Public Company Accounting Oversight Board Registration Number: ______________

(4) If yes to (3) above, is the *independent public accountant* subject to regular inspection by the Public Company Accounting Oversight Board in accordance with its rules? ☐ Yes ☐ No

(5) The *independent public accountant* is engaged to:

A. ☐ audit a pooled investment vehicle
B. ☐ perform a surprise examination of *clients'* assets
C. ☐ prepare an internal control report

(6) Since your last *annual updating amendments*, did all of the reports prepared by the *independent public accountant* that audited the pooled investment vehicle or that examined internal controls contain unqualified opinions? ☐ Yes ☐ No ☐ Report Not Yet Received

If you check "Report Not Yet Received," you must promptly file an amendment to your Form ADV to update your response when the accountant's report is available.

SECTION 10.A. *Control Persons*

You must complete a separate Schedule D Section 10.A. for each *control person* not named in Item 1.A. or Schedules A, B, or C that directly or indirectly *controls* your management or policies.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Firm or Organization Name

____

(2) *CRD* Number (if any) ______________ Effective Date ______________ Termination Date ______________
mm/dd/yyyy mm/dd/yyyy

Your Name____________________ *CRD* Number____________________
Date____________________ SEC 801- or 802 Number____________________

…ain items in Part 1A of Form ADV require additional information on Schedule D. Use this Schedule D to report details for items listed below. Report only new information or changes/updates to previously submitted information. Do not repeat previously submitted information.

This is an ☐ INITIAL or ☐ AMENDED Schedule D

(3) Business Address:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(4) Individual Name (if applicable) (Last, First, Middle)

____

(5) *CRD* Number (if any) ____________________ Effective Date ______________ Termination Date ______________
mm/dd/yyyy mm/dd/yyyy

(6) Business Address:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(7) Briefly describe the nature of the *control*:

____
____
____

SECTION 10.B. *Control Person* Public Reporting Companies

If any *person* named in Schedules A, B, or C, or in Section 10 A. of Schedule D is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934, please provide the following information (you must complete a separate Schedule D Section 10.B. for each public reporting company):

(1) Full legal name of the public reporting company: ______________________________________

(2) The public reporting company's CIK number (Central Index Key number that the SEC assigns to each reporting company):

____

Miscellaneous

You may use the space below to explain a response to an Item or to provide any other information.

____
____
____
____
____
____
____
____

FORM ADV Schedule R Page 1 of 7	Your Name___________________ Date___________________	*CRD* Number___________________ SEC 801- Number___________________

Check the box that indicates what you would like to do:

Submit a new Schedule R

☐ Submit an initial Schedule R.

Amend a Schedule R

☐ Amend an existing Schedule R

Delete a Schedule R

☐ Delete an existing Schedule R for a *relying adviser* that is no longer eligible for SEC registration

☐ Delete an existing Schedule R for a *relying adviser* that is no longer relying on this *umbrella registration*

SECTION 1 Identifying Information

Responses to this Section 1 tell us who you (the *relying adviser*) are, where you are doing business, and how we can contact you.

A. Your full legal name:

____

B. Name under which you primarily conduct your advisory business, if different from Section 1.A or Item 1.A of the *filing adviser's* Form ADV Part 1A.

____

C. List any other business names and the jurisdictions in which you use them. Complete this question for each other business name. ☐ Add ☐ Delete ☐ Amend

Name ______________________________ Jurisdiction ______________________________

You do not have to include the names or jurisdictions of the filing adviser or other relying adviser(s) in response to this Section 1.C.

D. If you have a number ("*CRD* Number") assigned by the *FINRA's CRD* system or by the IARD system (other than the *filing adviser's CRD* number), your *CRD* number: __________

*If you do not have a CRD number, skip this Section 1.D. Do not provide the CRD number of one of your officers, employees, or affiliates (*including *the filing adviser).*

E. *Principal Office and Place of Business*

☐ Same as the *filing adviser*.

(1) Address (do not use a P.O. Box):

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(2) Days of week that you normally conduct business at your *principal office and place of business*:

☐ Monday - Friday ☐ Other: ______________________________________

Normal business hours at this location: ________________________________

(3) Telephone number at this location: __________________________________
(area code) (telephone number)

(4) Facsimile number at this location, if any: __________________________________
(area code) (facsimile number)

F. Mailing address, if different from your *principal office and place of business* address:

☐ Same as the *filing adviser*.

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

G. Provide your *Legal Entity Identifier* if you have one: ____________________

A *legal entity identifier* is a unique number that companies use to identify each other in the financial marketplace. You may not have a *legal entity identifier*.

H: If you have Central Index Key numbers assigned by the SEC ("CIK Number"), all of your CIK numbers:

____

SECTION 2

SEC Registration

Responses to this Section help us (and you) determine whether you are eligible to register with the SEC.

A. To be a *relying adviser*, you must be independently eligible to register (or remain registered) with the SEC. You must check **at least one** of the Sections 2.A.(1) through 2.A.(8), below. Part 1A Instruction 2 provides information to help you determine whether you may affirmatively respond to each of these items.

You (the *relying adviser*):

☐ (1) are a **large advisory firm** that either:

(a) has regulatory assets under management of $100 million (in U.S. dollars) or more, or

(b) has regulatory assets under management of $90 million (in U.S. dollars) or more at the time of filing its most recent *annual updating amendment* and is registered with the SEC;

☐ (2) are a **mid-sized advisory firm** that has regulatory assets under management of $25 million (in U.S. dollars) or more but less than $100 million (in U.S. dollars) and you are either:

(a) not required to be registered as an adviser with the *state securities authority* of the state where you maintain your *principal office and place of business*, or

(b) not subject to examination by the *state securities authority* of the state where you maintain your *principal office and place of business*;

☐ (3) have your *principal office and place of business* **in Wyoming** (which does not regulate advisers);

☐ (4) have your *principal office and place of business* **outside the United States**;

☐ (5) are a **related adviser** under rule 203A-2(b) that *controls*, is *controlled* by, or is under common *control* with, an investment adviser that is registered with the SEC, and your *principal office and place of business* is the same as the registered adviser;

☐ (6) are an **adviser** relying on rule 203A-2(c) because you **expect to be eligible for SEC registration within 120 days;**

If you check this box, you must make both of the representations below:

☐ I am not registered or required to be registered with the SEC or a *state securities authority* and I have a reasonable expectation that I will be eligible to register with the SEC within 120 days after the date my registration with the SEC becomes effective.

☐ By submitting this Form ADV to the SEC, the *filing adviser* undertakes to file an amendment to this *umbrella registration* to remove this Schedule R if, on the 120th day after this application for *umbrella registration* with the SEC becomes effective, I would be prohibited by Section 203A(a) of the Advisers Act from registering with the SEC.

☐ (7) are a **multi-state adviser** that is required to register in 15 or more states and is relying on rule 203A-2(d);

If this is your initial filing as a *relying adviser*, you must make both of these representations:

☐ I have reviewed the applicable state and federal laws and have concluded that I am required by the laws of 15 or more states to register as an investment adviser with the *state securities authorities* in those states.

☐ The *filing adviser* undertakes to file an amendment to this *umbrella registration* to remove this Schedule R if, at the time of the *annual updating amendment*, I would be required by the laws of fewer than 15 states to register as an investment adviser with the *state securities authorities* of those states.

If you are submitting your *annual updating amendment*, you must make this representation:

☐ Within 90 days prior to the date of filing this amendment, I have reviewed the applicable state and federal laws and have concluded that I am required by the laws of at least 15 states to register as an investment adviser with the *state securities authorities* in those states.

☐ (8) have **received an SEC *order*** exempting you from the prohibition against registration with the SEC;
If you check this box, provide the following information:

Application Number: 803-____________ Date of *order*: ____________
(mm/dd/yyyy)

☐ (9) are **no longer eligible** to remain registered with the SEC.

SECTION 3 Form of Organization

A. How are you organized?

☐ Corporation ☐ Sole Proprietorship ☐ Limited Liability Partnership (LLP)
☐ Partnership ☐ Limited Liability Company (LLC) ☐ Limited Partnership (LP)
☐ Other (specify):____

B. In what month does your fiscal year end each year? ________________

C. Under the laws of what state or country are you organized? ________________

If you are a partnership, provide the name of the state or country under whose laws your partnership was formed.

SECTION 4 Control Persons

In this Section 4. we ask you to identify each other *person* that, directly or indirectly, *controls* you.

A. Direct Owners and Executive Officers

(1) Section 4.A asks for information about your direct owners and executive officers.

(2) Direct Owners and Executive Officers. List below the names of:

(a) each Chief Executive Officer, Chief Financial Officer, Chief Operations Officer, Chief Legal Officer, director and any other individuals with similar status or functions;

(b) if you are organized as a corporation, each shareholder that is a direct owner of 5% or more of a class of your voting securities, unless you are a public reporting company (a company subject to Section 12 or 15(d) of the Exchange Act);

Direct owners include any *person* that owns, beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 5% or more of a class of your voting securities. For purposes of this Section 4.A. a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

(c) if you are organized as a partnership, <u>all</u> general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 5% or more of your capital;

(d) in the case of a trust that directly owns 5% or more of a class of your voting securities, or that has the right to receive upon dissolution, or has contributed, 5% or more of your capital, the trust and each trustee; and

(e) if you are organized as a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 5% or more of your capital, and (ii) if managed by elected managers, all elected managers.

(3) Do you have any indirect owners to be reported in Section 4.B below? ☐ Yes ☐ No

(4) In the DE/FE/I column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "I" if the owner or executive officer is an individual.

(5) Complete the Title or Status column by entering board/management titles; status as partner, trustee, sole proprietor, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

(6) Ownership codes are:

NA - less than 5%	B - 10% but less than 25%	D - 50% but less than 75%
A - 5% but less than 10%	C - 25% but less than 50%	E - 75% or more

(7) (a) In the *Control Person* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form ADV, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.

(b) In the PR column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Exchange Act.

(c) Complete each column.

FORM ADV Schedule R 	Your Name____________________ Date____________________	*CRD* Number____________________ SEC 801- Number____________________

Check this box if you are filing this Form ADV through the IARD system and want the IARD system to pre-fill the chart below with the same direct owners and executive officers you have provided in Schedule A for your *filing adviser*. If you check the box, the system will pre-fill these fields for you, but you will be able to manually edit the information after it is pre-filled and before you submit your filing. ☐

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Entity in Which Interest is Owned	Status	Date Status Acquired MM	YYYY	Ownership Code	*Control Person*	PR	*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax ID No. or Employer ID NO

B. Indirect Owners

(1) Section 4.B asks for information about your indirect owners; you must first complete Section 4.A, which asks for information about your direct owners.

(2) Indirect Owners. With respect to each owner listed in Section 4.A (except individual owners), list below:

(a) in the case of an owner that is a corporation, each of its shareholders that beneficially owns, has the right to vote, or has the power to sell or direct the sale of, 25% or more of a class of a voting security of that corporation;

For purposes of this Section, a *person* beneficially owns any securities: (i) owned by his/her child, stepchild, grandchild, parent, stepparent, grandparent, spouse, sibling, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, sharing the same residence; or (ii) that he/she has the right to acquire, within 60 days, through the exercise of any option, warrant, or right to purchase the security.

(b) in the case of an owner that is a partnership, all general partners and those limited and special partners that have the right to receive upon dissolution, or have contributed, 25% or more of the partnership's capital;

(c) in the case of an owner that is a trust, the trust and each trustee; and

(d) in the case of an owner that is a limited liability company ("LLC"), (i) those members that have the right to receive upon dissolution, or have contributed, 25% or more of the LLC's capital, and (ii) if managed by elected managers, all elected managers.

(3) Continue up the chain of ownership listing all 25% owners at each level. Once a public reporting company (a company subject to Sections 12 or 15(d) of the Exchange Act) is reached, no further ownership information need be given.

(4) In the DE/FE/I column below, enter "DE" if the owner is a domestic entity, "FE" if the owner is an entity incorporated or domiciled in a foreign country, or "I" if the owner is an individual.

(5) Complete the Status column by entering the owner's status as partner, trustee, elected manager, shareholder, or member; and for shareholders or members, the class of securities owned (if more than one is issued).

(6) Ownership codes are: C - 25% but less than 50%, D - 50% but less than 75%, E - 75% or more, F - Other (general partner, trustee, or elected manager)

(7) (a) In the *Control Person* column, enter "Yes" if the *person* has *control* as defined in the Glossary of Terms to Form ADV, and enter "No" if the *person* does not have *control*. Note that under this definition, most executive officers and all 25% owners, general partners, elected managers, and trustees are *control persons*.

Your Name ____________________ CRD Number ____________________
Date ____________________ SEC 801- Number ____________________

(b) In the PR column, enter "PR" if the owner is a public reporting company under Sections 12 or 15(d) of the Exchange Act.
(c) Complete each column.

Check this box if you are filing this Form ADV through the IARD system and want the IARD system to pre-fill Schedule B with the same indirect owners you have provided in Schedule B for your *filing adviser*. If you check the box, the system will pre-fill these fields for you, but you will be able to manually edit the information after it is pre-filled and before you submit your filing. ☐

FULL LEGAL NAME (Individuals: Last Name, First Name, Middle Name)	DE/FE/I	Entity in Which Interest is Owned	Status	Date Status Acquired MM	YYYY	Ownership Code	*Control Person*	PR	*CRD* No. If None: S.S. No. and Date of Birth, IRS Tax ID No. or Employer ID NO

C. Does any *person* not named in Section 1.A., Section 4.A, or Section 4.B directly or indirectly, *control* your management or policies? ☐ Yes ☐ No

If yes, you must complete the information below for each *control person* not named in Section 1.A., Section 4.A, or Section 4.B that directly or indirectly *controls* your management or policies.

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Firm or Organization Name

____

(2) *CRD* Number (if any) __________ Effective Date __________ Termination Date __________
mm/dd/yyyy mm/dd/yyyy

(3) Business Address:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(4) Individual Name (if applicable) (Last, First, Middle)

____

(5) *CRD* Number (if any) __________ Effective Date __________ Termination Date __________
mm/dd/yyyy mm/dd/yyyy

(6) Business Address:

____
(number and street)

____
(city) (state/country) (zip+4/postal code)

If this address is a private residence, check this box: ☐

(7) Briefly describe the nature of the *control*:

____

____

____

D. If any *person* named in Section 4.A, Section 4.B, or Section 4.C is a public reporting company under Sections 12 or 15(d) of the Securities Exchange Act of 1934, complete the information below (you must complete this information for each public reporting company).

Check only one box: ☐ Add ☐ Delete ☐ Amend

(1) Full legal name of the public reporting company: ____

(2) The public reporting company's CIK number (Central Index Key number that the SEC assigns to each reporting company): ________________________

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS
This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Items 11.A. or 11.B. of Form ADV.
Check item(s) being responded to: ☐ 11.A(1) ☐ 11.A(2) ☐ 11.B(1) ☐ 11.B(2)
Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.
Multiple counts of the same charge arising out of the same event(s) should be reported on the same DRP. Unrelated criminal actions, including separate cases arising out of the same event, must be reported on separate DRPs. Use this DRP to report all charges arising out of the same event. One event may result in more than one affirmative answer to the items listed above.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
☐ You (the advisory firm)
☐ You and one or more of your *advisory affiliates*
☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number	This *advisory affiliate* is ☐a firm ☐an individual Registered: ☐Yes ☐No

Name (For individuals, Last, First, Middle)

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC or reporting as an *exempt reporting adviser* with the SEC and the event was resolved in the adviser's or *advisory affiliate's* favor.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

____
____
____

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.
☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)
(continuation)

PART II

1. If charge(s) were brought against an organization over which you or an *advisory affiliate* exercise(d) *control*: Enter organization name, whether or not the organization was an *investment-related* business and your or the *advisory affiliate's* position, title, or relationship.

2. Formal Charge(s) were brought in: (include name of Federal, Military, State or Foreign Court, Location of Court - City or County and State or Country, Docket/Case number).

3. Event Disclosure Detail (Use this for both organizational and individual charges.)

   A. Date First *Charged* (MM/DD/YYYY): ☐ Exact ☐ Explanation

   If not exact, provide explanation:

   B. Event Disclosure Detail (include Charge(s)/Charge Description(s), and for each charge provide: (1) number of counts, (2) *felony* or *misdemeanor*, (3) plea for each charge, and (4) product type if charge is *investment-related*).

   C. Did any of the Charge(s) within the Event involve a *felony*? ☐ Yes ☐ No

   D. Current status of the Event? ☐ Pending ☐ On Appeal ☐ Final

   E. Event Status Date (complete unless status is Pending) (MM/DD/YYYY):

   ☐ Exact ☐ Explanation

   If not exact, provide explanation:

4. Disposition Disclosure Detail: Include for each charge (a) Disposition Type (e.g., convicted, acquitted, dismissed, pretrial, etc.), (b) Date, (c) Sentence/Penalty, (d) Duration (if sentence-suspension, probation, etc.), (e) Start Date of Penalty, (f) Penalty/Fine Amount, and (g) Date Paid.

(continued)

CRIMINAL DISCLOSURE REPORTING PAGE (ADV)
(continuation)

5. Provide a brief summary of circumstances leading to the charge(s) as well as the disposition. Include the relevant dates when the conduct which was the subject of the charge(s) occurred. (Your response must fit within the space provided.)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Items 11.C., 11.D., 11.E., 11.F. or 11.G. of Form ADV.

Check item(s) being responded to:

☐ 11.C(1)	☐ 11.C(2)	☐ 11.C(3)	☐ 11.C(4)	☐ 11.C(5)
☐ 11.D(1)	☐ 11.D(2)	☐ 11.D(3)	☐ 11.D(4)	☐ 11.D(5)
☐ 11.E(1)	☐ 11.E(2)	☐ 11.E(3)	☐ 11.E(4)	
☐ 11.F.	☐ 11.G.			

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Items 11.C., 11.D., 11.E., 11.F. or 11.G. Use only one DRP to report details related to the same event. If an event gives rise to actions by more than one regulator, provide details for each action on a separate DRP.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
☐ You (the advisory firm)
☐ You and one or more of your *advisory affiliates*
☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number	This *advisory affiliate* is ☐ a firm ☐ an individual Registered: ☐ Yes ☐ No

Name (For individuals, Last, First, Middle)

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC or reporting as an *exempt reporting adviser* with the SEC and the event was resolved in the adviser's or *advisory affiliate's* favor.

If you are registered or registering with a *state securities authority*, you may remove a DRP for an event you reported only in response to Item 11.D(4), and only if that event occurred more than ten years ago. If you are registered or registering with the SEC, you may remove a DRP for any event listed in Item 11 that occurred more than ten years ago.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

____

____

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.
☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

PART II

1. Regulatory Action initiated by:
☐ SEC ☐ Other Federal ☐ State ☐ *SRO* ☐ Foreign

(Full name of regulator. *foreign financial regulatory authority*, federal, state or *SRO*)

____

2. Principal Sanction (check appropriate item):

☐ Civil and Administrative Penalty(ies)/Fine(s)
☐ Bar
☐ Cease and Desist
☐ Censure
☐ Denial
☐ Disgorgement
☐ Expulsion
☐ Injunction
☐ Prohibition
☐ Reprimand
☐ Restitution
☐ Revocation
☐ Suspension
☐ Undertaking
☐ Other ____________

Other Sanctions:

____
____
____

3. Date Initiated (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ____

4. Docket/Case Number:

5. *Advisory Affiliate* Employing Firm when activity occurred which led to the regulatory action (if applicable):

6. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed
☐ Annuity(ies) - Variable
☐ CD(s)
☐ Commodity Option(s)
☐ Debt - Asset Backed
☐ Debt - Corporate
☐ Debt - Government
☐ Debt - Municipal
☐ Derivative(s)
☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Equity - OTC
☐ Equity Listed (Common & Preferred Stock)
☐ Futures - Commodity
☐ Futures - Financial
☐ Index Option(s)
☐ Insurance
☐ Investment Contract(s)
☐ Money Market Fund(s)
☐ Mutual Fund(s)
☐ No Product
☐ Options
☐ Penny Stock(s)
☐ Unit Investment Trust(s)
☐ Other ____________

Other Product Types:

____
____

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

7. Describe the allegations related to this regulatory action (your response must fit within the space provided):

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, regulatory action appealed to (SEC, *SRO*, Federal or State Court) and Date Appeal Filed:

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 13 only.

10. How was matter resolved (check appropriate item):

☐Acceptance, Waiver & Consent (AWC) ☐Dismissed ☐Vacated
☐Consent ☐*Order* ☐Withdrawn
☐Decision ☐Settled ☐Other ____________
☐Decision & *Order* of Offer of Settlement ☐Stipulation and Consent

11. Resolution Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ________________________________

12. Resolution Detail:

A. Were any of the following Sanctions *Ordered* (check all appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution

Amount: $ ☐Censure ☐ Cease and Desist/Injunction ☐ Bar ☐ Suspension

B. Other Sanctions *Ordered*:

Sanction detail: if suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal. Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against you or an *advisory affiliate*, date paid and if any portion of penalty was waived:

(continued)

REGULATORY ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

13. Provide a brief summary of details related to the action status and (or) disposition and include relevant terms, conditions and dates (your response must fit within the space provided).

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)

GENERAL INSTRUCTIONS

This Disclosure Reporting Page (DRP ADV) is an ☐ INITIAL ***OR*** ☐ AMENDED response used to report details for affirmative responses to Item 11.H. of Part 1A and Item 2.F. of Part 1B of Form ADV.

Check Part 1A item(s) being responded to: ☐ 11.H(1)(a) ☐ 11.H(1)(b) ☐ 11.H(1)(c) ☐ 11.H(2)
Check Part 1B item(s) being responded to: ☐ 2.F(1) ☐ 2.F(2) ☐ 2.F(3) ☐ 2.F(4) ☐ 2.F(5)

Use a separate DRP for each event or *proceeding*. The same event or *proceeding* may be reported for more than one *person* or entity using one DRP. File with a completed Execution Page.

One event may result in more than one affirmative answer to Item 11.H. of Part 1A or Item 2.F. of Part 1B. Use only one DRP to report details related to the same event. Unrelated civil judicial actions must be reported on separate DRPs.

PART I

A. The *person(s)* or entity(ies) for whom this DRP is being filed is (are):
☐ You (the advisory firm)
☐ You and one or more of your *advisory affiliates*
☐ One or more of your *advisory affiliates*

If this DRP is being filed for an *advisory affiliate*, give the full name of the *advisory affiliate* below (for individuals, Last name, First name, Middle name).

If the *advisory affiliate* has a *CRD* number, provide that number. If not, indicate "non-registered" by checking the appropriate box.

Your Name	Your *CRD* Number

ADV DRP - *ADVISORY AFFILIATE*

CRD Number

This *advisory affiliate* is ☐ a firm ☐ an individual
Registered: ☐ Yes ☐ No

Name (For individuals, Last, First, Middle)

☐ This DRP should be removed from the ADV record because the *advisory affiliate(s)* is no longer associated with the adviser.

☐ This DRP should be removed from the ADV record because: (1) the event or *proceeding* occurred more than ten years ago or (2) the adviser is registered or applying for registration with the SEC or reporting as an *exempt reporting adviser* with the SEC and the event was resolved in the adviser's or *advisory affiliate's* favor.

If you are registered or registering with a *state securities authority*, you may remove a DRP for an event you reported only in response to Item 11.H.(1)(a), and only if that event occurred more than ten years ago. If you are registered or registering with the SEC, you may remove a DRP for any event listed in Item 11 that occurred more than ten years ago.

☐ This DRP should be removed from the ADV record because it was filed in error, such as due to a clerical or data-entry mistake. Explain the circumstances:

____
____
____

B. If the *advisory affiliate* is registered through the IARD system or *CRD* system, has the *advisory affiliate* submitted a DRP (with Form ADV, BD or U-4) to the IARD or *CRD* for the event? If the answer is "Yes," no other information on this DRP must be provided.
☐ Yes ☐ No

NOTE: The completion of this form does not relieve the *advisory affiliate* of its obligation to update its IARD or *CRD* records.

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

PART II

1. Court Action initiated by: (Name of regulator, *foreign financial regulatory authority, SRO*, commodities exchange, agency, firm, private plaintiff, etc.)

____

2. Principal Relief Sought (check appropriate item):

☐ Cease and Desist
☐ Civil Penalty(ies)/Fine(s)
☐ Disgorgement
☐ Injunction
☐ Money Damages (Private/Civil Complaint)
☐ Restitution
☐ Restraining Order
☐ Other ________

Other Relief Sought:

____
____

3. Filing Date of Court Action (MM/DD/YYYY): ☐ ☐ Exact ☐ Explanation

If not exact, provide explanation: ____

4. Principal Product Type (check appropriate item):

☐ Annuity(ies) - Fixed
☐ Annuity(ies) - Variable
☐ CD(s)
☐ Commodity Option(s)
☐ Debt - Asset Backed
☐ Debt - Corporate
☐ Debt - Government
☐ Debt - Municipal
☐ Derivative(s)
☐ Direct Investment(s) - DPP & LP Interest(s)
☐ Equity - OTC
☐ Equity Listed (Common & Preferred Stock)
☐ Futures - Commodity
☐ Futures - Financial
☐ Index Option(s)
☐ Insurance
☐ Investment Contract(s)
☐ Money Market Fund(s)
☐ Mutual Fund(s)
☐ No Product
☐ Options
☐ Penny Stock(s)
☐ Unit Investment Trust(s)
☐ Other ____________

Other Product Types:

____

5. Formal Action was brought in (include name of Federal, State or Foreign Court, Location of Court - City or County <u>and</u> State or Country, Docket/Case Number):

____

6. *Advisory Affiliate* Employing Firm when activity occurred which led to the civil judicial action (if applicable):

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

7. Describe the allegations related to this civil action (your response must fit within the space provided):

8. Current status? ☐ Pending ☐ On Appeal ☐ Final

9. If on appeal, action appealed to (provide name of court) and Date Appeal Filed (MM/DD/YYYY):

10. If pending, date notice/process was served (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ______

If Final or On Appeal, complete all items below. For Pending Actions, complete Item 14 only.

11. How was matter resolved (check appropriate item):

☐ Consent ☐ Judgment Rendered ☐ Settled
☐ Dismissed ☐ Opinion ☐ Withdrawn ☐ Other ______

12. Resolution Date (MM/DD/YYYY): ☐ Exact ☐ Explanation

If not exact, provide explanation: ______

13. Resolution Detail:

A. Were any of the following Sanctions *Order*ed or Relief Granted (check appropriate items)?

☐ Monetary/Fine ☐ Revocation/Expulsion/Denial ☐ Disgorgement/Restitution

Amount: $ ☐ Censure ☐ Cease and Desist/Injunction ☐ Bar ☐ Suspension

B. Other Sanctions:

(continued)

CIVIL JUDICIAL ACTION DISCLOSURE REPORTING PAGE (ADV)
(continuation)

C. Sanction detail: if suspended, *enjoined* or barred, provide duration including start date and capacities affected (General Securities Principal, Financial Operations Principal, etc.). If requalification by exam/retraining was a condition of the sanction, provide length of time given to requalify/retrain, type of exam required and whether condition has been satisfied. If disposition resulted in a fine, penalty, restitution, disgorgement or monetary compensation, provide total amount, portion levied against you or an *advisory affiliate*, date paid and if any portion of penalty was waived:

14. Provide a brief summary of circumstances related to the action(s), allegation(s), disposition(s) and/or finding(s) disclosed above (your response must fit within the space provided).

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9782 / May 20, 2015

In the Matter of UBS AG	**ORDER UNDER RULE 405 OF THE SECURITIES ACT OF 1933, GRANTING A WAIVER FROM BEING AN INELIGIBLE ISSUER**

UBS AG (the "Company") has submitted a letter, dated May 20, 2015, constituting an application for relief from the Company being considered an "ineligible issuer" under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act of 1933 ("Securities Act"). The Company requests relief from being considered an "ineligible issuer" under Rule 405, due to the entry by the Company of a plea agreement with the United States Department of Justice on May 20, 2015 ("Plea Agreement"), in which the Company pleaded guilty to one count of wire fraud.

Under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer becomes an ineligible issuer and thus unable to avail itself of WKSI status, if "within the past three years, the issuer or any entity that at the time was a subsidiary of the issuer was convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934." Under Paragraph 2 of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.

Based on the facts and representations in the Company's May 20, 2015 request, and assuming the Company complies with the terms of the Plea Agreement, the Commission has determined that the Company has made a showing of good cause that the Company will not be considered an ineligible issuer by reason of the entry of the Plea Agreement. Accordingly, the relief requested in the Waiver Letter regarding the Company being an ineligible issuer under Rule 405 by reason of the entry of the Plea Agreement is granted, on the condition that that the Company fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Paragraph two of the definition of ineligible issuer in Rule 405 of the Securities Act, that a waiver from the Company being an ineligible issuer under Rule 405 of the Securities Act is hereby granted.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9781 / May 20, 2015

In the Matter of **THE ROYAL BANK OF SCOTLAND GROUP PLC**	**ORDER UNDER RULE 405 OF THE SECURITIES ACT OF 1933, GRANTING A WAIVER FROM BEING AN INELIGIBLE ISSUER**

The Royal Bank of Scotland Group plc (the "Company") has submitted a letter, dated May 20, 2015, constituting an application for relief from the Company being considered an "ineligible issuer" under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act of 1933 ("Securities Act"). The Company requests relief from being considered an "ineligible issuer" under Rule 405, due to the entry by The Royal Bank of Scotland plc ("RBS") of a plea agreement with the United States Department of Justice on May 20, 2015 ("Plea Agreement"), in which RBS pleaded guilty to a violation of the Sherman Antitrust Act, 15 U.S.C. § 1.

Under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer becomes an ineligible issuer and thus unable to avail itself of WKSI status, if "within the past three years, the issuer or any entity that at the time was a subsidiary of the issuer was convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934." Under Paragraph 2 of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.

Based on the facts and representations in the Company's May 20, 2015 request, and assuming RBS complies with the terms of the Plea Agreement, the Commission has determined that the Company has made a showing of good cause that the Company will not be considered an ineligible issuer by reason of the entry of the Plea Agreement. Accordingly, the relief requested in the Waiver Letter regarding the Company being an ineligible issuer under Rule 405 by reason of the entry of the Plea Agreement is granted, on the condition that that RBS fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Paragraph two of the definition of ineligible issuer in Rule 405 of the Securities Act, that a waiver from the Company being an ineligible issuer under Rule 405 of the Securities Act is hereby granted.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9780 / May 20, 2015

In the Matter of **JPMORGAN CHASE & CO.**	**ORDER UNDER RULE 405 OF THE SECURITIES ACT OF 1933, GRANTING A WAIVER FROM BEING AN INELIGIBLE ISSUER**

JPMorgan Chase & Co. (the "Company") has submitted a letter, dated May 20, 2015, constituting an application for relief from the Company being considered an "ineligible issuer" under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act of 1933 ("Securities Act"). The Company requests relief from being considered an "ineligible issuer" under Rule 405, due to the entry by the Company of a plea agreement with the United States Department of Justice on May 20, 2015 ("Plea Agreement"), in which the Company pleaded guilty to a violation of the Sherman Antitrust Act, 15 U.S.C. § 1.

Under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer becomes an ineligible issuer and thus unable to avail itself of WKSI status, if "within the past three years, the issuer or any entity that at the time was a subsidiary of the issuer was convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934." Under Paragraph 2 of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.

Based on the facts and representations in the Company's May 20, 2015 request, and assuming the Company complies with the terms of the Plea Agreement, the Commission has determined that the Company has made a showing of good cause that the Company will not be considered an ineligible issuer by reason of the entry of the Plea Agreement. Accordingly, the relief requested in the Waiver Letter regarding the Company being an ineligible issuer under Rule 405 by reason of the entry of the Plea Agreement is granted, on the condition that that the Company fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Paragraph two of the definition of ineligible issuer in Rule 405 of the Securities Act, that a waiver from the Company being an ineligible issuer under Rule 405 of the Securities Act is hereby granted.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9779 / May 20, 2015

In the Matter of **CITIGROUP INC.**	**ORDER UNDER RULE 405 OF THE SECURITIES ACT OF 1933, GRANTING A WAIVER FROM BEING AN INELIGIBLE ISSUER**

Citigroup Inc. (the "Company") has submitted a letter, dated May 20, 2015, constituting an application for relief from the Company being considered an "ineligible issuer" under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act of 1933 ("Securities Act"). The Company requests relief from being considered an "ineligible issuer" under Rule 405, due to the entry by Citicorp of a plea agreement with the United States Department of Justice on May 20, 2015 ("Plea Agreement"), in which Citicorp pleaded guilty to a violation of the Sherman Antitrust Act, 15 U.S.C. § 1.

Under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer becomes an ineligible issuer and thus unable to avail itself of WKSI status, if "within the past three years, the issuer or any entity that at the time was a subsidiary of the issuer was convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934." Under Paragraph 2 of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.

Based on the facts and representations in the Company's May 20, 2015 request, and assuming Citicorp complies with the terms of the Plea Agreement, the Commission has determined that the Company has made a showing of good cause that the Company will not be considered an ineligible issuer by reason of the entry of the Plea Agreement. Accordingly, the relief requested in the Waiver Letter regarding the Company being an ineligible issuer under Rule 405 by reason of the entry of the Plea Agreement is granted, on the condition that that Citicorp fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Paragraph two of the definition of ineligible issuer in Rule 405 of the Securities Act, that a waiver from the Company being an ineligible issuer under Rule 405 of the Securities Act is hereby granted.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9778 / May 20, 2015

In the Matter of **BARCLAYS PLC**	**ORDER UNDER RULE 405 OF THE SECURITIES ACT OF 1933, GRANTING A WAIVER FROM BEING AN INELIGIBLE ISSUER**

Barclays PLC (the "Company") has submitted a letter, dated May 20, 2015, constituting an application for relief from the Company being considered an "ineligible issuer" under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act of 1933 ("Securities Act"). The Company requests relief from being considered an "ineligible issuer" under Rule 405, due to the entry by the Company of a plea agreement with the United States Department of Justice on May 20, 2015 ("Plea Agreement"), in which the Company pleaded guilty to a violation of the Sherman Antitrust Act, 15 U.S.C. § 1.

Under Clause (1)(v) of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer becomes an ineligible issuer and thus unable to avail itself of WKSI status, if "within the past three years, the issuer or any entity that at the time was a subsidiary of the issuer was convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934." Under Paragraph 2 of the definition of ineligible issuer in Rule 405 of the Securities Act, an issuer shall not be an ineligible issuer if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the issuer be considered an ineligible issuer.

Based on the facts and representations in the Company's May 20, 2015 request, and assuming the Company complies with the terms of the Plea Agreement, the Commission has determined that the Company has made a showing of good cause that the Company will not be considered an ineligible issuer by reason of the entry of the Plea Agreement. Accordingly, the relief requested in the Waiver Letter regarding the Company being an ineligible issuer under Rule 405 by reason of the entry of the Plea Agreement is granted, on the condition that that the Company fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Paragraph two of the definition of ineligible issuer in Rule 405 of the Securities Act, that a waiver from the Company being an ineligible issuer under Rule 405 of the Securities Act is hereby granted.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9786 / May 20, 2015

In the Matter of

Barclays PLC, Barclays Bank PLC, and Barclays Capital Inc.

Respondents.

ORDER UNDER RULE 506(d) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 506(d)(1)(iii) DISQUALIFICATION PROVISION

I.

Barclays PLC, Barclays Bank PLC, and Barclays Capital Inc. ("Barclays") submitted a letter dated May 20, 2015, requesting that the Securities and Exchange Commission (the "Commission") grant a waiver of disqualification under Rule 506(d)(2)(ii) of Regulation D under the Securities Act of 1933 (the "Securities Act").

II.

On May 20, 2015, the U.S. Commodity Futures Trading Commission (the "CFTC") entered two orders CFTC Docket No. 15-24 and CFTC Docket No. 15-25 (together the "CFTC Orders") instituting administrative proceedings pursuant to Sections 6(c), 6(c)(4)(A) and 6(d) of the Commodity Exchange Act, and finding certain violations as a result of Barclays' conduct relating to FX benchmark rates and the U.S. Dollar International Swaps and Derivatives Association Fix.

III.

Rule 506(d)(2)(ii) of Regulation D provides that disqualification "shall not apply. . . upon a showing of good cause and without prejudice to any other action by the Commission, if the Commission determines that it is not necessary under the circumstances that an exemption be denied."

IV.

Based on the facts and representations in the Barclays' request for a waiver of disqualification, and assuming that Barclays complies with the CFTC Orders, the Commission has determined that Barclays has made a showing of good cause under Rule 506(d)(2)(ii) that it is not necessary under the circumstances to deny reliance on Rule 506 of Regulation D by reason of the entry of the CFTC Orders. Any different facts from those represented or failure to comply with the terms of the CFTC Orders would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, **IT IS ORDERED**, pursuant to Rule 506(d) of Regulation D under the Securities Act, that a waiver from the application of the disqualification provision of Rule 506(d)(1)(iii) under the Securities Act resulting from the entry of the CFTC Orders is hereby granted to Barclays.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9787 / May 20, 2015

In the Matter of **UBS AG** **Respondent.**	**ORDER UNDER RULE 506(d) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 506(d)(1)(i) DISQUALIFICATION PROVISION**

I.

UBS AG ("UBS") submitted a letter dated May 20, 2015, requesting that the Securities and Exchange Commission (the "Commission") grant a waiver of disqualification under Rule 506(d)(2)(ii) of Regulation D under the Securities Act of 1933 (the "Securities Act").

II.

On May 20, 2015, the United States Department of Justice, Criminal Division, Fraud Section (the "DOJ") filed a one-count criminal information (the "Information") in the United States District Court, District of Connecticut (the "District Court") charging wire fraud, in violation of Title 18, United States Code Section 1343 and 2. UBS has agreed to resolve the action brought by the DOJ through a plea agreement dated May 20, 2015 (the "Plea Agreement"). Under the Plea Agreement, UBS pleaded guilty to the charge set out in the Information (the "Guilty Plea"). UBS expects that the District Court will enter a judgment against UBS that will require remedies that are materially the same as set forth in the Plea Agreement.

III.

Rule 506(d)(2)(ii) of Regulation D provides that disqualification "shall not apply. . . upon a showing of good cause and without prejudice to any other action by the Commission, if the Commission determines that it is not necessary under the circumstances that an exemption be denied."

IV.

Based on the facts and representations in UBS's request for a waiver of disqualification, and assuming that UBS complies with the Plea Agreement, the Commission has determined that UBS has made a showing of good cause under Rule 506(d)(2)(ii) that it is not necessary under the circumstances to deny reliance on Rule 506 of Regulation D by reason of the entry of the Guilty Plea. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination that good cause has been shown and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, **IT IS ORDERED**, pursuant to Rule 506(d) of Regulation D under the Securities Act, that a waiver from the application of the disqualification provision of Rule 506(d)(1)(i) under the Securities Act resulting from the entry of the Guilty Plea is hereby granted to UBS.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9785 / May 20, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75009 / May 20, 2015

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

JPMorgan Chase & Co. (the "Company") has submitted a letter, dated May 20, 2015, requesting a waiver of the Section 27A(b)(1)(A)(i) disqualification from the safe harbor provision of Section 27A(c) of the Securities Act of 1933 ("Securities Act"), and the Section 21E(b)(1)(A)(i) disqualification from the safe harbor provision of Section 21E(c) of the Securities Exchange Act of 1934 ("Exchange Act"). The Company requests such relief due to the entry by the Company of a plea agreement with the United States Department of Justice on May 20, 2015 ("Plea Agreement"), in which the Company pleaded guilty to a violation of the Sherman Antitrust Act, 15 U.S.C. § 1.

Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act exclude reliance on the safe harbor for forward-looking statements if, among other things, the statement is made with respect to an issuer that has, within the past three years, been convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act; Section 21E(b) of the Exchange Act.

Based on the facts and representations in the Company's May 20, 2015 request, and assuming the Company complies with the terms of the Plea Agreement, the Commission has determined the request for a waiver of the disqualifications resulting from entry of the Plea Agreement is appropriate and should be granted. Accordingly, the relief requested in the Waiver

Letter regarding the Company being disqualified from the safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Securities Exchange Act is hereby granted, on the condition that that the Company fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provision of Section 27A(b)(1)(A)(i) of the Securities Act and Section 21E(b)(1)(A)(i) of the Exchange Act as to the Company and its present and future affiliates resulting from entry of the Order is granted.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9783 / May 20, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75007 / May 20, 2015

In the Matter of **BARCLAYS PLC**	**ORDER UNDER SECTION 27A(b) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(i) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b)(1)(A)(i) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO BARCLAYS PLC**

Barclays PLC (the "Company") has submitted a letter, dated May 20, 2015, requesting a waiver of the Section 27A(b)(1)(A)(i) disqualification from the safe harbor provision of Section 27A(c) of the Securities Act of 1933 ("Securities Act"), and the Section 21E(b)(1)(A)(i) disqualification from the safe harbor provision of Section 21E(c) of the Securities Exchange Act of 1934 ("Exchange Act"). The Company requests such relief due to the entry by the Company of a plea agreement with the United States Department of Justice on May 20, 2015 ("Plea Agreement"), in which the Company pleaded guilty to a violation of the Sherman Antitrust Act, 15 U.S.C. § 1.

Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act exclude reliance on the safe harbor for forward-looking statements if, among other things, the statement is made with respect to an issuer that has, within the past three years, been convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act; Section 21E(b) of the Exchange Act.

Based on the facts and representations in the Company's May 20, 2015 request, and assuming the Company complies with the terms of the Plea Agreement, the Commission has determined the request for a waiver of the disqualifications resulting from entry of the Plea Agreement is appropriate and should be granted. Accordingly, the relief requested in the Waiver

Letter regarding the Company being disqualified from the safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Securities Exchange Act is hereby granted, on the condition that that the Company fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provision of Section 27A(b)(1)(A)(i) of the Securities Act and Section 21E(b)(1)(A)(i) of the Exchange Act as to the Company and its present and future affiliates resulting from entry of the Order is granted.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9784 / May 20, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75008 / May 20, 2015

In the Matter of **UBS AG**	**ORDER UNDER SECTION 27A(b) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(i) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b)(1)(A)(i) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO UBS AG**

UBS AG (the "Company") has submitted a letter, dated May 20, 2015, requesting a waiver of the Section 27A(b)(1)(A)(i) disqualification from the safe harbor provision of Section 27A(c) of the Securities Act of 1933 ("Securities Act"), and the Section 21E(b)(1)(A)(i) disqualification from the safe harbor provision of Section 21E(c) of the Securities Exchange Act of 1934 ("Exchange Act"). The Company requests such relief due to the entry by the Company of a plea agreement with the United States Department of Justice on May 20, 2015 ("Plea Agreement"), in which the Company pleaded guilty to one count of wire fraud in violation of Title 18, U.S.C. § 1343.

Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act exclude reliance on the safe harbor for forward-looking statements if, among other things, the statement is made with respect to an issuer that has, within the past three years, been convicted of any felony or misdemeanor described in paragraphs (i) through (iv) of Section 15(b)(4)(B) of the Securities Exchange Act of 1934. The disqualifications may be waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act; Section 21E(b) of the Exchange Act.

Based on the facts and representations in the Company's May 20, 2015 request, and assuming the Company complies with the terms of the Plea Agreement, the Commission has determined the request for a waiver of the disqualifications resulting from entry of the Plea Agreement is appropriate and should be granted. Accordingly, the relief requested in the Waiver Letter regarding the Company being disqualified from the safe harbor provisions of Section 27A(c) of the Securities Act, and Section 21E(c) of the Securities Exchange Act is hereby granted, on the condition that that the Company fully complies with the terms of the Plea Agreement. Any different facts from those represented or failure to comply with the terms of the Plea Agreement would require us to revisit our determination and could constitute grounds to revoke or further condition the waiver. The Commission reserves the right, in its sole discretion, to revoke or further condition the waiver under those circumstances.

Accordingly, IT IS ORDERED, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provision of Section 27A(b)(1)(A)(i) of the Securities Act and Section 21E(b)(1)(A)(i) of the Exchange Act as to the Company and its present and future affiliates resulting from entry of the Order is granted.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chair White
Commissioner Aguilar
Not participating

SECURITIES AND EXCHANGE COMMISSION

Release No. IC-31613; File No. 812-14466

J.P. Morgan Chase & Co., et al.; Notice of Application and Temporary Order

May 20, 2015

Agency: Securities and Exchange Commission ("Commission")

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

Summary of Application: Applicants have received a temporary order ("Temporary Order") exempting them from section 9(a) of the Act, with respect to a guilty plea entered on May 20, 2015, by J.P. Morgan Chase & Co. ("JPMC" or the "Settling Firm"), a Delaware corporation, in the United States District Court for the District of Connecticut (the "District Court") in connection with a plea agreement ("Plea Agreement") between JPMC and the United States Department of Justice ("DOJ"), until the Commission takes final action on an application for a permanent order (the "Permanent Order," and with the Temporary Order, the "Orders"). Applicants also have applied for a Permanent Order.

Applicants: JPMC, J.P. Morgan Investment Management Inc. ("JPMIM"), J.P. Morgan Institutional Investments, Inc. ("JPMII"), J.P. Morgan Partners, LLC ("JPMP"); J.P. Morgan Private Investments Inc. ("JPMPI"), J.P. Morgan Alternative Asset Management, Inc. ("JPMAAM"); Bear Stearns Asset Management Inc. ("BSAM"); BSCGP Inc. ("BSCGP"); Constellation Growth Capital LLC ("Constellation"); Constellation Ventures Management II, LLC ("Constellation II"); JF International Management Inc. ("JFIMI"); JPMorgan Distribution Services, Inc. ("JPMDS"); OEP Co-Investors Management II, Ltd. ("OEP II"); OEP Co-Investors Management III, Ltd. ("OEP III," and together with OEP II, the "OEP Entities"); Security Capital Research & Management Incorporated ("Security

Capital"); and Sixty Wall Street Management Company, LLC ("Sixty Wall Management", and together with JPMIM, JPMII, JPMP, JPMPI, JPMAAM, BSAM, BSCGP, Constellation, Constellation II, JFIMI, JPMDS, the OEP Entities, and Security Capital, the "Fund Servicing Applicants") (each an "Applicant" and collectively, the "Applicants").

Filing Date: The application was filed on May 20, 2015.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on June 15, 2015, 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.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicants: JPMC, JPMIM, JPMII, JPMP, JPMPI, JPMAAM, BSAM, BSCGP, Constellation II and Sixty Wall Management, 270 Park Avenue, New York, NY 10017; Constellation, 40 W. 57th Street, 32nd Floor, New York, NY 10019; JFIMI, 21st Floor, Chater House, 8 Connaught Road Central, Hong Kong; JPMDS, 1111 Polaris Parkway, Columbus, Ohio 43240; OEP II and OEP III, 270 Park Avenue, 10th Floor, New York, NY 10017; and Security Capital, 10 South Dearborn Street, Suite 1400, Chicago, Illinois 60063

For Further Information Contact: Elizabeth G. Miller, Senior Counsel, Vanessa M. Meeks, Senior Counsel, or Holly Hunter-Ceci, Branch Chief, at (202) 551-6825 (Division of Investment Management, Chief Counsel's Office).

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

Applicants' Representations:

1. JPMC, a Delaware corporation, is a financial services holding company whose businesses provide a broad range of financial services to consumer and corporate customers. JPMC is also the ultimate parent of each of the Fund Servicing Applicants. JPMC does not provide Fund Service Activities (as defined below) to any Fund.[1]

2. JPMIM, JPMPI, JPMAAM, JFIMI and Security Capital are registered as investment advisers under the Investment Advisers Act of 1940, as amended (the "Advisers Act") and serve as investment advisers or sub-advisers to various Funds. JPMP and Sixty Wall Management are registered as investment advisers under the Advisers Act and serve as investment advisers or sub-advisers to ESCs. BSAM is registered as an investment adviser under the Advisers Act and serves as general partner that provides

[1] For purposes of the application, "Funds" refer to any registered investment company, business development company, or ESC for which a Covered Person serves, or may in the future serve, as an investment adviser, sub-adviser, general partner or depositor, or any registered open-end investment company, registered unit investment trust or registered face amount certificate company for which a Covered Person (as defined below) serves, or may in the future serve, as principal underwriter.

investment advisory services to various ESCs (as defined below).[2] BSCGP, Constellation II and the OEP Entities serve as general partners that provide investment advisory services to various ESCs. Constellation serves as a sub-adviser to various ESCs. JPMDS and JPMII are registered as broker-dealers under the Securities Exchange Act of 1934 and serve as principal underwriter to various Funds.

3. Other than the Fund Servicing Applicants, no existing company of which JPMC is an affiliated person currently serves as an investment adviser (as defined in section 2(a)(20) of the Act), or depositor of any Fund, employees' securities companies (as defined in section 2(a)(13) of the Act) subject to section 9 of the Act ("ESCs") or investment company that has elected to be treated as a business development company under the Act, or principal underwriter for any registered open-end company, unit investment trust under the Act ("UIT"), or face-amount certificate company registered under the Act (such activities, collectively, "Fund Service Activities"). Applicants request that any relief granted by the Commission also apply to any other existing company of which JPMC is an affiliated person within the meaning of section 2(a)(3) of the Act and to any other company of which JPMC may become an affiliated person in the future (together with the Applicants, the "Covered Persons").

4. On May 20, 2015, the DOJ filed a one-count criminal information in the District Court charging JPMC with a one-count violation of the Sherman Antitrust Act, 15 U.S.C. § 1 (the "Information"). The Information charges that from July 2010 until at least January 2013, JPMC, through one of its euro/U.S. dollar ("EUR/USD") traders, entered

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

into and engaged in a conspiracy to fix, stabilize, maintain, increase or decrease the price of, and rig bids and offers for, the EUR/USD currency pair exchanged in the FX spot market by agreeing to eliminate competition in the purchase and sale of the EUR/USD currency pair in the U.S. and elsewhere (the "Conduct"). The Conduct involved near daily conversations, some of which were in code, in an exclusive electronic chat room used by certain EUR/USD traders, including the EUR/USD trader employed by JPMC.

5. JPMC has agreed to resolve the action brought through the Plea Agreement presented to the District Court on May 20, 2015. Under the Plea Agreement, JPMC agreed to enter a plea of guilty to the charge set out in the Information (the "Plea"). In addition, JPMC will make an admission of guilt to the District Court. Applicants expect that the District Court will enter a judgment against JPMC that will require remedies that are materially the same as set forth in the Plea Agreement. According to the Plea Agreement, JPMC agrees that the District Court shall order a term of probation, which would include certain conditions, as outlined in the application. Along with the DOJ, the Board of Governors of the Federal Reserve System ("FRB"), the Office of the Comptroller of the Currency ("OCC"), the U.S. Commodity Futures Trading Commission ("CFTC"), and the United Kingdom Financial Conduct Authority ("FCA") have or have been conducting investigations into the practices of JPMC and its direct and indirect subsidiaries relating to FX trading. Specifically, the FRB entered a cease and desist order on May 20, 2015 against JPMC concerning unsafe and unsound banking practices relating to JPMC's FX business ("FRB Order"); the OCC entered a cease and desist order on November 11, 2014 against JPMorgan Chase Bank, N.A. ("JPMCB") concerning deficiencies and unsafe or unsound practices relating to JPMCB's wholesale FX business ("OCC Order"); the CFTC entered a cease and desist order on November 11, 2014 against JPMCB relating to certain

FX trading activities ("CFTC Order"); and the FCA entered a warning notice on November 11, 2014 against JPMCB for failing to control business practices in its G10 spot FX trading operations ("FCA Order").

Applicants' Legal Analysis:

1. Section 9(a)(1) of the Act provides, in pertinent part, that a person may not serve or act as, among other things, an investment adviser or depositor of any investment company registered under the Act or business development company or as a principal underwriter for any registered open-end investment company, registered UIT, or registered face-amount certificate company, or as investment adviser of an ESC if the person "within 10 years has been convicted of any felony or misdemeanor . . . arising out of such person's conduct" as a bank, among other things. Section 2(a)(10) of the Act defines the term "convicted" to include a plea of guilty. Section 9(a)(3) of the Act extends the prohibitions of section 9(a)(1) to a company, any "affiliated person" of which is disqualified under the provisions of section 9(a)(1). "Affiliated person" is defined in section 2(a)(3) of the Act to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that JPMC is an affiliated person of the Fund Servicing Applicants within the meaning of section 2(a)(3). Applicants state that a guilty plea would result in a disqualification of such Fund Servicing Applicants and other Covered Persons for ten years under section 9(a) of the Act because JPMC would become the subject of a conviction described in 9(a)(1).

2. Section 9(c) of the Act provides that, upon application, the Commission shall by order grant a person an exemption from the provisions of section 9(a), either unconditionally or on an appropriate temporary or other conditional basis, if the person establishes that: (1) the prohibitions of section 9(a), as applied to the person, are unduly or

disproportionately severe; or (2) the conduct of the person has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a Temporary Order and a Permanent Order exempting the Applicants and other Covered Persons from the disqualification provisions of section 9(a) of the Act. The Applicants and other Covered Persons may, if the relief is granted, in the future act in any of the capacities contemplated by section 9(a) of the Act subject to the applicable terms and conditions of the Orders.

3. Applicants believe they meet the standards for exemption specified in section 9(c). Applicants assert that the prohibitions of section 9(a), if applied to Covered Persons, would be unduly or disproportionately severe, and that the conduct of JPMC is not such as to make it against the public interest or the protection of investors to issue the Orders. Applicants represent that the Conduct giving rise to the Plea did not involve any of the Applicants acting in the capacity of investment adviser, sub-adviser, or depositor for a Fund (including as general partner providing investment advisory services to ESCs) or principal underwriter for any registered open-end investment company, registered UIT, or registered face amount certificate company. Applicants further represent that the Conduct did not relate to the Funds' management or distribution, and that the Conduct did not involve any Fund or the assets of any Fund. Applicants also state that the individual referenced in the Complaint as responsible for the Conduct is no longer employed by JPMC or its affiliates. As a result of the foregoing, Applicants assert that the conduct of Applicants has not been such as to make it against the public interest or the protection of investors to grant the application.

4. Applicants assert that their inability to continue to serve as investment adviser or sub-adviser of the Funds (including as general partner providing investment

advisory services to ESCs) or principal underwriter for the Funds that are registered open-end investment companies would result in the Funds and their shareholders facing potentially severe hardships. Applicants argue that neither the protection of investors nor the public interest would be served by permitting the section 9(a) disqualifications to apply to the Applicants because those disqualifications would deprive the shareholders of the Funds of the investment advisory or sub-advisory and underwriting services (including as general partner providing investment advisory services to ESCs) that shareholders expected the Funds would receive when they decided to invest in the Funds. Applicants also outline a number of other uncertainties, inefficiencies, and expenses that they submit would result from the prohibitions of section 9(a) and operate to the detriment of the financial interests of the Funds and their shareholders.

5. Applicants further assert that the prohibitions of section 9(a) would have an adverse effect on the Applicants, including their employees, as outlined in the application. Applicants therefore assert that the imposition of the section 9(a) disqualification on the Fund Servicing Applicants would be unduly and disproportionately severe.

6. Applicants represent that: (i) none of the current or former directors, officers or employees of the Fund Servicing Applicants had any knowledge of, or had any involvement in, the Conduct; (ii) no current or former employee of JPMC or of any other Covered Person who previously has been or who subsequently may be identified by JPMC, or any U.S. or non-U.S. regulatory or enforcement agencies as having been responsible for the Conduct will have any involvement in providing Fund Service Activities (including as general partners providing advisory services to ESCs) or will be an officer, director, or employee of any Applicant or of any other Covered Person; (iii) no employee of JPMC or of any other Covered Person who was involved in the Conduct had any, or will have any

future, involvement in the Covered Persons' activities in any capacity described in section 9(a) of the Act; and (iv) because the personnel of the Fund Servicing Applicants did not have any involvement in the Conduct, shareholders of the Funds were not affected any differently than if the Funds had received services from any other non-affiliated investment adviser or principal underwriter. Applicants assert that the conduct of Applicants has not been such as to make it against the public interest or the protection of investors to grant the requested exemption from section 9(a).

7. To provide further assurance that the exemptive relief being requested herein would be consistent with the public interest and the protection of investors, the Applicants undertake that they will, as soon as reasonably practicable, distribute to the boards of directors ("Boards") of the Funds written materials describing the circumstances that led to the Plea, any impact on the Funds and the application. The written materials will include an offer to discuss the materials at an in-person meeting with each Board for which the Applicants provide Fund Service Activities (excluding for this purpose, the ESCs), including the directors who are not "interested persons" of such Funds as defined in section 2(a)(19) of the Act and their independent legal counsel as defined in rule 0-1(a)(6) under the Act. The Applicants undertake to provide such Funds' Boards with the information concerning the Plea Agreement and the application necessary for those Funds to fulfill their disclosure and other obligations under the federal securities laws and will provide them a copy of the Plea Agreement as entered by the District Court.

8. Applicants further state that JPMC has implemented remedial measures to protect against conduct similar to the Conduct, as outlined in greater detail in the application. For example, JPMC has enhanced governance through the development of a Macro Trading Business Control Committee. JPMC has improved its compliance risk

assessment to better identify risks, including the types of risk identified during the FX matters, through improvements to: (1) the risk assessment framework, which includes more detailed guidance and procedures to enhance quality and consistency of execution; (2) the risk assessment tool and process, which includes improvements to compliance officers' ability to document risk/control impact at a more granular level; and (3) qualitative data collection to improve the qualitative information gathered by Compliance, including about lessons from internal and external control issues. JPMC has also developed a plan to improve monitoring and surveillance, including, among other things, expanding transaction surveillance across thirty-six currency pair benchmarks and establishing a process whereby it reviews its electronic communication lexicons and transaction surveillance scenarios and makes enhancements, as appropriate, at least annually. JPMC has also identified improvements in its internal audit function that it has taken or will take, including the establishment of a team dedicated to the identification of, and focus on, cross business issues and emerging risks.

9. Applicants state that certain of the Applicants and their affiliates have previously received an order under section 9(c) of the Act, as the result of conduct that triggered section 9(a), as described in greater detail in the application.

Applicants' Conditions:

Applicants agree that any order granted by the Commission pursuant to the application will be subject to the following conditions:

1. Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including, without limitation, the consideration by the

Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

2. Neither the Applicants nor any of the other Covered Persons will employ any of the current or former employees of the Settling Firm or any Covered Person who previously has been or who subsequently may be identified by the Settling Firm or any U.S. or non-U.S. regulatory or enforcement agency as having been responsible for the Conduct, without first making a further application to the Commission pursuant to section 9(c).

3. Each Applicant and Covered Person will adopt and implement policies and procedures reasonably designed to ensure that it will comply with the terms and conditions of the Orders within 60 days of the date of the Permanent Order or, with respect to condition 4, such date as may be contemplated by the Plea Agreement, or the CFTC Order, the OCC Order, the FRB Order, the FCA Order, or any other orders issued by regulatory or enforcement agencies addressing the Conduct.

4. The Settling Firm will comply in all material respects with the material terms and conditions of the Plea Agreement, the CFTC Order, the OCC Order, the FRB Order, the FCA Order, or any other orders issued by regulatory or enforcement agencies addressing the Conduct.

5. Applicants will provide written notification to the Chief Counsel of the Commission's Division of Investment Management with a copy to the Chief Counsel of the Commission's Division of Enforcement of a material violation of the terms and conditions of any of the Orders within 30 days of discovery of the material violation.

Temporary Order:

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

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the guilty plea entered into pursuant to the Plea Agreement, subject to the representations and conditions in the application, from May 20, 2015 until the Commission takes final action on their application for a permanent order.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

Release No. IC-31642; File No. 812-14469

The Royal Bank of Scotland plc, et al.; Notice of Application and Temporary Order

May 20, 2015

Agency: Securities and Exchange Commission ("Commission")

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

Summary of Application: Applicants have received a temporary order ("Temporary Order") exempting them from section 9(a) of the Act, with respect to a guilty plea entered on May 20, 2015, by the Royal Bank of Scotland plc ("RBS" or the "Settling Firm") in the United States District Court for the District of Connecticut (the "District Court") in connection with a plea agreement ("Plea Agreement") between the Settling Firm and the United States Department of Justice ("DOJ"), until the Commission takes final action on an application for a permanent order (the "Permanent Order," and with the Temporary Order, the "Orders"). Applicants also have applied for a Permanent Order.

Applicants: RBS and Citizens Investment Advisors ("Citizens IA") (each an "Applicant" and together, the "Applicants").

Filing Date: The application was filed on May 20, 2015.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on June 15, 2015, 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.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicants: RBS: RBS, Gogarburn, PO Box 1000 Edinburgh, EH12 1HQ, Scotland; Citizens IA: c/o Citizens Bank, N.A., Mail Stop RC 03-30, One Citizens Plaza, Providence, Rhode Island 02903.

For Further Information Contact: Parisa Haghshenas, Senior Counsel, Vanessa M. Meeks, Senior Counsel, or Holly Hunter-Ceci, Branch Chief, at (202) 551-6825 (Division of Investment Management, Chief Counsel's Office).

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

Applicants' Representations:

1. RBS is a company organized under the laws of Scotland and is a wholly-owned subsidiary of The Royal Bank of Scotland Group plc ("RBSG"). RBS and RBSG are international banking and financial services companies that provide a wide range of products and services to customers around the world. RBS and RBSG are both foreign banking organizations for purposes of Section 8 of the International Banking Act of 1978, as amended, and Subpart B of Regulation K, bank holding companies for purposes of the Bank Holding Company Act of 1956, as amended (the "BHC Act") and financial holding companies for purposes of the BHC Act. Citizens IA is a separately identifiable

department of Citizens Bank, N.A., which is an indirect subsidiary of RBSG and bank subsidiary of Citizens Financial Group, Inc.

2. Citizens IA is an investment adviser registered under the Investment Advisers Act of 1940, as amended. Citizens IA serves as investment sub-adviser to one management investment company registered under the Act (the "Fund"). No existing company of which the Settling Firm is an "affiliated person" within the meaning of section 2(a)(3) of the Act ("Affiliated Person") (other than Citizens IA as described above) currently serves as an investment adviser or depositor of any investment company registered under the Act ("RIC"), employees' securities company ("ESC") or investment company that has elected to be treated as a business development company under the Act ("BDC"), or principal underwriter for any open-end registered investment company under the Act ("Open-End Fund"), unit investment trust registered under the Act ("UIT"), or face-amount certificate company registered under the Act ("FACC") (such activities, "Fund Service Activities"), Applicants request that any relief granted by the Commission pursuant to the application also apply to any existing company of which the Settling Firm is an Affiliated Person and to any other company of which the Settling Firm may become an Affiliated Person in the future (together with the Applicants, the "Covered Persons") with respect to any activity contemplated by section 9(a) of the Act.[1]

3. On May 20, 2015, the United States Department of Justice (the "Department of Justice") filed a one-count criminal information (the "Information") in the U.S. District Court for the District of Connecticut (the "District Court"). The Information charges that between approximately December 2007 and April 2010, the Settling Firm,

[1] The Applicants and other Covered Persons may, if the Orders are granted, in the future act in any of the capacities contemplated by Section 9(a) of the Act subject to the applicable conditions of the Orders.

through one of its euro/U.S. dollar ("EUR/USD") traders, entered into and engaged in a conspiracy to fix, stabilize, maintain, increase or decrease the price of, and rig bids and offers for, the EUR/USD currency pair exchanged in the foreign currency exchange spot market ("FX Spot Market") by agreeing to eliminate competition in the purchase and sale of the EUR/USD currency pair in the United States and elsewhere (the "Conduct") in violation of Title 15, United States Code, Section 1. The Conduct involved near daily conversations, some of which were in code, in an exclusive electronic chat room used by certain EUR/USD traders, including the EUR/USD trader employed by RBS.

4. Pursuant to the Plea Agreement, the Settling Firm entered a plea of guilty (the "Guilty Plea") on May 20, 2015 in the District Court to the offense charged in the Information. In the Plea Agreement, the Settling Firm, among other things, agreed to a fine of $395 million. The Applicants expect that the District Court will enter a judgment against the Settling Firm (the "Judgment") that will require remedies that are materially the same as set forth in the Plea Agreement. The individual at the Settling Firm who was identified by the Settling Firm, RBSG or any U.S. or non-U.S. regulatory or enforcement agencies as being responsible for the Conduct has left RBS as of April 2010. RBS and RBS Securities Inc. will also enter into a settlement with the Board of Governors of the Federal Reserve System to resolve certain findings by the Federal Reserve (the "Federal Reserve Order"). Additionally, RBS entered into a settlement with the U.S. Commodity Futures Trading Commission on November 11, 2014 to resolve certain findings by the CFTC (the "CFTC Order") and with the U.K. Financial Conduct Authority ("FCA") on November 11, 2014 to resolve certain findings by the FCA (the "FCA Order").

Applicants' Legal Analysis:

1. Section 9(a)(1) of the Act provides, in pertinent part, that a person may not serve or act as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end investment company, registered unit investment trust, or registered face-amount certificate company, if such person within ten years has been convicted of any felony or misdemeanor, including those arising out of such person's conduct as a bank. Section 2(a)(10) of the Act defines the term "convicted" to include a plea of guilty. Section 9(a)(3) of the Act extends the prohibitions of section 9(a)(1) to a company any affiliated person of which has been disqualified under the provisions of section 9(a)(1). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. The Settling Firm is an Affiliated Person of Citizens IA within the meaning of section 2(a)(3) of the Act. Therefore, the Applicants state that the Guilty Plea would result in a disqualification of the Applicants for ten years under section 9(a)(3) were they to act in any of the capacities listed in section 9(a) because they would become the subject of a conviction described in section 9(a)(1).

2. Section 9(c) of the Act provides that, upon application, the Commission shall by order grant an exemption from the disqualification provisions of section 9(a) of the Act, either unconditionally or on an appropriate temporary or other conditional basis, to any person if that person establishes that: (a) the prohibitions of section 9(a), as applied to the person, are unduly or disproportionately severe or (b) the conduct of the person has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a Temporary Order and a Permanent Order exempting the Applicants and other Covered

Persons from the disqualification provisions of section 9(a) of the Act. The Applicants and other Covered Persons may, if the relief is granted, in the future act in any of the capacities contemplated by section 9(a) of the Act subject to the applicable terms and conditions of the Orders.

3. Applicants believe they meet the standards for exemption specified in section 9(c). Applicants assert that (i) the scope of the misconduct was limited and did not involve the Adviser Applicant (as defined below) or Fund Service Activities, (ii) application of the statutory bar would impose significant hardships on the Fund and its shareholders, (iii) the prohibitions of section 9(a), if applied to the Adviser Applicant and other Covered Persons, would be unduly or disproportionately severe and (iv) the Conduct did not constitute conduct that would make it against the public interest or protection of investors to grant the exemption from section 9(a).

4. Applicants represent that the Conduct did not involve the Adviser Applicant nor did it involve any of the Applicants acting in the capacity of investment adviser, sub-adviser or depositor to any RIC, or in the capacity of principal underwriter for any Open-End Fund, UIT or FACC. Applicants represent that the Conduct similarly did not involve any RIC, Open-End Fund, UIT or FACC with respect to which the Applicants engaged in Fund Service Activities. Instead, a single employee, who was not employed by the Adviser Applicant or engaged in Fund Service Activities, was identified as being responsible for the Conduct. That employee is no longer employed, and will not be employed in the future, by the Applicants or any other Covered Person. Applicants assert that, in light of the limited scope of the Conduct, it would be unduly and disproportionately severe to impose a section 9(a) disqualification on the Applicants. Applicants further represent that depriving the Fund of the Adviser Applicant as its sub-adviser because of the

activities of the Settling Firm would be an unduly severe result, both for the Adviser Applicant's financial position and for the shareholders of the Fund, who would be deprived of the knowledge and expertise of a key service provider. Applicants assert that the conduct of the Applicants has not been such to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

5. Applicants assert that the inability of the Applicant, i.e., Citizens IA, that serves as investment sub-adviser to the Fund (the "Adviser Applicant") to continue providing such services to the Fund would result in the Fund and its shareholders facing potential hardship, as outlined in the application. Applicants assert that neither the protection of investors nor the public interest would be served by permitting the section 9(a) disqualifications to apply to the Adviser Applicant because those disqualifications would deprive the Fund of the sub-advisory services that shareholders expected the Fund would receive when they decided to invest in the Fund. Applicants also assert that the prohibitions of section 9(a) could operate to the financial detriment of the Fund and its shareholders, which would be an unduly and disproportionately severe consequence given that the Adviser Applicant was not involved in the Conduct and that the Conduct did not involve Fund Service Activities.

6. Applicants assert that if the Adviser Applicant were barred under section 9(a) from providing investment advisory services to the Fund and were unable to obtain the requested exemption, the effect on its business and employees would be unduly and disproportionately severe. Applicants state that the Adviser Applicant has committed substantial capital and other resources to establishing expertise in sub-advising RICs. Applicants further state that prohibiting the Adviser Applicant from engaging in Fund Service Activities would not only adversely affect its business, but would also adversely

affect its employees who are involved in these activities. Many of these employees could experience significant difficulties in finding alternative, fund-related employment. In addition, Applicants assert that if the Applicants or Covered Persons are unable to expand their businesses in the future because of the imposition of the section 9(a) disqualification, it could also have an adverse impact on their businesses.

7. Applicants represent that: (i) none of the current or former directors, officers or employees of Citizens IA had any knowledge of, or had any involvement in, the Conduct; (ii) no current or former employee of the Settling Firm or of any other Covered Person who previously has been or who subsequently may be identified by the Settling Firm, or any U.S. or non-U.S. regulatory or enforcement agencies as having been responsible for the Conduct will have any involvement in providing Fund Service Activities on behalf of any Covered Person or will be an officer, director, or employee of any Applicants or of any other Covered Person; (iii) no employee of the Settling Firm or of any other Covered Person who was involved in the Conduct had any, or will have any future, involvement in the Covered Persons' activities in any capacity described in section 9(a) of the Act; and (iv) because the personnel of Citizens IA did not have any involvement in the Conduct, shareholders of the Fund were not affected any differently than if the Fund had received services from any other non-affiliated investment adviser or principal underwriter.

8. Applicants have agreed that neither they nor any of the other Covered Persons will employ any of the current or former employees of Settling Firm or any Covered Person who previously have been or who subsequently may be identified by the Settling Firm, RBSG or any U.S. or non-U.S. regulatory or enforcement agency as having

been responsible for the Conduct without first making a further application to the Commission pursuant to section 9(c).

9. Applicants have also agreed that each Applicant (and any Covered Person) will adopt and implement policies and procedures reasonably designed to ensure compliance with the terms and conditions of the Orders granted under section 9(c).

10. In addition, the Settling Firm has agreed to comply in all material respects with the material terms and conditions of the Plea Agreement, the CFTC Order, the Federal Reserve Order, the FCA Order, or any other orders issued by regulatory or enforcement agencies addressing the Conduct. Applicants further state that RBS and its affiliates have undertaken certain remedial measures, as described in greater detail in the application. These include certain remedial measures as required by the Plea Agreement, the CFTC Order, the Federal Reserve Order, and the FCA Order, including improvements to the oversight, internal controls, compliance, risk management and audit programs for FX trading. Specifically, Applicants represent that RBSG and RBS have taken a number of steps to enhance its internal controls, policies and procedures relating to its FX activities. These changes, include, but are not limited to the following: restricting participation by traders in multi-bank chat rooms; prohibiting mobile communication devices on dealing floors; strengthening surveillance of electronic, audio and trade communications at FX desks; mandating regular training for all FX employees concerning appropriate trading behavior; enhancing policies, procedures and guidance related to market color, client orders and FX fix orders; and improving customer disclosures relating to and enhancing controls around FX fix orders.

11. As a result, Applicants submit that granting an exemption as requested in the application would be consistent with the public interest and the protection of investors.

12. To provide further assurance that the exemptive relief being requested herein would be consistent with the public interest and the protection of the investors, the Applicants agree that they will, as soon as reasonably practical, distribute to the board of trustees ("Board") of the Fund written materials describing the circumstances that led to the Guilty Plea, any impact on the Fund and the application. The written materials will include an offer to discuss the materials at an in-person meeting with the Board of the Fund, including the directors who are not "interested persons" of the Fund as defined in section 2(a)(19) of the Act and their independent legal counsel as defined in rule 0-1(a)(6) under the Act. The Applicants undertake to provide the Fund's Board with all information concerning the Plea Agreement and the application necessary for the Fund to fulfill its disclosure and other obligations under the federal securities laws and will provide it a copy of the Judgment as entered by the District Court.

13. Applicants state that certain of the Applicants and their affiliates have previously received an order under section 9(c) of the Act, as the result of conduct that triggered section 9(a), as described in greater detail in the application.

<u>Applicants' Conditions</u>:

Applicants agree that any order granted by the Commission pursuant to the application will be subject to the following conditions:

1. Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including, without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to

the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

2. Neither the Applicants nor any of the other Covered Persons will employ any of the current or former employees of the Settling Firm or any Covered Person who previously has been or who subsequently may be identified by the Settling Firm, RBSG or any U.S. or non-U.S. regulatory or enforcement agency as having been responsible for the Conduct, without first making a further application to the Commission pursuant to section 9(c).

3. Each Applicant and Covered Person will adopt and implement policies and procedures reasonably designed to ensure that it will comply with the terms and conditions of the Orders within 60 days of the date of the Permanent Order or, with respect to condition 4, such date as may be contemplated by the Plea Agreement, or the CFTC Order, the Federal Reserve Order, the FCA Order, or any other orders issued by regulatory or enforcement agencies addressing the Conduct.

4. The Settling Firm will comply in all material respects with the material terms and conditions of the Plea Agreement, with the material terms of the CFTC Order, the Federal Reserve Order, the FCA Order or any other orders issued by regulatory or enforcement agencies addressing the Conduct.

5. Applicants will provide written notification to the Chief Counsel of the Commission's Division of Investment Management with a copy to the Chief Counsel of the Commission's Division of Enforcement of a material violation of the terms and conditions of any of the Orders within 30 days of discovery of the material violation.

Temporary Order:

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

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the guilty plea entered into pursuant to the Plea Agreement, subject to the representations and conditions in the application, from May 20, 2015 until the Commission takes final action on their application for a permanent order.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

Release No. IC-31612; File No. 812-14465

UBS AG, et al.; Notice of Application and Temporary Order

May 20, 2015

Agency: Securities and Exchange Commission ("Commission")

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

Summary of Application: Applicants have received a temporary order ("Temporary Order") exempting them from section 9(a) of the Act, with respect to a guilty plea entered on May 20, 2015, by UBS AG ("UBS AG" or the "Settling Firm") in the United States District Court for the District of Connecticut (the "District Court") in connection with a plea agreement ("Plea Agreement") between the Settling Firm and the United States Department of Justice ("DOJ"), until the Commission takes final action on an application for a permanent order (the "Permanent Order," and with the Temporary Order, the "Orders"). Applicants also have applied for a Permanent Order.

Applicants: UBS AG ("UBS AG" or the "Settling Firm"), UBS IB Co-Investment 2001 GP Limited ("ESC GP"), UBS Alternative and Quantitative Investments LLC ("UBS Alternative"), UBS O'Connor LLC ("UBS O'Connor"), UBS Global Asset Management (Americas) Inc. ("UBS Global AM Americas"), and UBS Global Asset Management (US) Inc. ("UBS Global AM US") (each an "Applicant" and together, the "Applicants").

Filing Date: The application was filed on May 20, 2015.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on June 15, 2015, 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.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicants: UBS AG and ESC GP: c/o UBS Investment Bank, 677 Washington Boulevard, Stamford, CT 06901; UBS Alternative: 677 Washington Boulevard, Stamford, CT 06901; UBS O'Connor and UBS Global AM Americas: One North Wacker Drive, Chicago, IL 60606; UBS Global AM US: 1285 Avenue of the Americas, 12th Floor, New York, NY 10019.

For Further Information Contact: David Joire, Senior Counsel, Parisa Haghshenas, Senior Counsel, or Holly Hunter-Ceci, Branch Chief, at (202) 551-6825 (Division of Investment Management, Chief Counsel's Office).

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

Applicants' Representations:

1. As set forth below, the Applicants collectively serve as investment adviser (as defined in section 2(a)(20) of the Act) to 90 investment management companies registered under the Act or series thereof and to two employees' securities companies ("ESCs"), and as principal underwriter (as defined in section 2(a)(29) of the Act) to eight open-end registered investment companies under the Act ("Open-End Funds") (each a "Fund," collectively, "Funds").

2. UBS AG, a company organized under the laws of Switzerland, is a Swiss-based global financial services firm. UBS AG and its subsidiaries provide global wealth management, securities, and retail and commercial banking services. UBS AG provides investment advisory services to two ESCs.[1] Other than the investment services provided to the two ESCs, UBS AG does not engage in, and will not engage in, Fund Service Activities (as hereinafter defined) and acknowledges that it may not provide Fund Service Activities in reliance on the Orders without seeking further relief from the Commission. ESC GP, a company established under the laws of the Cayman Islands, is the general partner of the two ESCs and provides investment advisory services to the ESCs. The ESCs have completed their investment programs and only hold cash pending final distribution and liquidation, which will occur as soon as practicable. UBS AG and the ESC GP do not receive any compensation for the investment advisory services provided to the ESCs. ESC GP is a direct, wholly owned subsidiary of UBS AG. The two ESCs were established to provide investment opportunities for highly compensated key employees, officers, directors and current consultants of UBS AG and its affiliates.

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1 In the Matter of UBS AG, et al.; Notice of Application, Inv. Co. Act Rel. No. 31019 (Apr. 17, 2014); Order, Inv. Co. Act Rel. No. 31042 (May 13, 2014).

3. UBS Alternative, a Delaware limited liability company, is a wholly-owned subsidiary of UBS AG and is registered as an investment adviser under the Investment Advisers Act of 1940 (the "Advisers Act"). UBS Alternative is the investment adviser to the following funds: A&Q Equity Opportunity Fund LLC, A&Q Event Fund LLC, A&Q Alternative Fixed-Income Strategies Fund LLC, A&Q Long/Short Strategies Fund LLC, A&Q Multi-Strategy Fund LLC, A&Q Technology Fund LLC, A&Q Aggregated Alpha Strategies Fund LLC, and A&Q Masters Fund LLC. UBS O'Connor, a Delaware limited liability company, is a wholly-owned subsidiary of UBS AG and is registered as an investment adviser under the Advisers Act. UBS O'Connor is the investment adviser to the O'Connor Equus fund. UBS Global AM US and UBS Global AM Americas are corporations organized under the laws of Delaware. UBS Global AM Americas is registered as an investment adviser under the Advisers Act. UBS Global AM US is registered under the Securities Exchange Act of 1934 (the "Exchange Act") as a broker-dealer. UBS Global AM US and UBS Global AM Americas are each indirect, wholly owned subsidiaries of UBS AG. UBS Global AM Americas provides investment advisory services to the UBS Managed Municipal Trust, UBS RMA Money Fund Inc., UBS RMA Tax-Free Fund Inc., Fort Dearborn Income Securities Inc., Global High Income Fund Inc., Managed High Yield Plus Fund Inc., Strategic Global Income Fund, Inc., UBS Funds, UBS Investment Trust, UBS Money Series, UBS PACE Select Advisors Trust, UBS Relationship Funds, SMA Relationship Trust, Master Trust funds and provides sub-advisory services to the Curian Variable Series Trust, EQ Advisors Trust, Lincoln Variable Insurance Products Trust, MFS Series Trust XIII, Nationwide Mutual Funds Series, Pacific Life Funds, Pacific Select Fund, and the VALIC Company II. UBS Global AM US serves as principal underwriter to the UBS Investment Trust, UBS Money Series,

UBS Managed Municipal Trust, UBS RMA Money Fund, Inc., UBS RMA Tax-Free Fund, Inc., UBS PACE Select Advisors Trust, UBS Funds, and the SMA Relationship Trust. While no existing company of which the Settling Firm is an "affiliated person" within the meaning of section 2(a)(3) of the Act ("Affiliated Person") (other than the Applicants) currently serves as an investment adviser or depositor of any investment company registered under the Act ("RIC"), ESC, or investment company that has elected to be treated as a business development company under the Act ("BDC"), or principal underwriter for any Open-End Fund, unit investment trust registered under the Act ("UIT"), or face-amount certificate company registered under the Act ("FACC") (such activities, collectively "Fund Service Activities"), Applicants request that any relief granted by the Commission pursuant to the application also apply to any existing company of which the Settling Firm is an Affiliated Person and to any other company of which the Settling Firm may become an Affiliated Person in the future (together with the Applicants, the "Covered Persons") with respect to any activity contemplated by section 9(a) of the Act.[2]

4. On December 18, 2012, the Criminal Division, Fraud Section ("DOJ Criminal Division") of the DOJ and the Settling Firm entered into a Non-Prosecution Agreement ("LIBOR NPA") related to the LIBOR Conduct, described and defined below.

5. After identifying certain foreign exchange ("FX") issues resulting from an internal review, the Settling Firm notified the DOJ Criminal Division (as well as the Antitrust Division of the DOJ and other authorities) that it had identified evidence of potential FX market trading coordination and thereafter provided extensive cooperation to

[2] The Applicants and other Covered Persons may, if the Orders are granted, in the future act in any of the capacities contemplated by section 9(a) of the Act subject to the applicable conditions of the Orders.

the DOJ Criminal Division and other relevant authorities in connection with investigations into FX-related conduct. The DOJ Criminal Division determined that the Settling Firm had breached the LIBOR NPA. Relevant considerations in reaching that determination included certain conduct, namely certain employees engaging in fraudulent and deceptive currency trading and sales practices in conducting certain FX market transactions with customers via telephone, email, and/or electronic chat, to the detriment of UBS AG's customers, and colluding with other participants in certain FX markets (the "FX Conduct").

6. Pursuant to the Plea Agreement, entered into on May 20, 2015, by the Settling Firm and the DOJ Criminal Division, the Settling Firm entered a plea of guilty (the "Guilty Plea") on May 20, 2015 in the District Court to the offense charged in the one-count criminal Information filed in District Court on May 20, 2015 (the "Information"). The Information charges that between approximately 2001 and in or about 2010, the Settling Firm devised and engaged in a scheme to defraud counterparties to interest rate derivatives transactions by secretly manipulating benchmark interest rates to which the profitability of those transactions was tied (the "LIBOR Conduct"). Specifically, the Information charges that the Settling Firm committed wire fraud in furtherance of that scheme in violation of Title 18, United States Code, Sections, 1343 and 2 on or about June 29, 2009 by transmitting or causing the transmission of certain electronic communications.

7. Pursuant to the Plea Agreement, the Settling Firm agreed to, among other things, a fine of $203 million and a term of probation of three years. The Applicants expect that the District Court will enter a judgment against the Settling Firm (the "Judgment") that will require remedies that are materially the same as set forth in the Plea Agreement.

8. The Settling Firm has entered into settlements with several other authorities related to the FX Conduct and has agreed to a number of undertakings to address the conduct. On November 12, 2014, the Settling Firm reached a settlement with the U.S. Commodity Futures Trading Commission ("CFTC") to resolve certain findings by the CFTC (the "CFTC Order") and with the U.K. Financial Conduct Authority ("FCA") to resolve certain findings by the FCA (the "FCA Order"). On November 11, 2014, the Swiss Financial Market Supervisory Authority ("FINMA") issued an order concluding its formal proceedings with respect to the FX Conduct and precious metals ("PM") trading ("FINMA Order"). Additionally, on May 20, 2015, the Board of Governors of the Federal Reserve System ("Fed") and the State of Connecticut Department of Banking ("CT DOB") issued a cease and desist order and imposed a civil money penalty upon consent of the Settling Firm related to the FX Conduct (the "Fed-CTDOB Order").

Applicants' Legal Analysis:

1. Section 9(a)(1) of the Act provides, in pertinent part, that a person may not serve or act as an investment adviser or depositor of any registered investment company or a principal underwriter for any registered open-end investment company, registered unit investment trust, or registered face-amount certificate company, if such person within ten years has been convicted of any felony or misdemeanor, including those arising out of such person's conduct as a bank or an Affiliated Person of a bank. Section 2(a)(10) of the Act defines the term "convicted" to include a plea of guilty. Section 9(a)(3) of the Act extends the prohibitions of section 9(a)(1) to a company any affiliated person of which has been disqualified under the provisions of section 9(a)(1). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. The Settling Firm is an

Affiliated Person of each of the other Applicants within the meaning of section 2(a)(3) of the Act. Therefore, the Applicants state that the Guilty Plea would result in a disqualification of each Applicant for ten years under section 9(a)(3) were they to act in any of the capacities listed in section 9(a) because the Settling Firm would become the subject of a conviction described in section 9(a)(1).

2. Section 9(c) of the Act provides that, upon application, the Commission shall by order grant an exemption from the disqualification provisions of section 9(a) of the Act, either unconditionally or on an appropriate temporary or other conditional basis, to any person if that person establishes that: (a) the prohibitions of section 9(a), as applied to the person, are unduly or disproportionately severe; or (b) the conduct of the person has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a Temporary Order and a Permanent Order exempting the Applicants and other Covered Persons from the disqualification provisions of section 9(a) of the Act. The Applicants and other Covered Persons may, if the relief is granted, in the future act in any of the capacities contemplated by section 9(a) of the Act subject to the applicable terms and conditions of the Orders.

3. Applicants believe they meet the standards for exemption specified in section 9(c). Applicants assert that (i) the scope of the Conduct was limited and did not involve the Adviser Applicants (as defined below), Fund Service Activities, or ESCs with respect to which the Settling Firm engaged in Fund Service Activities, (ii) application of the statutory bar would impose significant hardships on the Funds and their shareholders, (iii) the prohibitions of section 9(a), if applied to the Adviser Applicants and other Covered Persons, would be unduly or disproportionately severe, and (iv) the Conduct did not

constitute conduct that would make it against the public interest or protection of investors to grant the exemption from section 9(a).

4. Applicants represent that both the LIBOR Conduct and the FX Conduct (collectively, the "Conduct") did not involve any of the Applicants acting as an investment adviser or depositor of any RIC or ESC (including as general partner providing investment advisory services to the ESCs), or principal underwriter for any Open-End Fund, UIT or FACC ("Adviser Applicants"). The Settling Firm is an Adviser Applicant only to the extent that it provides investment advisory services to the two ESCs. The Conduct similarly did not involve any RIC, Open-End Fund, UIT or FACC with respect to which the Applicants engaged in Fund Service Activities. No traders identified by the Settling Firm or any U.S. or non-U.S. regulatory or enforcement agency as being responsible for the Conduct provided Fund Service Activities to the Funds. Moreover, the FX Conduct that occurred after the LIBOR NPA, and which is the basis for the breach of the LIBOR NPA, was extremely limited in scope. The Applicants assert that the LIBOR Conduct only involved approximately 14 of the approximately 65,000 total employees of the Settling Firm and its affiliates; similarly, the FX Conduct involved less than ten employees. The Applicants assert that of the individuals identified as having been responsible for the FX Conduct who remain employees of Settling Firm, except as noted below, all have been terminated.[3] Applicants assert that, in light of the limited scope of the Conduct, it would be unduly and disproportionately severe to impose a section 9(a) disqualification on the Applicants. Applicants further represent that Adviser Applicants did not engage in the Conduct, and depriving the Funds of the Fund Service Activities performed by an Adviser Applicant because of the activities of the Settling Firm would be an unduly severe result,

[3] All of the individuals at the Settling Firm and its affiliates who were identified as being responsible for the LIBOR Conduct have either resigned or have had their employment terminated.

both for the Adviser Applicant's financial position and for the shareholders of the Funds, who would be deprived of the knowledge and expertise of a key service provider. Similarly, Applicants assert that depriving the shareholders of the ESCs of the Fund Service Activities of the Settling Firm would be unduly severe given that none of the employees of the Settling Firm who were responsible for the Conduct provide any Fund Service Activities to the ESCs. Applicants assert that the conduct of the Applicants has not been such to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

5. Applicants assert that the inability of the Adviser Applicants to continue providing such services to the Funds (including as general partner providing investment advisory services to ESCs) would result in the Funds and their shareholders facing potential hardship, as described in greater detail in the application. Applicants assert that neither the protection of investors nor the public interest would be served by permitting the section 9(a) disqualifications to apply to the Adviser Applicants because those disqualifications would deprive the Funds of the Fund Service Activities provided by the Adviser Applicants (including as general partner providing investment advisory services to ESCs) that shareholders expected the Funds would receive when they decided to invest in the Funds. Applicants also outline a number of other uncertainties, inefficiencies, and expenses that they submit would result from the prohibitions of section 9(a) and operate to the detriment of the financial interests of the Funds and their shareholders.

6. Applicants assert that if the Adviser Applicants were barred under section 9(a) from providing Fund Service Activities to the Funds and were unable to obtain the requested exemption, the effect on their business and employees would be unduly and disproportionately severe. Applicants state that the Adviser Applicants have committed

substantial capital and other resources to establishing expertise in advising, sub-advising and underwriting Funds. Applicants further state that prohibiting the Adviser Applicants from engaging in Fund Service Activities would not only adversely affect their business, but would also adversely affect their employees who are involved in these activities. Many of these employees could experience significant difficulties in finding alternative, fund-related employment. Applicants assert that, with respect to the Settling Firm and ESC GP in particular, their disqualification from providing advisory or sub-advisory services to the ESCs would not be in the public interest or in furtherance of the protection of investors in light of the fact that the ESCs have completed their investment programs and only hold cash pending final distribution and liquidation. In addition, Applicants assert that if the Applicants or Covered Persons are unable to expand their businesses in the future because of the imposition of the section 9(a) disqualification, it could also have an adverse impact on their businesses.

7. Applicants represent that: (i) none of the current or former directors, officers or employees of Applicants (other than certain personnel of the Settling Firm who were not involved in any of the Applicants' Fund Service Activities) had any knowledge of, or had any involvement in, the Conduct; (ii) no current or former employee of any Applicant or of any other Covered Person who previously has been or who subsequently may be identified by any Applicant, or any U.S. or non-U.S. regulatory or enforcement agencies as having been responsible for the Conduct will have any involvement in providing Fund Service Activities on behalf of any Covered Person or will be an officer, director, or employee of any Applicant or of any other Covered Person;[4] (iii) no employee

[4] However, in the case of three employees, UBS AG has delayed taking final action to terminate such employees in order to ensure their ongoing cooperation with governmental investigations and/or to comply with applicable foreign labor laws. Subject to these issues, UBS AG will terminate the employment of all of

of any Applicant or of any other Covered Person who was involved in the Conduct had any, or will have any future, involvement in the Covered Persons' activities in any capacity described in section 9(a) of the Act; and (iv) because the personnel of the Applicants (other than certain personnel of the Settling Firm who were not involved in any of the Applicants' Fund Service Activities) did not have any involvement in the Conduct, shareholders of those Funds were not affected any differently than if those Funds had received services from any other non-affiliated investment adviser or principal underwriter.

8. Except as set forth in Section III.E. in the application, Applicants have agreed that neither they nor any of the other Covered Persons will employ any of the current or former employees of Settling Firm or any other Covered Person who previously have been or who subsequently may be identified by the Settling Firm or any U.S. or non-U.S. regulatory or enforcement agency as having been responsible for the Conduct without first making a further application to the Commission pursuant to section 9(c).

9. Applicants have also agreed that each Applicant and Covered Person will adopt and implement policies and procedures reasonably designed to ensure it will comply with the terms and conditions of the Orders granted under section 9(c).

10. In addition, the Settling Firm has agreed to comply in all material respects with the material terms and conditions of the Plea Agreement, the CFTC Order, the Fed-CTDOB Order, the FCA Order, the FINMA Order or any other orders issued by regulatory or enforcement agencies addressing the Conduct. Applicants further state that

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these employees within four months of the entry of the Plea Agreement. Because of foreign labor laws, UBS may be required to provide a notice of termination which may delay the final termination of employment beyond that four month period. In any event, however, the employment of the employees will be terminated, and the employees will have no further association with UBS or its affiliates in any capacity, no later than eight months after the date of the Guilty Plea. The Settling Firm will notify the Chief Counsel of the Division of Investment Management when all employees of the Settling Firm responsible for the FX Conduct have been terminated or are no longer employed by the Settling Firm. UBS has already terminated several employees of the Settling Firm who engaged in misconduct relating to the FX business, including two employees who engaged in collusive conduct at other institutions.

the Settling Firm has undertaken certain remedial measures, as described in greater detail in the application, related to the Conduct. These include certain remedial measures as required by the Plea Agreement, the CFTC Order, the Fed-CTDOB Order, the FCA Order, and the FINMA Order including (but not limited to) developing and maintaining monitoring systems and performing periodic internal audits and annual external audits, conducting an audit of specific areas to ensure its culture, governance arrangements, policies, procedures, systems, and controls are appropriate and adequate to effectively manage specific risks with respect to the FX business, and implementing and improving control measures to avoid conflicts of interest between client trading and the active proprietary trading. Specifically, Applicants represent that the Settling Firm has taken a number of steps to enhance its internal controls, policies and procedures relating to its FX activities. These changes, include, but are not limited to the following: transitioning its FX business to adopt principles, systems, and controls more akin to that of regulated markets by, for example, introducing continuous transaction monitoring and detailed time stamping of orders to ensure it can conduct additional forensic analysis of trading activity, improving compliance monitoring, intraday supervision and operational risk management assessment to more swiftly detect inappropriate activity, strengthened front office processes, and enhanced guidance and training.

11. As a result, Applicants submit that the conduct of the Applicants has been such as not to make it against the public interest or the protection of investors to grant the exemption from Section 9(a).

12. To provide further assurance that the exemptive relief being requested herein would be consistent with the public interest and the protection of the investors, the Applicants agree that they will, as soon as reasonably practical, distribute to the board of

directors or trustees ("Board") of the Funds (excluding, for this purpose, the ESCs) written materials describing the circumstances that led to the Guilty Plea, any impact on the Funds and the application. The written materials will include an offer to discuss the materials at an in-person meeting with each Board for which the Applicants provide Fund Service Activities, including the directors who are not "interested persons" of the Funds as defined in section 2(a)(19) of the Act and their independent legal counsel as defined in rule 0-1(a)(6) under the Act. The Applicants undertake to provide the Funds' Boards with all information concerning the Plea Agreement and the application necessary for the Funds to fulfill their disclosure and other obligations under the federal securities laws and will provide them a copy of the Judgment as entered by the District Court.

13. Applicants state that the Settling Firm and the other Applicants have previously received exemptive orders under section 9(c) of the Act, as the result of conduct that triggered section 9(a), as described in greater detail in the application.

Applicants' Conditions:

Applicants agree that any order granted by the Commission pursuant to the application will be subject to the following conditions:

1. Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including, without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

2. Except as set forth in Section III.E. of the application, neither the Applicants nor any of the other Covered Persons will employ any of the current or former employees of the Settling Firm or any other Covered Person who previously have been or who subsequently may be identified by the Settling Firm or any U.S. or non-U.S. regulatory or enforcement agency as having been responsible for the Conduct, without first making a further application to the Commission pursuant to section 9(c).

3. Each Applicant and Covered Person will adopt and implement policies and procedures reasonably designed to ensure that it will comply with the terms and conditions of the Orders within 60 days of the date of the Permanent Order or, with respect to condition 4, such date as may be contemplated by the Plea Agreement, or the CFTC Order, the Fed-CTDOB Order, the FCA Order, the FINMA Order, or any other orders issued by regulatory or enforcement agencies addressing the Conduct.

4. The Settling Firm will comply in all material respects with the material terms and conditions of the Plea Agreement, with the material terms of the CFTC Order, the Fed-CTDOB Order, the FCA Order, the FINMA Order, or any other orders issued by regulatory or enforcement agencies addressing the Conduct.

5. Applicants will provide written notification to the Chief Counsel of the Commission's Division of Investment Management with a copy to the Chief Counsel of the Commission's Division of Enforcement of a material violation of the terms and conditions of any of the Orders within 30 days of discovery of the material violation.

Temporary Order:

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

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the guilty plea entered into pursuant to the Plea Agreement, subject to the representations and conditions in the application, from May 20, 2015 until the Commission takes final action on their application for a permanent order.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

Release No. IC-31615; File No. 812-14468

Citicorp, et al.; Notice of Application and Temporary Order

May 20, 2015

Agency: Securities and Exchange Commission ("Commission")

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

Summary of Application: Applicants have received a temporary order ("Temporary Order") exempting them from section 9(a) of the Act, with respect to a guilty plea entered on May 20, 2015, by the Settling Firm (as defined below) in the United States District Court for the District of Connecticut (the "District Court") in connection with a plea agreement ("Plea Agreement") between the Settling Firm and the United States Department of Justice ("DOJ"), until the Commission takes final action on an application for a permanent order (the "Permanent Order," and with the Temporary Order, the "Orders"). Applicants also have applied for a Permanent Order.

Applicants: Citicorp, a Delaware corporation, (the "Settling Firm"), Citigroup Global Markets Inc. ("CGMI"), CEFOF GP I Corp. ("CEFOF"), CELFOF GP Corp. ("CELFOF"), Citibank, N.A. ("Citibank"), Citigroup Alternative Investments LLC ("Citigroup Alternative"), Citigroup Capital Partners I GP I Corp. ("CCP I"), Citigroup Capital Partners I GP II Corp. ("CCP II"), Citigroup Private Equity (Offshore) LLC ("CPE (Offshore)"), and Citigroup First Investment Management Americas LLC ("CFIMA", and along, together with CGMI, CEFOF, CELFOF, Citibank, Citigroup Alternative, CCP I, CCP II, and CPE (Offshore), the "Adviser Applicants" and the Settling Firm together with the Adviser Applicants, the "Applicants").

the Applicants state that Adviser Applicants have committed substantial resources to establishing an expertise in providing services covered by section 9(a) and that prohibiting the Adviser Applicants from providing Fund Service Activities to the Funds not only would affect Adviser Applicants' current and future businesses adversely, but also the employees of the Adviser Applicants. Applicants also assert that the Conduct did not constitute conduct that would make it against the public interest or protection of investors to issue the Orders.

7. Applicants assert that the Adviser Applicants' inability to continue to serve as investment adviser or sub-adviser of the Funds (including as general partner providing investment advisory services to ESCs) would result in the Funds and their shareholders facing potentially severe hardship. Applicants argue that neither the protection of investors nor the public interest would be served by permitting the section 9(a) disqualifications to apply to the Adviser Applicants because those disqualifications would deprive the shareholders of the Funds of the investment advisory or sub-advisory services provided by the Adviser Applicants (including as general partner providing investment advisory services to ESCs) that shareholders expected the Funds would receive when they decided to invest in the Funds. Applicants also outline a number of other uncertainties, inefficiencies, and expenses that they submit would result from the prohibitions of section 9(a) and operate to the detriment of the financial interests of the Funds and their shareholders.

8. Applicants have agreed that neither they nor any of the other Covered Persons will employ any of the current or former employees of Citi or any Covered Person who previously have been or who subsequently may be identified by the Settling Firm or any U.S. or non-U.S. regulatory or enforcement agency as having been responsible for the

the Commission's Division of Enforcement of a material violation of the terms and conditions of any of the Orders within 30 days of discovery of the material violation.

Temporary Order:

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

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the guilty plea entered into pursuant to the Plea Agreement, subject to the representations and conditions in the application, from June 15, 2015 until the Commission takes final action on their application for a permanent order.

By the Commission.

Jill M. Peterson

Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75014 / May 20, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3657 / May 20, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16550

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

I.

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

[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.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III(3) below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to 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. Tang, age 41, is a Chinese national residing in the People's Republic of China ("China"). Tang has served as Chief Financial Officer ("CFO") for China Valves Technology, Inc. ("CVVT") since June 2013. Tang served as CVVT's Financial Controller from December 2010 through June 2013; interim CFO between February 2009 and July 2009 and between May 2010 and December 2010; CFO from December 2007 through March 2009; and Director from December 2007 through November 2008. Tang held himself out and acted as CFO and Treasurer of CVVT from at least August 2010 to at least November 2010. Tang also held a variety of positions related to finance and accounting with CVVT's subsidiaries between 1994 and 2008. Tang holds himself out as an "International Certified Public Accountant."

2. CVVT was, at all relevant times, a Nevada corporation with its principal place of business in China. CVVT purports to develop, manufacture, supply, and provide services related to water flow management products. At all relevant times, CVVT's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). CVVT's securities traded on the NASDAQ Global Market until September 21, 2012.

3. On September 29, 2014, the Commission filed a complaint against Tang in SEC v. China Valves Technology, Inc., Civil Action No. 1:14-cv-01630 (D.D.C.). On May 13, 2015, the court entered an order permanently enjoining Tang, by consent, from future violations of Section 10(b) of the Exchange Act and Rules 10b-5(b) and 13a-14 thereunder, and aiding and abetting violations of Sections 10(b), 13(a), and 13(b)(2)(A) of the Exchange Act and Rules 10b-5(b), 12b-20, and 13a-13 thereunder. Tang was also ordered to pay a $40,000 civil money penalty.

4. The Commission's complaint alleged, among other things, that Tang signed and certified CVVT's Form 10-Q filing for the third quarter of 2010, which contained material misstatements and omissions related to CVVT's acquisition of Watts Valve Changsha Co., Ltd. ("Changsha Valve"). According to the complaint, the filing misrepresented the nature of the Changsha Valve transaction and related payments, and failed to disclose the role of related

parties and the existence of an investigation into potential violations of the Foreign Corrupt Practices Act. The complaint alleged that Tang knew, or was reckless in not knowing, that the Form 10-Q was inaccurate because he had received information alerting him to the true nature of the transaction. Further, as CFO and Treasurer of CVVT, he had access to CVVT's finances and was responsible for the accuracy of CVVT's books and records.

IV.

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

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

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

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

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his 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 as an accountant provided that he is in possession of an accounting license in good standing and he has resolved any disciplinary issues with any applicable licensing authority. However, if the resolution of any disciplinary action by a licensing authority 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75000 / May 20, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16548

In the Matter of **GUY M. JEAN-PIERRE, Esq., a/k/a "MARCELO DOMINGUEZ DE GUERRA"** **Respondent.**	**ORDER OF SUSPENSION PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Guy M. Jean-Pierre, a/k/a "Marcelo Dominguez de Guerra" ("Respondent" or "Jean-Pierre") pursuant to Rule 102(e)(2)[1] of the Commission's Rules of Practice (17 C.F.R. § 200.102(e)(2)).

II.

The Commission finds that:

1. Guy M. Jean-Pierre is an attorney previously licensed in the State of Florida.

2. On January 13, 2014, the Supreme Court of Florida issued an order disbarring Jean-Pierre from the practice of law in Florida, based on his filing of fraudulent attorney opinion letters with Pink OTC Markets. The order became final after thirty days.

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1 Rule 102(e)(2) provides, in relevant part, that "[a]ny attorney who has been suspended or disbarred by a court of the United States or any State . . . shall be forthwith suspended from appearing or practicing before the Commission."

III.

In view of the foregoing, the Commission finds that Jean-Pierre has been disbarred from the practice of law by the Supreme Court of the State of Florida, within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

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

By the Commission.

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. 74999 / May 20, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16547

In the Matter of **GUY M. JEAN-PIERRE, Esq., a/k/a "MARCELO DOMINGUEZ DE GUERRA"** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND IMPOSING TEMPORARY SUSPENSION PURSUANT TO RULE 102(e)(3)(i)(B) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Guy M. Jean-Pierre, a/k/a "Marcelo Dominguez de Guerra" ("Respondent" or "Jean-Pierre") pursuant to Rule 102(e)(3)(i)(B)[1] of the Commission's Rules of Practice (17 C.F.R. § 200.102(e)(3)(i)(B)).

II.

The Commission finds that:

1. Guy M. Jean-Pierre is an attorney licensed in the State of New York and the State of California.

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[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any attorney . . . who has been by name: (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.

2. During 2010 and 2011, Jean-Pierre forged numerous attorney opinion letters as a means of circumventing a ban from issung opinion letters instituted against him by Pink OTC Markets Inc. (formerly, Pink Sheets LLC).

3. On December 6, 2012, the Commission filed a complaint against Jean-Pierre in the United States District Court for the Southern District of New York charging him with issuing fraudulent attorney opinion letters in violation 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. The complaint sought a permanent injunction; disgorgement of unlawful proceeds plus pre-judgment interest; a financial penalty; an officer/director bar; and a penny stock bar. *SEC v. Guy M. Jean-Pierre, a/k/a "Marcelo Dominguez de Guerra,"* Case Number 1:12-cv-08886-LGS-HBP (S.D.N.Y.). Jean-Pierre defaulted on the complaint.

4. On December 3, 2014, in a report and recommendation prepared after a referral by the district court, a magistrate judge found that Jean-Pierre willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder. In an opinion and order dated March 9, 2015, the district court adopted the magistrate judge's report and recommendation in its entirety and ordered Jean-Pierre to pay $62,000 in disgorgement with interest and a civil monetary penalty of $1,425,000. Additionally, the district court permanently enjoined Jean-Pierre from participating in any penny stock offerings.

III.

Based on the foregoing, the Commission finds that Jean-Pierre has been found by a court of competent jurisdiction, in an action brought by the Commission, to have willfully violated provisions of the Federal securities laws, within the meaning of Rule 102(e)(3)(i)(B) of the Commission's Rules of Practice. In view of this finding, the Commission deems it appropriate and in the public interest that Jean-Pierre be temporarily suspended from appearing or practicing before the Commission as an attorney.

IT IS HEREBY ORDERED that Jean-Pierre be, and hereby is, temporarily suspended from appearing or practicing before the Commission as an attorney. This Order will be effective upon service on the Respondent.

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

If a petition is received within thirty days after service of this Order, the Commission will, within thirty days after the filing of the petition, either lift the temporary suspension, or schedule the matter for hearing at a time and place to be designated by the Commission, or both. If a hearing is ordered, following the hearing, the Commission may lift the suspension, censure the petitioner, or disqualify the petitioner from appearing or practicing before the Commission for a period of time, or permanently, pursuant to Rule 102(e)(3)(iii).

This Order shall be served upon Jean-Pierre personally or by certified mail at his last known address.

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. 74997 / May 20, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16545

In the Matter of **Composite Solutions, Inc.,** **Ruby Creek Resources, Inc., and** **Voyager Entertainment 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 Composite Solutions, Inc., Ruby Creek Resources, Inc., and Voyager Entertainment International Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Composite Solutions, Inc. (CIK No. 1061822) is a dissolved Florida corporation located in La Jolla, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Composite Solutions is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2005, which reported a net loss of $163,606 for the prior nine months. As of May 5, 2015, the company's stock (symbol "CPUT") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Ruby Creek Resources, Inc. (CIK No. 1379810) is a Nevada corporation located in Los Angeles, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ruby Creek Resources is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 2012, which reported a net loss of $7,412,798 for the prior nine months. As of May 5, 2015, the company's stock (symbol "RBYC") was quoted on OTC Link, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. Voyager Entertainment International Inc. (CIK No. 1028394) is a Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Voyager Entertainment International 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, 2011, which reported a net loss of $20,915,781 from the company's March 1, 1997 inception through September 30, 2011. As of May 5, 2015, the company's stock (symbol "VEII") was quoted on OTC Link, had seven market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

4. As 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.

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

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9788 / May 20, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75010 / May 20, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16549

In the Matter of **RANDY E. OLSHEN** **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, 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 pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Sections 15(b), and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Randy E. Olshen ("Respondent" or "Olshen").

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 consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing 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 Olshen's fraudulent conduct in the unregistered offer or sale of securities and in connection with the unregistered purchase or sale of securities of Innovative Health Solutions, LLC ("IHS"), a manufacturer and seller of sports hydration drinks. Olshen devised a scheme to defraud investors and potential investors through the use of material misrepresentations and omissions of fact related to actual and forecasted sales and receivables. To further his scheme, Olshen fabricated company accounting and sales records. Olshen failed to disclose material facts, including that IHS was behind in payments to creditors, that Olshen used investment proceeds for his own personal benefit and to pay undisclosed commissions to others for obtaining investments for IHS, and that he had declared personal Chapter 7 Bankruptcy. IHS raised over $7 million from approximately 50 investors through Olshen's fraudulent scheme.

Respondent

1. Olshen, age 52, is a resident of Newport Beach, California. Olshen was a founder and the President of IHS. From 2009 to February 2013, Olshen offered and sold securities in Innovative Health Solutions, LLC.

Other Relevant Entity

2. IHS is a Delaware entity, formed in July 2008. IHS was headquartered in Utah and had an office in California. IHS specialized in manufacturing and selling sports hydration drinks designed to boost energy and stamina. One of the products marketed by IHS was "H2O Overdrive." IHS's Delaware business registration has been in "Cease Good Standing" status since June 1, 2013, for failure to pay franchise taxes.

Background

3. To advance the growth of IHS, Olshen sought investors and made representations and promises to encourage investments.

4. Beginning in and around 2009, and continuing until on or about February 2013, in the offer or sale of and in connection with the purchase or sale of securities, Olshen devised a scheme and artifice to defraud and to obtain money and property from IHS investors and potential investors by the means of making untrue statements of materials facts and omissions.

---

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.

5. The IHS securities that Olshen offered and sold were not registered for offer or sale with the Commission. Olshen used the mails and means of interstate commerce to sell and deliver securities in IHS.

6. Olshen offered and sold IHS securities through the use of private placement memoranda, which purported to rely upon the exemption from registration "under Rule 505 Promulgated by the Securities and Exchange Commission and in Sections 3(b) and 4(2) of the Securities Act of 1933 and Regulation D of the General Rules and Regulations thereunder."

7. Olshen solicited and received $7,799,266.05 from 50 or more victims as part of his scheme.

8. Olshen is not and has never been registered with the Commission as a broker or dealer or in any other capacity.

9. Olshen controlled IHS's bank account and funds and was the sole signatory on IHS's bank account.

10. Olshen solicited investors to purchase IHS securities, negotiated the terms of sales to investors, completed paperwork related to sales, and received and handled investor funds. Olshen had sole control of IHS's bank account and misappropriated investor funds for his personal expenses.

11. Olshen utilized finders to whom he paid transaction-based compensation in the form of commissions for the sale of IHS securities.

12. As part of his scheme and artifice to defraud, Olshen knowingly made, orally and/or in writing, the following false and fraudulent representations to IHS investors:

a. That IHS had approximately $1.1 million in sales in 2009, when in fact, IHS had approximately $98,275 in sales in 2009;

b. That IHS had approximately $4.3 million in sales in 2010, when in fact, IHS had approximately $129,253 in sales in 2010;

c. That IHS had approximately $9.9 million in sales in 2011, when in fact, IHS had approximately $228,802 in sales in 2011;

d. That IHS had projected over $28 million in sales in 2012, when in fact, IHS had approximately $579,239 in sales in 2012; and

e. That IHS had large receivable accounts with various national chains such as Costco, CVS, Rite Aid, and Food Lion, when in fact, no such large receivable accounts were owed to IHS.

13. As part of his scheme and artifice to defraud, Olshen concealed and omitted the following material facts:

a. Olshen created two sets of IHS accounting records, one that accurately represented company finances and one that was provided to investors and potential investors;

b. Olshen fabricated paperwork, such as sales records, to support his misrepresentations regarding the exponential growth of IHS;

c. IHS failed to make numerous payments to its creditors;

d. Olshen paid a portion of investor funds to others as commissions for obtaining investments for IHS;

e. Olshen personally declared Chapter 7 Bankruptcy on or about October 11, 2011; and

f. Olshen diverted portions of the invested funds for purposes not disclosed or authorized by the investors in a manner wholly inconsistent with his promises and representations.

14. The material misrepresentations and omissions of fact outlined above were important to IHS investors' investment decisions. Investors expressed that they would not have invested monies in IHS if not for Olshen's material misrepresentations and omissions.

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

16. As a result of the conduct described above, Olshen willfully violated Section 15(a) of the Exchange Act, which prohibits a person from inducing or attempting to induce the purchase or sale of securities unless registered with the Commission as a broker or dealer.

Disgorgement and Civil Penalties

17. In light of Respondent's agreement to plead guilty and pay restitution in the amount of $7,799,266.05 to victims in the criminal matter styled *United States v. Randy Elliot Olshen*, Crim. No. 2:14-cr-00476, in the United States District Court for the District of Utah, the Commission is not seeking disgorgement and prejudgment interest or the imposition of civil monetary penalties.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act and Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Olshen cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Olshen be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;
>
> barred from participating in an offering of penny stock, including engaging in activities with a broker, dealer, or issuer for purposes of issuing, trading, or inducing or attempting to induce the purchase or sale of any penny stock. A penny stock is any equity security that has a price of less than five dollars, except as provided in Rule 3a51-1 under the Exchange Act [17 C.F.R. 240.3a51-1]; and

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.

By the Commission.

Brent J. Fields
Secretary

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

Commissioner Gallagher
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9789 / May 21, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75021 / May 21, 2015

INVESTMENT ADVISERS ACT OF 1940
Release No. 4094 / May 21, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31643 / May 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16554

In the Matter of **GRAY FINANCIAL GROUP, INC., LAURENCE O. GRAY, AND ROBERT C. HUBBARD, IV,** **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(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 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 Respondent Gray Financial Group, Inc. ("Gray Financial"), Respondent Laurence O. Gray ("Gray"), and Respondent Robert C. Hubbard, IV ("Hubbard") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. These proceedings arise out of violations of the anti-fraud provisions of the federal securities laws by Gray Financial Group Inc., an Atlanta-based registered investment adviser, and two of its senior officers in connection with a fiduciary duty breach related to their unsuitable recommendation of Gray Financial's proprietary fund of funds to several Georgia-based public pension clients.

2. In July 2012, the State of Georgia allowed, for the first time, most of its public pension plans to invest in alternative investments. However, such investments were subject to certain specific restrictions as to investment size and timing.

3. Between July 2012 and August 2013, Gray Financial, its founder Laurence O. Gray, and current co-CEO Robert C. Hubbard, IV, recommended, offered and sold investments in GrayCo Alternative Partners II, LP ("GrayCo Alt. II"), to four Georgia public pension clients, despite the fact that they knew, were reckless in not knowing, or should have known that these investments did not comply with the restrictions on alternative investments imposed by Georgia law.

4. Additionally, in October 2012, when recommending GrayCo Alt. II to one of these clients, Gray Financial and Gray made specific material misrepresentations concerning the investment's compliance with the Georgia law and the number and identity of prior investors in the fund.

B. RESPONDENTS

5. Gray Financial Group, Inc., doing business as Gray & Company, is an Atlanta, Georgia-based investment adviser that has been registered with the Commission since 1998. It primarily provides consulting services to pension and profit sharing plans, endowments, and other entities. According to its annual amendment to its Form ADV, filed with the Commission on March 31, 2015, it has 28 non-discretionary accounts with approximately $5.6 billion in plan assets and 18 discretionary accounts with approximately $933 million in assets under management. Gray Financial also created and advised (through a division of Gray Financial) two alternative investment fund of funds, GrayCo Alternative Partners I, LP ("GrayCo Alt. I") and GrayCo Alt. II.

6. Laurence O. Gray, age 53, is a resident of Atlanta, Georgia. Since its founding, he has been President and, until July 2013, he has served as Chief Executive Officer of Gray Financial. According to Gray Financial's Form ADV, Gray also has at least a 75% ownership interest in Gray Financial. At various prior times, though not during the relevant period, Gray has been associated with broker-dealers.

7. Robert C. Hubbard, IV, age 40, is a resident of Mableton, Georgia. He has been employed by Gray Financial since August 2006 in various senior positions. Prior to Gray Financial, he was employed by Washtenaw County, Michigan from 2000 to 2006 in various positions, including, Retirement Administrator and Strategic Operations Manager. He was Chief Operating Officer of Gray Financial from October 2009 until July 2013, when he became co-CEO, a position he currently holds.

C. OTHER RELEVANT ENTITIES

8. GrayCo Alternative Partners II, LP is a private fund of funds organized in Delaware. It filed a Form D with the Commission on December 20, 2012. GrayCo Investment Management II, LLC is its general partner and GrayCo Global Advisors is its manager. Gray and Hubbard are both members of GrayCo Alt. II's executive committee.

D. FACTS

Background

9. Since at least 2006, Gray Financial, Gray and Hubbard have provided investment advice and consulting services to public and private pension funds nationwide, including a number of Atlanta, Georgia-area public pension plans.

10. Among other clients, Gray Financial served as pension consultant to: (a) the City of Atlanta Firefighters' Pension Fund ("Atlanta Firefighters' Pension"); (b) the City of Atlanta General Employees' Pension Fund ("Atlanta General Pension"); (c) the City of Atlanta Police Officers' Pension Fund ("Atlanta Police Pension"); and (d) the MARTA/ATU Local 732 Employees Retirement Plan ("MARTA/ATU Retirement") (all plans cumulatively, "the Georgia-based public pension clients").

11. Beginning in 2011, Gray and Hubbard expanded Gray Financial's business to include originating, managing and advising alternative investment fund of funds.

12. In 2012, the State of Georgia enacted a law that authorized eligible large Georgia public pension and retirement systems to invest in alternative investments for the first time, subject to certain limitations and restrictions (the bill was entitled the "Employees' Retirement System of Georgia Enhanced Investment Authority Act" and is codified as Official Code of Georgia Annotated (O.C.G.A.) § 47-20-87, hereinafter, the "Georgia Investment Act"). For example, any single Georgia-based public pension's investment in alternative investments "shall not exceed in any case 20 percent of the aggregate amount of: (1) the capital to be invested in the applicable private pool, including all parallel pools and other related investment vehicles established as part of the investment program of the applicable private pool; . . . ." The Georgia Investment Act also requires that "[e]ach alternative investment by an eligible large retirement system shall have previously been or shall be concurrently made or committed to be made by at least four other investors not affiliated with the issuer." Finally, the law provides that "[a]lternative

investments shall only be made in private pools and issuers that have at least $100 million in assets, including committed capital, at the time the investment is initially made or committed to be made" by a Georgia-based public pension.

Respondents Fraudulently Recommended and Sold Investments in GrayCo Alt. II to Public Pensions

13. By early to mid-2012, Gray and Hubbard, with knowledge of the Georgia Investment Act, conceived and created Gray Financial's second fund of funds, GrayCo Alt. II, an alternative investments-based fund of funds.

14. Gray was largely responsible for marketing GrayCo Alt II to public pension clients. Hubbard was largely responsible for arranging the drafting of the offering and subscription documents, providing the investment documents containing proposed investors' names to Gray, and tracking the date and amount of the ultimate investments in the GrayCo Alt. II.

15. By no later than July 2012 and throughout the fall 2012, Gray Financial and Gray began to recommend GrayCo Alt. II to their Georgia-based public pension clients. At their formal Board meetings, Gray recommended that Atlanta General Pension and MARTA/ATU Retirement invest in GrayCo Alt. II and recommended that the Boards of Atlanta Firefighters' Pension and Atlanta Police Pension authorize their Chairs to execute the necessary paperwork for the alternative investments.

16. Gray Financial's Georgia-based public pension clients, based upon Gray Financial's recommendation, invested in GrayCo Alt. II, as follows (table includes initial required investment of the general partner, a Gray Financial affiliate):

Investor	Investment Date	Amount	Investor's Percentage of Total Fund Assets (As of 12/31/2012)
Atlanta Firefighters Pension	10/20/2012	$15 million	19.2%
Atlanta Police Pension	10/22/2012	$21 million	26.9%
Atlanta General Pension	11/7/2012	$28 million	35.9%
MARTA/ATU Retirement	11/30/2012	$13 million	16.7%
General Partner (Gray Financial affiliate)		$1 million	1.3%
Total		**$78 million**	

17. By recommending and selling these investments, Gray Financial and Gray breached their fiduciary duty to their advisory clients.

18. The investments were unsuitable for the Georgia-based public pension clients because, as sold, the investments violated the Georgia Investment Act. Specifically, GrayCo Alt. II never met the $100 million requirement at the time of the investment of any of Gray Financial's Georgia-based public pension clients, or at any subsequent time. The fund only raised $78 million initially, and at no time to date exceeded $100 million.

19. Furthermore, two of the Georgia-based public pension clients invested an amount greater than 20% of the capital invested in GrayCo Alt. II. Both the Atlanta Police Pension (26.9%) and the Atlanta General Pension (35.9%) investments exceeded the 20% statutory ceiling of investment in GrayCo Alt. II (based upon the initial investment of $78 million).

20. Finally, each of the four Georgia-based public pension clients' investments even if considered concurrent, would fall outside the statutory requirement that four non-issuer affiliated investors exist prior to the investment by a Georgia public pension.

<u>Gray Financial and Gray Made Material Misrepresentations</u>

21. In a meeting of the Board of Trustees of the Atlanta General Pension on November 7, 2012, Gray Financial and Gray, in recommending an investment in GrayCo Alt. II, made two specific material misrepresentations.

22. First, Gray told the Board that the Atlanta General Pension's then-proposed investment in GrayCo Alt. II was consistent with Georgia law. When asked by an Atlanta General Pension trustee prior to voting if the proposed $28 million alternative investment that Gray Financial was recommending was "consistent with the law," Gray responded that it "absolutely" was and that "the only reason you can do this now is because of the change in the law."

23. Gray knew, was reckless in not knowing, or should have known his claim was false, as the three relevant limitations of the Georgia Investment Act were not met at that time. Specifically, (a) Atlanta General Pension's $28 million investment was and still is greater than 20% of the capital to be invested in GrayCo Alt. II;(b) there were not four other investors not affiliated with Gray Financial that had previously been invested or concurrently invested or committed to invest; and (c) GrayCo Alt. II did not have at least $100 million in assets, including committed capital, at the time Atlanta General Pension's investment was initially made or committed to be made.

24. Second, Gray falsely stated that certain other public pension clients had already invested in the GrayCo Alt. II. Prior to the conclusion of the November 7, 2012 meeting, a vote was called on whether to authorize a $28 million investment in GrayCo Alt. II. During the course of the vote, a trustee asked Gray who else had invested in the fund. In response, Gray referenced, among a few others, four pension plans, three of which never invested in the fund and one of which did not invest until three weeks later. Specifically, in response to the trustee questions, Gray stated that "MARTA is already

done" and that "Michigan, New York, Chicago, those plans are already executed, as well." Gray had no reasonable basis to claim that MARTA/ATU Retirement was "done", because its board did not even vote to invest or execute its subscription agreement until November 30, 2012, more than three weeks after Atlanta General Pension's investment. Moreover, there have never been any investors in GrayCo Alt. II from Michigan, New York, or Chicago.

Gray Financial Profits Due to the Fraudulent Investments

25. Through December 31, 2014, Gray Financial's four Georgia public pension clients have paid fees totaling over an estimated $1.7 million since their original investments in November 2012.

E. VIOLATIONS

26. As a result of the conduct described above, Gray Financial and Gray willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities. Hubbard willfully violated Sections 17(a)(1) and (3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) thereunder. Alternatively, Hubbard willfully aided, abetted, and caused Gray Financial and Gray's violations of Sections 17(a)(1) and (3) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5(a) and (c) thereunder.

27. As a result of the conduct described above, Gray Financial and Gray willfully violated Sections 206(1), 206(2) and 206(4) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser, and Rule 206(4)-8 promulgated thereunder, which prohibits fraudulent conduct by advisers to "pooled investment vehicles" with respect to investors or prospective investors in those pools. Hubbard willfully aided, abetted, and caused Gray Financial and Gray's violations of Sections 206(1), 206(2), and 206(4) and Rule 206(4)-8(a)(2) thereunder of the Advisers Act.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Gray Financial pursuant to Section 203(e) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

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

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

E. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act, and Rule 206(4)-8 thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, and Section 203(i) of the Advisers Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, and Section 203 of the Advisers Act.

IV.

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

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

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against 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 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

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. 75028 / May 21, 2015

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3658 / May 21, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16171

In the Matter of **MAYER HOFFMAN McCANN, P.C.** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS, CENSURE, AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 4C AND 21C OF THE EXCHANGE ACT AND RULE 102(e)(1)(ii) OF THE COMMISSION'S RULES OF PRACTICE**

I.

On September 25, 2014, the Securities and Exchange Commission ("Commission") issued the Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice[2] and Notice of Hearing against Mayer Hoffman McCann P.C. ("MHM" or

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:

> 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.

"Respondent"). Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept.

II.

Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or in which the Commission is a party, and without admitting or denying the findings contained in the Order, 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 Making Findings and Imposing Remedial Sanctions, Censure, and a Cease-and-Desist Order Pursuant to Sections 4C and 21C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice ("Order") as set forth below.

III.

On the basis of this Order and the Offer of MHM, the Commission finds[3] that:

SUMMARY

Mayer Hoffman McCann P.C. ("MHM") is a public accounting firm associated with CBIZ, Inc. ("CBIZ"), a publicly traded company, through a business model referred to as an alternative practice structure ("APS"). CBIZ's APS model with MHM utilizes an administrative service agreement ("ASA") under which MHM leases from CBIZ virtually all of the human capital, equipment and overhead MHM requires to perform its attest work, in exchange for a majority of MHM's revenue.

CBIZ is an associated entity of MHM, and CBIZ and MHM are viewed as a single entity for Commission auditor independence purposes.

MHM has numerous attest clients that file reports with the Commission. One of those clients was Tradebot Systems, Inc. "(Tradebot"), a privately-owned registered broker-dealer with no customers. Pursuant to Rule 17a-5 promulgated under Section 17(a) of the Exchange Act, Tradebot is required to file annual reports with the Commission containing financial statements audited by an independent public accountant ("Annual Reports").

MHM audited Tradebot's Annual Reports from 2004 through 2012. From 2008 to at least 2013, Tradebot periodically invested in CBIZ stock (using an alogorithmic computerized trading program), thereby impairing MHM's independence with respect to its audits of Tradebot's 2008 through 2012 financial statements. As a result, Tradebot's Annual Reports did not comply with Rule 17a-5 for those periods.

In addition to MHM's independence violations related to the Tradebot audits, MHM's procedures were deficient to prevent such independence violations for all of its broker-dealer and investment fund audit clients.

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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.

MHM lacked an appropriate system of quality controls to detect transactions in CBIZ stock by its attest clients in order to ensure that those engagements complied with the firm's legal and ethical requirements. MHM's quality control and audit procedures failed to meet adequate professional standards with respect to its audits of Tradebot.

During the audit of its 2012 year, Tradebot was made aware that trading in CBIZ stock would impair MHM's independence. Tradebot continued to trade in CBIZ stock.

A. RESPONDENT

1. **Mayer Hoffman McCann P.C.**, is a Missouri professional corporation headquartered in Leawood, Kansas, with offices throughout the U.S. MHM's Commission-related attest practice includes registered broker-dealers, investment funds and publicly traded companies.

B. RELATED ENTITIES

2. **CBIZ, Inc.**, is a Delaware corporation headquartered in Cleveland, Ohio, that provides products and services to businesses throughout the U.S. CBIZ associates with several U.S. public accounting firms through its APS model, with MHM being the largest. CBIZ's stock is traded on the New York Stock Exchange.

3. **Tradebot Systems, Inc.**, is a broker dealer registered with the Commission, and is located in Kansas City, Missouri.

C. FACTS

4. In about 1996, CBIZ began using the APS model to expand its revenue base by acquiring the non-attest practices of public accounting firms and forming relationships with those public accounting firms by means of ASAs.

5. From about 1998 to present, CBIZ entered into periodic ASAs with MHM which provide, among other things, that virtually all of MHM's shareholders are salaried employees of CBIZ and are leased to MHM along with other CBIZ professional and non-professional staff, office space, equipment, and marketing and other services, to enable MHM to perform its attest practice, in exchange for approximately 85% of MHM's revenues.

6. On November 2, 1998, the Commission's Office of Chief Accountant ("OCA") became aware of CBIZ's use of the APS model and its acquisition of non-attest practices of accounting firms. OCA notified CBIZ of the application of the Commission's independence rules:

> [Y]our affiliation with certain accounting firms ... may subject you to the application of the independence rules set forth in Rule 2-01 of Regulation S-X.
>
> ... [A]ny accounting firm and the acquirer ("acquirer") of that accounting firm that employs any accountants that work on SEC clients of the accounting firm should continue to fully comply with the SEC's independence requirements.

> In determining whether an accountant may in fact not be independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof and will not confine itself to the relationships existing in connection with the filing of reports with the Commission.

7. On August 13, 1999, OCA sent guidance to CBIZ related to independence disclosures provided in a CBIZ Form S-4 filing then under review. In that letter, OCA stated:

> [T]he Commission and the staff are concerned about the significant public policy issues that are raised in situations where audits of public companies are performed by auditors under an alternative business structure. . . . [CBIZ] has acquired the non-attest businesses of several accounting firms ("the Attest Firms") that have audited clients required to file financial statements with the [Commission]. . . .
>
> . . . [I]n the application of the independence rules, the SEC staff will view [CBIZ] and all Attest Firms as a single entity. As a result, [CBIZ] must abide by all of the independence rules that the Attest Firm must follow in order for the Attest Firm to be independent of an SEC audit client. . . .
>
> The revised disclosure should also state that an Attest Firm would not be independent from entities involved in the [CBIZ] offering process and in making a market for or otherwise facilitating the trading of [CBIZ] shares in the secondary market. Accordingly, the revised document should indicate that an Attest Firm's independence would be impaired with respect to all members of the syndicate underwriting the [CBIZ] offering and to broker-dealer firms that exercise discretionary buy and sell authority over customer accounts holding significant positions in [CBIZ] or employ securities analysts who follow [CBIZ].
>
> Further, the disclosure should indicate that because [CBIZ] and its officers, directors and affiliates, and the Attest Firm are viewed as one entity for purposes of the independence rules, [CBIZ] or its officers, directors or affiliates would impair the independence of the Attest Firms if they held any financial interest in or entered into any business relationships with or sold any services to an SEC audit client of an Attest Firm that the Attest Firm itself would be precluded from under the SEC independence rules.

On this same date, CBIZ sent correspondence to OCA stating that CBIZ and the CPA firms with which it had a relationship through an ASA believed that the CPA firms could perform audits on SEC reporting clients holding 5% or less of CBIZ stock.

8. In 2000, the Commission promulgated an extensive revision of its auditor independence requirements under Rule 2-01 of Regulation S-X. 17 C.F.R. § 210.2-01. The revised rule was adopted in response to "an increasingly complex web of business and financial

relationships" of public accounting firms. Included in the revision was subsection 2-01(c)(1)(iv)(A). It provides:

> (iv) Audit clients' financial relationships. An accountant is not independent when:
>
> (A) Investments by the audit client in the accounting firm. An audit client has, or has agreed to acquire, any direct investment in the accounting firm, such as stocks, bonds, notes, options, or other securities, or the audit client's officers or directors are record or beneficial owners of more than 5% of the equity securities of the accounting firm.

9. Rule 2-01(f)(2) of Regulation S-X defines "accounting firm" as "an organization . . . that is engaged in the practice of public accounting . . . and all of the organization's . . . associated entities . . . ." Rule 2-01 did not define the term "associated entities."

10. CBIZ is an associated entity of MHM by virtue of its APS relationship and ASA with MHM.

11. Pursuant to Rule 17a-5(d) of the Exchange Act, Tradebot is required to file an annual report ("Annual Report") which contains its audited financial statements. Rules 17a-5(d), (e) and (f) specifically require that the Annual Report be audited by an "independent public accountant" and a "public accountant who shall be in fact independent" as defined by Rule 2-01(b) and (c). From 2004 through 2012, Tradebot engaged MHM to audit its financial statements included in the Annual Report.

12. Commencing in 2008, unbeknownst to MHM, Tradebot began to regularly trade in CBIZ stock and continued to trade in that stock through 2013.

13. Prior to 2012, Tradebot was unaware of any prohibition against it acquiring any interest in the securities of CBIZ. Prior to the 2012 audit period, MHM never inquired whether Tradebot traded in CBIZ stock.

14. In about mid-2012, MHM's engagement shareholder learned from Tradebot's CFO that Tradebot had traded in CBIZ stock and discussed with Tradebot's CFO the possibility that such trades may impact MHM's independence.

15. In response, MHM's engagement shareholder contacted MHM's Director of Quality Control and asked "whether or not that was something we need to be concerned about from an independence issue." MHM's Director of Quality Control forwarded the question to MHM's national director of professional standards, MHM's president, and members of MHM's executive committee.

16. On September 4, 2012, Tradebot's CFO emailed MHM's engagement shareholder seeking further guidance on the impact of Tradebot's trading in CBIZ, asking: "Can you send me the link pointing to the independence issue related to trading public stock."

17. On September 6, 2012, MHM's engagement shareholder responded to Tradebot's CFO's email, stating: "I do not have anything specific to this situation to send (as it does not exist). It is basically an interpretation of the SEC rules. Our New York office had inquired of a similar situation in which the entity holds CBIZ stock and it was determined to be an issue.... Unfortunately our chief independence officer is on a long vacation and I am trying to get a hold of him for thoughts."

18. On October 3, 2012, before resolving whether MHM was independent, Tradebot engaged MHM for the 2012 audit. In connection with that engagement, MHM did not discuss with Tradebot the unresolved independence issue and proceeded to sign the engagement letter.

19. MHM's potential independence conflict should have been resolved prior to signing the engagement letter.

20. On October 28, 2012, MHM's director of quality control contacted MHM's national director of professional standards and MHM's president regarding the Tradebot independence issue. On October 30, 2012, MHM's national director of professional standards provided guidance to MHM's director of quality control and MHM's engagement shareholder, citing Rule 2-01(c)(1)(iv)(A) and instructing them that he thought MHM would have to resign if Tradebot would be able to acquire more than 5% of the equity securities of CBIZ.

21. MHM's national director of professional standards' guidance to MHM's director of quality control and MHM's engagement shareholder did not comply with Rule 2-01(c)(1)(iv)(A).

22. In October 2012, MHM requested a meeting with the Commission staff ("Staff") to discuss matters relevant to the investigation, including a response to a request by the Staff to know whether MHM monitored the holdings of its broker-dealer clients for CBIZ stock, and whether there were instances of a broker-dealer client taking a position in CBIZ stock.

23. The Staff met with MHM on December 4, 2012; MHM's president attended the meeting with MHM's counsel. At that meeting the Staff conveyed to MHM that an audit client holding even one share of CBIZ would impair MHM's independence.

24. On December 5, 2012, MHM's engagement shareholder emailed Tradebot concerning MHM's conclusion regarding the independence question posed in September 2012, stating:

> Following up on the independence issues we discussed earlier this year, below is the SEC rule. I am assuming Tradebot has not become the beneficial owner of more than 5% of the CBIZ stock at one time, however, I would like to propose perhaps you put a limit on the number of shares to be acquired at any one time. Is that possible??
>
> Reg. SX §210.2-01(c)(1)(iv)(A)-
>
> An accountant is not independent when:

(A) Investments by the audit client in the accounting firm. An audit client has, or has agreed to acquire, any direct investment in the accounting firm, such as stocks, bonds, notes, options, or other securities, or the audit client's officers or directors are record or beneficial owners of more than 5% of the equity securities of the accounting firm.

25. MHM's engagement shareholder's instruction to Tradebot was erroneous because the 5% threshold referenced in the rule does not apply to Tradebot; rather, it only applies to Tradebot's officers and directors.

26. Tradebot responded to MHM's engagement shareholder's email by indicating it would place a 10,000 share limit on trades in CBIZ, an amount that was below 5% of CBIZ's outstanding shares.

27. Tradebot continued to trade in CBIZ stock through 2013.

28. Until 2013, MHM did not have any quality control or audit procedures to ensure clients did not trade in CBIZ stock or to otherwise comply with Rule 2-01(c)(1)(iv)(A). Until 2013, MHM provided no guidance to any audit client, including Tradebot, regarding trading prohibitions in CBIZ stock by the audit client. Further, MHM did not implement any audit procedures during its audits of Tradebot, or any other broker-dealer clients, to review the securities they were trading to ensure compliance with Rule 2-01(c)(1)(iv)(A).

29. MHM performed audits of Tradebot's financial statements for the periods 2008 through 2012 in connection with Tradebot's Annual Reports filed with the Commission. MHM provided audit opinions for those audits which indicated, among other things, that MHM was independent of Tradebot for those audits, when in fact, MHM was not independent.

D. VIOLATIONS

MHM's IMPROPER PROFESSIONAL CONDUCT

30. Section 4C(2) of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice allow the Commission to censure, or deny temporarily or permanently, an accounting firm's privilege of practicing before it if the firm is found to have "engaged . . . in improper professional conduct."

31. Pursuant to Section 4C(2) and Rule 102(e)(1)(ii), improper professional conduct involves a violation of applicable professional standards through intentional, knowing or reckless conduct, and two types of negligent conduct: a single instance of highly unreasonable conduct for which heightened scrutiny is warranted; or repeated instances of unreasonable conduct that indicate a lack of competence to practice before the Commission.

32. "Because of the importance of an accountant's independence to the integrity of the financial reporting system, the Commission has concluded that circumstances that raise questions about an accountant's independence always merit heightened scrutiny." Amendment

to Rule 102(e) of the Commission's Rules of Practice, Release No. 33-7593 (Oct. 19, 1998), 63 Fed. Reg. 57168.

1. Relevant Audit Standards

33. The term "applicable professional standards" primarily refers to generally accepted accounting principles ("GAAP"), generally accepted auditing standards ("GAAS"), the AICPA Code of Professional Conduct, and Commission regulations, but is broad enough to accommodate changes in the body of professional guidance routinely used by accountants.

34. For auditors of registered broker-dealers, such as Tradebot, the applicable professional standards related to GAAS are those that have been issued by the AICPA.[4]

35. Both Rule 2-01 and GAAS require auditors to maintain strict independence from their audit clients. AICPA Auditing Standards AU Section 150.02 requires that the auditor "maintain independence . . . in all matters relating to the audit." AICPA Auditing Standards AU Section 220.03 states "[i]t is of utmost importance to the profession that the general public maintain confidence in the independence of auditors."

36. GAAS requires that an auditor have policies and procedures designed to prevent independence impairment, and client acceptance and continuance procedures that ensure compliance with legal requirements, discussed below.

37. MHM was negligent in its failure to comply with those professional standards.

2. MHM'S Independence Was Impaired When It Audited Tradebot's 2008 – 2012 Financial Statements

a. Rule 17a-5

38. Rule 17a-5 of the Exchange Act requires registered broker dealers to file periodic reports with the Commission including, pursuant to Rule 17a-5(d)(1)(i), an annual report "which shall be audited by an independent public accountant." Rule 17a-5(e)(1)(i) further states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and shall give an opinion covering the statements filed pursuant to paragraph (d)..."

39. Rule 17a-5(f)(3) defines independence as "in accordance with the provisions of § 210.2-01(b) and (c) of this chapter."

b. Rule 2-01(b) and (c)

40. The general standard of auditor independence is described in Rule 2-01(b).

[4] The AICPA auditing standards are applicable for the audits of broker-dealers, *Commission Guidance Regarding Auditing, Attestation, and Related Practice Standards Related to Brokers and Dealers,* Release No. 34-62991, Sept. 24, 2010.

41. Additionally, Rule 2-01(c)'s subsections set forth "a non-exclusive specification of circumstances inconsistent with" Rule 2-01(b)'s general requirement. The Commission stated: "As to circumstances specifically set forth in our rule, we have set forth a bright-line test: an auditor is not independent if he or she maintains the relationships, acquires the interests, or engages in the transactions specified in the rule." Revision of the Commission's Auditor Independence Requirements, Release No. 33-7919, 65 Fed. Reg. 76008 at 76030.

42. When MHM audited Tradebot's financial statements during the audit periods in which Tradebot had acquired direct investments in CBIZ stock, namely 2008 through 2012, MHM's independence was impaired as to those audits.

3. MHM Violated Other Applicable Professional Standards

43. MHM violated professional standards that require an accounting firm to establish policies and procedures designed to assure independence, and client engagement procedures that ensure compliance with legal requirements and risks associated with the engagement.

a. MHM Failed to Design Policies and Procedures That Assured Independence

44. AICPA quality control standards are professional standards under GAAS. Pursuant to AICPA QC Section 10 Paragraph 22, an auditor is required to have policies and procedures "designed to provide with reasonable assurance that the firm ... maintain independence . . . ."

45. In about 2012, MHM had well over a hundred broker dealer and investment fund clients, including Tradebot, which regularly trade in the securities of thousands of public companies. Despite the risks of audit clients trading in CBIZ securities, until 2013 MHM did not have any written policies or procedures to address the independence issues established by Rule 2-01(c)(1)(iv)(A) of audit clients trading in CBIZ securities.

46. Further, until 2013 MHM did not have any written procedures to inform audit clients of the transactional proscriptions of trading in CBIZ securities or any written procedures to follow if audit clients traded in CBIZ securities in violation of Rule 2-01(c)(1)(iv)(A).

47. Until 2013, MHM's audit clients were unaware of restrictions on the trading of CBIZ securities.

b. MHM Failed To Follow Proper Client Engagement Procedures

48. Pursuant to AICPA QC Section 10 Paragraph 27, an auditor is required to have adequate policies and procedures for client continuance that are "designed to provide the firm with reasonable assurance that it will ... continue ... engagements only when the firm can comply with legal and relevant ethical requirements."

49. After learning in 2012 of Tradebot's CBIZ transactions, MHM failed to perform adequate client acceptance procedures to ensure it was independent when being engaged and

beginning substantive field work. Shortly after internal consultation over the independence question was initiated but before MHM's national director of professional standards had provided any guidance to the engagement shareholder, MHM proceeded with the engagement. By doing so, MHM entered into an engagement without determining whether it could continue with the audit.

4. MHM Violated AICPA Professional Standards

50. Through the conduct described above, MHM violated GAAS provisions AU Sections 150.02 and 220.03, AICPA QC Section 10 Paragraphs 22 and 27 and thereby negligently engaged in improper professional conduct.

51. Through its repeated instances of unreasonable conduct resulting in violations of applicable professional standards, MHM demonstrated a lack of competence to practice before the Commission.

5. MHM CAUSED TRADEBOT'S VIOLATION OF SECTION 17(a) AND RULE 17a-5

52. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that its act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter.

53. MHM caused Tradebot's violations of Section 17(a) and Rule 17a-5 by certifying, as independent public accountants, Tradebot's financial statements contained in its Annual Reports, when, in fact, MHM was not independent of Tradebot.

54. Further, MHM lacked an adequate system of controls to maintain independence and failed to inform Tradebot of the proscription against trading in CBIZ stock. Those failures impaired MHM's independence and thereby caused Tradebot to file Annual Reports that did not contain audits by an independent accountant.

55. MHM was negligent in certifying it was independent of Tradebot and having an inadequate system of controls and by failing to notify Tradebot of the proscription against trading in CBIZ stock.

IV.

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

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

A. MHM shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 thereunder;

B. Pursuant to Section 4C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice, MHM is hereby censured;

C. MHM shall, within 14 days of entry of the Order, pay disgorgement of $65,245, which represents profits gained as a result of the conduct described herein, prejudgment interest of $9,755, and civil penalties of $675,000 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 Mayer Hoffman McCann P.C. 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 Martinez, Regional Director, Salt Lake Regional Office, Securities and Exchange Commission, 351 South West Temple, Suite 6.100, Salt Lake City, Utah 84101.

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 ACT OF 1933
Release No. 9791 / May 26, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75043 / May 26, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16354

In the Matter of **David B. Havanich, Jr., Carmine A. DellaSala, Matthew D. Welch, Richard Hampton Scurlock, III, RTAG Inc. d/b/a Retirement Tax Advisory Group, Jose F. Carrio, Dennis K. Karasik, Carrio, Karasik & Associates, LLP, and Michael J. Salovay,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AGAINST DAVID B. HAVANICH, JR. 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 to issue this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Against David B. Havanich, Jr. Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order").

II.

David B. Havanich, Jr. ("Havanich") has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept.

III.

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, and except as provided herein in Section VI,

Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Against David Havanich, Jr., Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.[1]

IV.

On the basis of this Order and Respondent's Offer, the Commission finds that:[2]

A. RESPONDENTS

1. Havanich is 48 years old and resides in Jupiter, Florida. He was the co-founder, president, and director of Diversified Energy Group, Inc. ("Diversified") and is the president and director of St. Vincent de Paul Childrens Foundation Inc. ("St. Vincent"), a non-operating, non-profit corporation.

2. DellaSala is 54 years old and resides in Jupiter, Florida. DellaSala was the co-founder, vice president of business development, and director of Diversified and is the vice president and director of St. Vincent. DellaSala previously held a series 3 commodities license at various times between 1988 and 2002 while associated with 10 different commodities firms. In addition, DellaSala previously was a registered representative of SEC-registered broker dealers Meyers Pollock Robbins, Inc. and Joseph Charles & Assoc., Inc. between February 1997 and May 1997. The state of Kansas issued a cease-and-desist order against DellaSala as president of Apex Petroleum, Inc. ("Apex") in December 1995 in connection with the offer and sale of Apex securities. In the Matter of Apex Petroleum, Inc., et. al, Docket No. 96E046 (December 20, 1995).

[1]On January 23, 2015, the Commission instituted public administrative and cease-and-desist proceedings pursuant to:

(a) Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Havanich and co-respondents Carmine A. DellaSala ("DellaSala") and Matthew D. Welch ("Welch");

(b) Sections 15(b) and 21C of the Exchange Act against co-respondents Jose F. Carrio ("Carrio"), Carrio, Karasik & Associates, LLP ("CKA"), and Michael J. Salovay ("Salovay");

(c) Sections 15(b) and 21C of the Exchange Act and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against co-respondents Richard Hampton Scurlock, III ("Scurlock") and Dennis K. Karasik ("Karasik"); and,

(d) Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act against co-respondent RTAG Inc. d/b/a Retirement Tax Advisory Group ("RTAG").

[2]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. Welch is 34 years old and resides in Gainesville, Florida. He was the vice president of investor relations of Diversified and is a board member of St. Vincent. Welch previously held a series 3 commodities license from approximately 2000-2002.

4. Scurlock is 37 years old and resides in Lexington, Kentucky. Scurlock is the owner and president, and therefore an associated person of, RTAG, a Kentucky registered investment adviser. Between 1999 and 2005, in ascending order, Scurlock was a registered representative of SEC-registered broker-dealers IDS Life Insurance Company ("IDS Life"), Ameriprise Financial Services, Inc., Ameritas Investment Corp., and Synergy Investment Group, LLC.

5. RTAG is a Kentucky corporation and a Kentucky registered investment adviser. Scurlock is the owner and president of RTAG.

6. Carrio is 49 years old and resides in York, Pennsylvania. He is the co-founder and 50% owner of CKA, a limited liability partnership doing business in Baltimore County, Maryland. Carrio was not registered as a broker-dealer nor associated with a registered broker-dealer during the relevant period. Between 1989 and 2006, in ascending order, Carrio was a registered representative of SEC-registered broker-dealers First Investors Corporation, The Prudential Insurance Company of America, Pruco Securities Corporation, Equity Services, Inc., and New England Securities. On April 1, 2014 the Securities Division of the Office of the Maryland Attorney General ("Maryland AG") issued a consent order against Carrio in connection with his offer and sale of Diversified's bonds ordering that he cease and desist from violating certain of Maryland's anti-fraud and registration statutes and that he pay a $1,499,315.87 penalty which was waived based on his sworn financial statements. The consent order also permanently barred Carrio from engaging in the securities or investment advisory business in Maryland. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).

7. Karasik is 59 years old and resides in Reisterstown, Maryland. He is the co-founder and 50% owner of CKA. Between 1984 and 2013, in ascending order, Karasik was a registered representative of SEC-registered broker-dealers NEL Equity Services Corporation, MML Investors Services, Inc., VIP Financial Companies, Inc., Equity Services Inc., New England Securities, Multi-Financial Securities Corporation, and H. Beck, Inc. Between 2009 and 2013, Karasik was an investment adviser representative of, and associated with, first Multi-Financial Securities Corporation and later H. Beck, Inc, both dually registered as broker-dealers and investment advisers. Karasik was also a party to the Maryland AG consent order and received the same sanctions and waiver of penalty as Carrio and CKA. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).[3] On July 8, 2014, by consent, FINRA imposed a bar from association with any FINRA member firm against Karasik in connection with Karasik's offer and sale of Diversified's bonds. Dennis Keith Karasik, Letter of Acceptance, Waiver and Consent, No. 2012034750401 (Jul. 8, 2014).

8. CKA is a limited liability partnership doing business in Baltimore County, Maryland. CKA states it is an independent financial services firm for wealth management issues.

[3]In addition, the Maryland consent order revoked Karasik's Maryland investment adviser representative registration.

Carrio and Karasik each own 50% of CKA. CKA was not registered as a broker-dealer or an investment advisor during the relevant period. CKA was also a party to the Maryland AG consent order and received the same sanctions and waiver of penalty as Carrio and Karasik. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).

9. Salovay is 43 years old and resides in Pittsburgh, Pennsylvania. Salovay's current employment status is unknown. Between 1997 and 2007, in ascending order, Salovay was a registered representative of SEC-registered broker-dealers IDS Life, American Express Financial Advisors Inc., Metropolitan Life Insurance Company, Metlife Securities Inc., First Security Investments, Inc., Midsouth Capital, Inc., Nations Financial Group, Inc. and Natcity Investments, Inc. In October 2008, he settled an action with FINRA related to his failure to disclose material information on a Form U4 by agreeing to a nine-month suspension and a $5,000 fine.

B. OTHER RELEVANT ENTITIES

1. Diversified was a Delaware corporation founded by Havanich and DellaSala in 2006 and located in Tequesta, Florida. Diversified was dissolved on April 28, 2014. Diversified represented that it was primarily engaged in the business of buying and selling fractional interests in oil and gas producing properties and commodities trading in the futures market. Diversified filed nine Form Ds with the Commission between 2007 and 2012 claiming exemptions under Rules 504 and 506 of the Securities Act for approximately $19 million in stock and bonds in nine purportedly separate offerings but did not file Forms D for an additional $8 million in stock and bonds in five other purported separate offerings. Diversified has never been registered with the Commission nor registered any offering of securities under the Securities Act or a class of securities under the Exchange Act.

C. SUMMARY

1. Between 2006 and 2012, Diversified and its principal officers, Havanich, DellaSala, and Welch, raised at least $17.4 million from approximately 440 investors nationwide through a series of fraudulent, unregistered offerings of stock and bonds. Diversified represented that it was primarily engaged in the business of buying and selling fractional interests in oil and gas producing properties and also engaged in commodities trading in the futures market. Ultimately, as its disclosed use of proceeds expanded, Diversified used a portion of the investor funds to buy fractional interests in oil and gas wells, cattle, a hydrogen device that purported to increase gas mileage on vehicles, trade commodities contracts, and invest in real estate. Diversified, Havanich, DellaSala, and Welch made material misrepresentations and omissions about Diversified's financial performance and use of industry experts and technologies in Diversified's offering material and correspondence to investors. Havanich, DellaSala, and Welch also touted their affiliation with a charity organization in Diversified's offering materials but that charity never had any substantive charitable activities.

2. Starting in 2009, Diversified also hired unregistered sales agents to sell Diversified's bonds paying them commissions of 5% or 10% of the investor proceeds. Diversified and DellaSala employed the unregistered sales agents to raise money for Diversified even after receiving an email and other correspondence from Diversified's outside counsel detailing the limits

on Diversified's use of unregistered sales agents. Diversified's top grossing independent sales agents were (1) Scurlock and his state registered investment advisory firm RTAG, (2) Carrio, Karasik, and their limited liability partnership CKA, and (3) Salovay. Collectively, they earned approximately $985,000 in transaction-based compensation in connection with their sales activities.

D. OFFER AND SALE OF SECURITIES IN UNREGISTERED TRANSACTIONS

1. Beginning in 2006 and continuing through approximately 2008, Diversified submitted to potential investors one or more versions of a private placement memoranda ("PPM"), offering to sell Diversified common stock at per share prices ranging from 20 cents to $1.55 (the "Stock Offerings").

2. As a result of the Stock Offerings, Diversified raised approximately $910,304 from 160 investors both inside and outside the State of Florida.

3. No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the Stock Offerings.

4. No exemption from registration existed with respect to the Stock Offerings.

5. Between 2006 and 2008, there was no period of six months or more in which there was no offer or sale of Diversified's stock.

6. Beginning in approximately 2009 and continuing through 2012, Diversified submitted to potential investors various versions of a brochure, PPM, and business plan as part of offers to sell Diversified bonds with maturities between 12 and 24 months and paying annual interest rates between 8% and 10.25% (the "Bond Offerings"). Some of the bonds included an option to purchase Diversified common stock.

7. As a result of the Bond Offerings, Diversified raised approximately $16.5 million from 280 investors both inside and outside the State of Florida.

8. No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the Bond Offerings.

9. No exemption from registration existed with respect to the Bond Offerings.

10. Between 2009 and 2012, there was no period of six months or more in which there was no offer or sale of Diversified's bonds.

11. DellaSala, Havanich, and Welch participated in the Stock Offerings and the Bond Offerings by undertaking the offerings, by drafting and reviewing the brochures and business plans, reviewing and approving the PPMs, engaging sales agents to sell the bonds, facilitating Diversified's website, participating in presentations to potential investors, and soliciting potential investors for at least one stock offering using "lead lists." In addition, Havanich and DellaSala

touted Diversified's securities on radio broadcasts, where Havanich appeared under his own name and DellaSala appeared under the alias "Jim Clark."

E. DIVERSIFIED AND DELLASALA'S USE OF UNREGISTERED SALES AGENTS

1. Starting in April 2009, Diversified had a formal contract, titled Finder's Fee Agreement ("Finders agreement") that it used to employ unregistered sales agents to act as commissioned sales agents.

2. The unregistered sales agents solicited investors and received a commission of either 5% or 10% from Diversified based on the amount invested.

3. Diversified participated in the unregistered sales agents' solicitation of investment in Diversified bonds by entering into written agreements with the unregistered sales agents, paying them a commission, and supplying them with brochures, PPMs, and business plans relating to Diversified bonds. DellaSala participated in the unregistered sales agents' solicitation of investment in Diversified bonds by paying them commissions in his role as a principal of Diversified.

4. In connection with their efforts to obtain purchasers for Diversified bonds, the unregistered sales agents used the mails or means or instrumentality of interstate commerce.

5. The unregistered sales agents were either not associated with any registered brokers or dealers or were engaged in sales activities that occurred outside and without the knowledge of the broker-dealers with which they were associated.

F. THE UNREGISTERED SALES AGENTS' INVOLVEMENT IN THE SALE OF DIVERSIFIED'S BONDS

1. Scurlock and RTAG

a. Scurlock entered into a Finders agreement with Diversified in December 2009. That agreement stated Scurlock would be paid a 5% commission for each investor that purchased Diversified's bonds although in practice he was actually paid a 10% commission.

b. While RTAG did not enter into a Finders agreement with Diversified, starting in February 2012, Diversified paid commissions to RTAG instead of directly to Scurlock.

c. Between January 2010 and March 2012, Scurlock recommended Diversified's bonds to RTAG's clients and other investors, provided and discussed offering materials with prospective investors, highlighted the risks associated with the Diversified investment to prospective investors, assisted prospective investors with completing paperwork necessary for an investment in Diversified bonds, fielded investor inquiries, and handled investor funds.

d. Scurlock and RTAG collectively received approximately $448,000 in transaction-based compensation for selling Diversified bonds to approximately 50 investors while not registered as a broker-dealer or associated with a registered broker-dealer.

2. Carrio, Karasik, and CKA

a. In November 2009, Carrio entered into a Finders agreement with Diversified that paid him a 10% commission for each investor that purchased Diversified's bonds.

b. While Karasik and CKA did not enter into Finders agreements with Diversified, starting in December 2010, Carrio and CKA began equally sharing Diversified commissions. Karasik received either all or a supermajority of the Diversified commissions paid to CKA as some of the commissions were used to pay CKA expenses.

c. Between December 2009 and March 2012 Carrio, Karasik, and CKA recommended the bonds to CKA clients, provided prospective investors with offering documents, discussed the returns of the bond offerings with prospective investors, weighed in on the merits of the bond investment, provided and directed prospective investors to complete the paperwork necessary for an investment in the bonds, and, as to Karasik and CKA, handled investor funds.

d. Carrio, Karasik, and CKA collectively received approximately $434,974 in transaction-based compensation for selling Diversified's bonds to approximately 40 investors.

e. Between December 2009 and March 2012, Carrio and CKA were not registered as broker-dealers or associated with a registered broker-dealer.

f. Between December 2010 and March 2012, Karasik's activities occurred outside and without the knowledge of the broker-dealers with which he was associated during the relevant time.

3. Salovay

a. Salovay entered into a Finders agreement with Diversified in July 2009. That agreement provided that Salovay would be paid a 10% commission for each investor that purchased Diversified bonds.

b. Between August 2009 and March 2012, Salovay recommended Diversified's bonds to his insurance clients, provided and discussed offering materials with prospective investors, highlighted the risks associated with the Diversified investment to prospective investors, assisted prospective investors with completing paperwork necessary for an investment in the bonds, fielded investor inquiries, and handled investor funds.

c. Salovay received approximately $101,790 in transaction-based compensation for selling Diversified's bonds to approximately 20 investors while not registered as a broker-dealer or associated with a registered broker-dealer.

G. MISREPRESENTATIONS AND OMISSIONS TO INVESTORS

During the course of the Bond Offerings, Diversified, Havanich, DellaSala, and Welch made numerous false and misleading statements and omissions, many of which are described below. At the time these statements and omissions were made, Diversified. Havanich, DellaSala, and Welch either knew, or should have known, or were severely reckless in not knowing their false and misleading nature.

1. Misrepresentations and Omissions Concerning Diversified's Financial Performance

a. The PPMs Respondents distributed beginning in 2009 and continuing through 2010 list "Operating Deficits" as one of several risk factors, stating: "The expenses of operating the Company may exceed its income, thereby requiring that the difference be paid out of the Company's capital, reducing the Company's investments and potential for profitability." Diversified omitted disclosures regarding Diversified's current or past profitability, stating only that "[a]dditional financial information is available on a confidential basis upon request." In fact, Diversified's incurring of losses was not a mere contingency. To the contrary, Diversified had suffered steadily rising losses from its inception, as described below:

YEAR	NET INCOME (LOSS)
2006	(31,200)
2007	(257,975)
2008	(564,347))
2009	(672,749)
2010	(1,114,901)

b. While Diversified's October 2011 PPM disclosed that Diversified had recently sustained losses, it omitted the five-year history of losses.

c. In addition, Diversified's brochures paint a rosy picture of the company, claiming consistently over a three-year period of deepening insolvency that its bonds would produce "reliable monthly cash flow," were backed by "continually growing" assets, and were "[s]uperior to traditional fixed income instruments," while omitting that Diversified's survival depended upon its ability to borrow greater and greater sums.

d. In a brochure distributed in 2009 to prospective bond purchasers:

i. Diversified claimed one of Diversified's "Revenue Sources" was a "Hedge Account (for asset protection)," which earned an average monthly return on investment of 14.73%.

ii. Diversified represented that as of June 2009, Diversified had $2,126,269 in "Oil and Gas Assets," and that its "Asset Allocation" was 39% "Oil and Gas Acquisition" and 61% "Hedging Portfolio," implying that its Hedging Portfolio was worth $3,325,703.

iii. Diversified presented a bar chart comparing the three year returns of the "Trading Strategy History" with the returns on the "S&P." According to the chart, the trading strategy returned 82.70% in 2006, 138.70% in 2007, and 29.4% in 2008, for a three year average of 83.60%.

e. In brochures distributed in 2010, Diversified included a chart showing Diversified's "4 YR Average Strategy History" producing an average annual return of 90.9%.

f. In brochures distributed in 2010 and 2011, Diversified included a chart showing Diversified's "5 YR Average Strategy History" producing an average annual return of 79.4%.

g. As Diversified, Havanich, DellaSala, and Welch knew, the representations in the brochures distributed in 2009 and 2010 were false and misleading as to material matters. In fact, in 2006 and 2007, Diversified had no hedging assets and had engaged in no commodities trading. In 2008, Diversified never had more than $6500 in hedging assets and Diversified's portfolio had an annual return of -95%. During June 2009, Diversified had far less than $3,325,703 in its hedging portfolio—during this period the value of the Diversified portfolio ranged from $38,000 to $75,000.

h. On March 30, 2010, Welch signed and sent to at least 9 individuals in Pennsylvania who had bought Diversified bonds a letter stating: "Due to the tremendous demand for [Diversified] Bonds, and the favorable financial position in which the company finds itself, management has decided to 'call' the existing bonds and is providing you a complete repayment" of principal and interest. This statement was false and misleading:

i. as of March 30, 2010, Diversified was not in a "favorable" financial condition but had been suffering significant and increasing losses since its inception;

ii. Diversified was not calling all of its bonds, as the letter implied, but rather was only calling bonds sold to some Pennsylvania investors; and

iii. Diversified's motivation for calling the bonds was not related to the demand for Diversified's bonds or Diversified's financial condition; rather,

Diversified called the bonds because Pennsylvania regulatory authorities had raised questions regarding the legality of Diversified's sale of bonds to Pennsylvania residents.

i. Within approximately one month, several of the Pennsylvania investors reinvested their returned capital and some later invested additional funds.

2. Misrepresentations Concerning Diversified's Use of Industry Experts and Technologies

a. In business plans distributed to prospective investors between 2006 and 2011, Diversified stated, "Diversified will from time to time retain the advice and recommendation of experts based on the prospects we are looking at. ... [T]he company will look to hire the best qualified individuals to evaluate each new prospect before we make an investment."

b. In business plans distributed to prospective investors between at least 2009 and 2011, Diversified stated, "[t]he key is working with *our geologists* and industry partners to find the best prospects that meet the companies risk to reward ratio." (emphasis added).

c. Diversified's website stated that its business strategy includes, among other things, acquiring "proven producing properties which meet the standards of management and *our* independent reservoir engineering firm." (emphasis added).

d. In several 2009 and 2010 versions of Diversified's investor power point presentations, shown at investor summits in various cities and led by Havanich, DellaSala, and Welch, Diversified included the names of an independent geologist and a reservoir engineering firm as part of its "independent team."

e. In a business plan provided to a mid-2009 investor, Diversified stated, "[w]e utilize advanced 3-D seismic imaging, drilling and completion technologies to systematically evaluate domestic onshore oil and natural gas reserves." Later Diversified business plans utilized similar language until late 2010 when the language was ultimately changed to read, "...Diversified Energy Group focuses its acquisition and development activities in provinces where we believe technology and the knowledge of our technical staff can effectively maximize return and reduce risk...."

f. Diversified stated in each of its marketing brochures that it had "[a]n Experienced Location and Acquisition Team boasting a proven track record with such companies as Chesapeake Energy, Marathon Oil, Union Pacific, Hess and Torch Energy, to name a few."

g. The foregoing statements were false and misleading. In fact:

i. Diversified did not hire geologists or a reservoir engineering firm as represented to evaluate the oil and gas wells in which it invested. Diversified made at least 93 separate investments in at least 44 oil and gas prospects between 2006 and 2011, the majority of which were in producing oil and gas wells. While Diversified did retain a geologist in early 2007, that geologist only provided Diversified with 15 reports related to *non-producing* oil and gas prospects and it did not retain an independent reservoir engineering firm in connection with any of its investments;

ii. Diversified never had 3-D seismic imaging, drilling and completion technologies;

iii. Diversified did not have a technical staff; and,

iv. DellaSala, Havanich, and Welch were the sole members of Diversified's "location and acquisition team" and they had never worked with any of the major energy companies listed in the brochures.

H. HAVANICH, DELLASALA, AND WELCH TOUTED THEIR AFFILIATION WITH ST. VINCENT

1. In September 2006, shortly before the start of Diversified's capital raising activities, Havanich and DellaSala created St. Vincent. St. Vincent has no relationship to the St. Vincent de Paul Catholic voluntary organization.

2. In Diversified's business plans, Diversified described St. Vincent as "a non-profit corporation to benefit children in need around the world," and described DellaSala and Havanich as officers and directors of St. Vincent, and Welch as member of St. Vincent's board.

3. St. Vincent never raised any money for children or had any substantive charitable activities.

I. VIOLATIONS

1. As a result of the conduct described above, Havanich violated Sections 5(a) and (c) of the Securities Act, which makes it unlawful for any person, directly or indirectly, to sell or to offer to sell a security for which a registration statement is not filed or not in effect or there is not an applicable exemption from registration.

2. As a result of the conduct described above, Havanich violated Section 17(a) of the Securities Act and 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.

V.

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

Accordingly, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Havanich cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Havanich shall, within 30 days of the entry of this Order, pay (a) disgorgement of $603,000, which represents profits gained as a result of the conduct described herein, and (b) prejudgment interest of $33,910.31, and (c) civil money penalty of $150,000 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 David Havanich, 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 Andrew Schiff, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

C. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

VI.

It is further Ordered that, solely 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9793 / May 26, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75045 / May 26, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16354

In the Matter of **David B. Havanich, Jr., Carmine A. DellaSala, Matthew D. Welch, Richard Hampton Scurlock, III, RTAG Inc. d/b/a Retirement Tax Advisory Group, Jose F. Carrio, Dennis K. Karasik, Carrio, Karasik & Associates, LLP, and Michael J. Salovay,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AGAINST MATTHEW D. WELCH 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 to issue this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Against Matthew D. Welch Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order").

II.

Matthew D. Welch ("Welch") has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept.

III.

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, and except as provided herein in Section VI,

Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Against Matthew D. Welch Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.[1]

IV.

On the basis of this Order and Respondent's Offer, the Commission finds that:[2]

A. RESPONDENTS

1. Havanich is 48 years old and resides in Jupiter, Florida. He was the co-founder, president, and director of Diversified Energy Group, Inc. ("Diversified") and is the president and director of St. Vincent de Paul Childrens Foundation Inc. ("St. Vincent"), a non-operating, non-profit corporation.

2. DellaSala is 54 years old and resides in Jupiter, Florida. DellaSala was the co-founder, vice president of business development, and director of Diversified and is the vice president and director of St. Vincent. DellaSala previously held a series 3 commodities license at various times between 1988 and 2002 while associated with 10 different commodities firms. In addition, DellaSala previously was a registered representative of SEC-registered broker dealers Meyers Pollock Robbins, Inc. and Joseph Charles & Assoc., Inc. between February 1997 and May 1997. The state of Kansas issued a cease-and-desist order against DellaSala as president of Apex Petroleum, Inc. ("Apex") in December 1995 in connection with the offer and sale of Apex securities. In the Matter of Apex Petroleum, Inc., et. al, Docket No. 96E046 (December 20, 1995).

[1]On January 23, 2015, the Commission instituted public administrative and cease-and-desist proceedings pursuant to:

(a) Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Welch and co-respondents David B. Havanich, Jr. ("Havanich") and Carmine A. DellaSala ("DellaSala");

(b) Sections 15(b) and 21C of the Exchange Act against co-respondents Jose F. Carrio ("Carrio"), Carrio, Karasik & Associates, LLP ("CKA"), and Michael J. Salovay ("Salovay");

(c) Sections 15(b) and 21C of the Exchange Act and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against co-respondents Richard Hampton Scurlock, III ("Scurlock") and Dennis K. Karasik ("Karasik"); and,

(d) Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act against RTAG Inc. d/b/a Retirement Tax Advisory Group ("RTAG").

[2]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. Welch is 34 years old and resides in Gainesville, Florida. He was the vice president of investor relations of Diversified and is a board member of St. Vincent. Welch previously held a series 3 commodities license from approximately 2000-2002.

4. Scurlock is 37 years old and resides in Lexington, Kentucky. Scurlock is the owner and president, and therefore an associated person of, RTAG, a Kentucky registered investment adviser. Between 1999 and 2005, in ascending order, Scurlock was a registered representative of SEC-registered broker-dealers IDS Life Insurance Company ("IDS Life"), Ameriprise Financial Services, Inc., Ameritas Investment Corp., and Synergy Investment Group, LLC.

5. RTAG is a Kentucky corporation and a Kentucky registered investment adviser. Scurlock is the owner and president of RTAG.

6. Carrio is 49 years old and resides in York, Pennsylvania. He is the co-founder and 50% owner of CKA, a limited liability partnership doing business in Baltimore County, Maryland. Carrio was not registered as a broker-dealer nor associated with a registered broker-dealer during the relevant period. Between 1989 and 2006, in ascending order, Carrio was a registered representative of SEC-registered broker-dealers First Investors Corporation, The Prudential Insurance Company of America, Pruco Securities Corporation, Equity Services, Inc., and New England Securities. On April 1, 2014 the Securities Division of the Office of the Maryland Attorney General ("Maryland AG") issued a consent order against Carrio in connection with his offer and sale of Diversified's bonds ordering that he cease and desist from violating certain of Maryland's anti-fraud and registration statutes and that he pay a $1,499,315.87 penalty which was waived based on his sworn financial statements. The consent order also permanently barred Carrio from engaging in the securities or investment advisory business in Maryland. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).

7. Karasik is 59 years old and resides in Reisterstown, Maryland. He is the co-founder and 50% owner of CKA. Between 1984 and 2013, in ascending order, Karasik was a registered representative of SEC-registered broker-dealers NEL Equity Services Corporation, MML Investors Services, Inc., VIP Financial Companies, Inc., Equity Services Inc., New England Securities, Multi-Financial Securities Corporation, and H. Beck, Inc. Between 2009 and 2013, Karasik was an investment adviser representative of, and associated with, first Multi-Financial Securities Corporation and later H. Beck, Inc, both dually registered as broker-dealers and investment advisers. Karasik was also a party to the Maryland AG consent order and received the same sanctions and waiver of penalty as Carrio and CKA. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).[3] On July 8, 2014, by consent, FINRA imposed a bar from association with any FINRA member firm against Karasik in connection with Karasik's offer and sale of Diversified's bonds. Dennis Keith Karasik, Letter of Acceptance, Waiver and Consent, No. 2012034750401 (Jul. 8, 2014).

[3] In addition, the Maryland consent order revoked Karasik's Maryland investment adviser representative registration.

8. CKA is a limited liability partnership doing business in Baltimore County, Maryland. CKA states it is an independent financial services firm for wealth management issues. Carrio and Karasik each own 50% of CKA. CKA was not registered as a broker-dealer or an investment advisor during the relevant period. CKA was also a party to the Maryland AG consent order and received the same sanctions and waiver of penalty as Carrio and Karasik. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).

9. Salovay is 43 years old and resides in Pittsburgh, Pennsylvania. Salovay's current employment status is unknown. Between 1997 and 2007, in ascending order, Salovay was a registered representative of SEC-registered broker-dealers IDS Life, American Express Financial Advisors Inc., Metropolitan Life Insurance Company, Metlife Securities Inc., First Security Investments, Inc., Midsouth Capital, Inc., Nations Financial Group, Inc. and Natcity Investments, Inc. In October 2008, he settled an action with FINRA related to his failure to disclose material information on a Form U4 by agreeing to a nine-month suspension and a $5,000 fine.

B. OTHER RELEVANT ENTITIES

1. Diversified was a Delaware corporation founded by Havanich and DellaSala in 2006 and located in Tequesta, Florida. Diversified was dissolved on April 28, 2014. Diversified represented that it was primarily engaged in the business of buying and selling fractional interests in oil and gas producing properties and commodities trading in the futures market. Diversified filed nine Form Ds with the Commission between 2007 and 2012 claiming exemptions under Rules 504 and 506 of the Securities Act for approximately $19 million in stock and bonds in nine purportedly separate offerings but did not file Forms D for an additional $8 million in stock and bonds in five other purported separate offerings. Diversified has never been registered with the Commission nor registered any offering of securities under the Securities Act or a class of securities under the Exchange Act.

C. SUMMARY

1. Between 2006 and 2012, Diversified and its principal officers, Havanich, DellaSala, and Welch, raised at least $17.4 million from approximately 440 investors nationwide through a series of fraudulent, unregistered offerings of stock and bonds. Diversified represented that it was primarily engaged in the business of buying and selling fractional interests in oil and gas producing properties and also engaged in commodities trading in the futures market. Ultimately, as its disclosed use of proceeds expanded, Diversified used a portion of the investor funds to buy fractional interests in oil and gas wells, cattle, a hydrogen device that purported to increase gas mileage on vehicles, trade commodities contracts, and invest in real estate. Diversified, Havanich, DellaSala, and Welch made material misrepresentations and omissions about Diversified's financial performance and use of industry experts and technologies in Diversified's offering material and correspondence to investors. Havanich, DellaSala, and Welch also touted their affiliation with a charity organization in Diversified's offering materials but that charity never had any substantive charitable activities.

2. Starting in 2009, Diversified also hired unregistered sales agents to sell Diversified's bonds paying them commissions of 5% or 10% of the investor proceeds. Diversified

and DellaSala employed the unregistered sales agents to raise money for Diversified even after receiving an email and other correspondence from Diversified's outside counsel detailing the limits on Diversified's use of unregistered sales agents. Diversified's top grossing independent sales agents were (1) Scurlock and his state registered investment advisory firm RTAG, (2) Carrio, Karasik, and their limited liability partnership CKA, and (3) Salovay. Collectively, they earned approximately $985,000 in transaction-based compensation in connection with their sales activities.

D. OFFER AND SALE OF SECURITIES IN UNREGISTERED TRANSACTIONS

1. Beginning in 2006 and continuing through approximately 2008, Diversified submitted to potential investors one or more versions of a private placement memoranda ("PPM"), offering to sell Diversified common stock at per share prices ranging from 20 cents to $1.55 (the "Stock Offerings").

2. As a result of the Stock Offerings, Diversified raised approximately $910,304 from 160 investors both inside and outside the State of Florida.

3. No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the Stock Offerings.

4. No exemption from registration existed with respect to the Stock Offerings.

5. Between 2006 and 2008, there was no period of six months or more in which there was no offer or sale of Diversified's stock.

6. Beginning in approximately 2009 and continuing through 2012, Diversified submitted to potential investors various versions of a brochure, PPM, and business plan as part of offers to sell Diversified bonds with maturities between 12 and 24 months and paying annual interest rates between 8% and 10.25% (the "Bond Offerings"). Some of the bonds included an option to purchase Diversified common stock.

7. As a result of the Bond Offerings, Diversified raised approximately $16.5 million from 280 investors both inside and outside the State of Florida.

8. No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the Bond Offerings.

9. No exemption from registration existed with respect to the Bond Offerings.

10. Between 2009 and 2012, there was no period of six months or more in which there was no offer or sale of Diversified's bonds.

11. DellaSala, Havanich, and Welch participated in the Stock Offerings and the Bond Offerings by undertaking the offerings, by drafting and reviewing the brochures and business plans, reviewing and approving the PPMs, engaging sales agents to sell the bonds, facilitating

Diversified's website, participating in presentations to potential investors, and soliciting potential investors for at least one stock offering using "lead lists." In addition, Havanich and DellaSala touted Diversified's securities on radio broadcasts, where Havanich appeared under his own name and DellaSala appeared under the alias "Jim Clark."

E. DIVERSIFIED AND DELLASALA'S USE OF UNREGISTERED SALES AGENTS

1. Starting in April 2009, Diversified had a formal contract, titled Finder's Fee Agreement ("Finders agreement") that it used to employ unregistered sales agents to act as commissioned sales agents.

2. The unregistered sales agents solicited investors and received a commission of either 5% or 10% from Diversified based on the amount invested.

3. Diversified participated in the unregistered sales agents' solicitation of investment in Diversified bonds by entering into written agreements with the unregistered sales agents, paying them a commission, and supplying them with brochures, PPMs, and business plans relating to Diversified bonds. DellaSala participated in the unregistered sales agents' solicitation of investment in Diversified bonds by paying them commissions in his role as a principal of Diversified.

4. In connection with their efforts to obtain purchasers for Diversified bonds, the unregistered sales agents used the mails or means or instrumentality of interstate commerce.

5. The unregistered sales agents were either not associated with any registered brokers or dealers or were engaged in sales activities that occurred outside and without the knowledge of the broker-dealers with which they were associated.

F. THE UNREGISTERED SALES AGENTS' INVOLVEMENT IN THE SALE OF DIVERSIFIED'S BONDS

1. Scurlock and RTAG

a. Scurlock entered into a Finders agreement with Diversified in December 2009. That agreement stated Scurlock would be paid a 5% commission for each investor that purchased Diversified's bonds although in practice he was actually paid a 10% commission.

b. While RTAG did not enter into a Finders agreement with Diversified, starting in February 2012, Diversified paid commissions to RTAG instead of directly to Scurlock.

c. Between January 2010 and March 2012, Scurlock recommended Diversified's bonds to RTAG's clients and other investors, provided and discussed offering materials with prospective investors, highlighted the risks associated with the Diversified investment to prospective investors, assisted prospective investors with completing paperwork necessary for an investment in Diversified bonds, fielded investor inquiries, and handled investor funds.

d. Scurlock and RTAG collectively received approximately $448,000 in transaction-based compensation for selling Diversified bonds to approximately 50 investors while not registered as a broker-dealer or associated with a registered broker-dealer.

2. Carrio, Karasik, and CKA

a. In November 2009, Carrio entered into a Finders agreement with Diversified that paid him a 10% commission for each investor that purchased Diversified's bonds.

b. While Karasik and CKA did not enter into Finders agreements with Diversified, starting in December 2010, Carrio and CKA began equally sharing Diversified commissions. Karasik received either all or a supermajority of the Diversified commissions paid to CKA as some of the commissions were used to pay CKA expenses.

c. Between December 2009 and March 2012 Carrio, Karasik, and CKA recommended the bonds to CKA clients, provided prospective investors with offering documents, discussed the returns of the bond offerings with prospective investors, weighed in on the merits of the bond investment, provided and directed prospective investors to complete the paperwork necessary for an investment in the bonds, and, as to Karasik and CKA, handled investor funds.

d. Carrio, Karasik, and CKA collectively received approximately $434,974 in transaction-based compensation for selling Diversified's bonds to approximately 40 investors.

e. Between December 2009 and March 2012, Carrio and CKA were not registered as broker-dealers or associated with a registered broker-dealer.

f. Between December 2010 and March 2012, Karasik's activities occurred outside and without the knowledge of the broker-dealers with which he was associated during the relevant time.

3. Salovay

a. Salovay entered into a Finders agreement with Diversified in July 2009. That agreement provided that Salovay would be paid a 10% commission for each investor that purchased Diversified bonds.

b. Between August 2009 and March 2012, Salovay recommended Diversified's bonds to his insurance clients, provided and discussed offering materials with prospective investors, highlighted the risks associated with the Diversified investment to prospective investors, assisted prospective investors with completing paperwork necessary for an investment in the bonds, fielded investor inquiries, and handled investor funds.

c. Salovay received approximately $101,790 in transaction-based compensation for selling Diversified's bonds to approximately 20 investors while not registered as a broker-dealer or associated with a registered broker-dealer.

G. MISREPRESENTATIONS AND OMISSIONS TO INVESTORS

During the course of the Bond Offerings, Diversified, Havanich, DellaSala, and Welch made numerous false and misleading statements and omissions, many of which are described below. At the time these statements and omissions were made, Diversified. Havanich, DellaSala, and Welch either knew, or should have known, or were severely reckless in not knowing their false and misleading nature.

1. Misrepresentations and Omissions Concerning Diversified's Financial Performance

a. The PPMs Respondents distributed beginning in 2009 and continuing through 2010 list "Operating Deficits" as one of several risk factors, stating: "The expenses of operating the Company may exceed its income, thereby requiring that the difference be paid out of the Company's capital, reducing the Company's investments and potential for profitability." Diversified omitted disclosures regarding Diversified's current or past profitability, stating only that "[a]dditional financial information is available on a confidential basis upon request." In fact, Diversified's incurring of losses was not a mere contingency. To the contrary, Diversified had suffered steadily rising losses from its inception, as described below:

YEAR	NET INCOME (LOSS)
2006	(31,200)
2007	(257,975)
2008	(564,347))
2009	(672,749)
2010	(1,114,901)

b. While Diversified's October 2011 PPM disclosed that Diversified had recently sustained losses, it omitted the five-year history of losses.

c. In addition, Diversified's brochures paint a rosy picture of the company, claiming consistently over a three-year period of deepening insolvency that its bonds would produce "reliable monthly cash flow," were backed by "continually growing" assets, and were "[s]uperior to traditional fixed income instruments," while omitting that Diversified's survival depended upon its ability to borrow greater and greater sums.

d. In a brochure distributed in 2009 to prospective bond purchasers:

i. Diversified claimed one of Diversified's "Revenue Sources" was a "Hedge Account (for asset protection)," which earned an average monthly return on investment of 14.73%.

ii. Diversified represented that as of June 2009, Diversified had $2,126,269 in "Oil and Gas Assets," and that its "Asset Allocation" was 39% "Oil and Gas Acquisition" and 61% "Hedging Portfolio," implying that its Hedging Portfolio was worth $3,325,703.

iii. Diversified presented a bar chart comparing the three year returns of the "Trading Strategy History" with the returns on the "S&P." According to the chart, the trading strategy returned 82.70% in 2006, 138.70% in 2007, and 29.4% in 2008, for a three year average of 83.60%.

e. In brochures distributed in 2010, Diversified included a chart showing Diversified's "4 YR Average Strategy History" producing an average annual return of 90.9%.

f. In brochures distributed in 2010 and 2011, Diversified included a chart showing Diversified's "5 YR Average Strategy History" producing an average annual return of 79.4%.

g. As Diversified, Havanich, DellaSala, and Welch knew, the representations in the brochures distributed in 2009 and 2010 were false and misleading as to material matters. In fact, in 2006 and 2007, Diversified had no hedging assets and had engaged in no commodities trading. In 2008, Diversified never had more than $6500 in hedging assets and Diversified's portfolio had an annual return of -95%. During June 2009, Diversified had far less than $3,325,703 in its hedging portfolio—during this period the value of the Diversified portfolio ranged from $38,000 to $75,000.

h. On March 30, 2010, Welch signed and sent to at least 9 individuals in Pennsylvania who had bought Diversified bonds a letter stating: "Due to the tremendous demand for [Diversified] Bonds, and the favorable financial position in which the company finds itself, management has decided to 'call' the existing bonds and is providing you a complete repayment" of principal and interest. This statement was false and misleading:

i. as of March 30, 2010, Diversified was not in a "favorable" financial condition but had been suffering significant and increasing losses since its inception;

ii. Diversified was not calling all of its bonds, as the letter implied, but rather was only calling bonds sold to some Pennsylvania investors; and

iii. Diversified's motivation for calling the bonds was not related to the demand for Diversified's bonds or Diversified's financial condition; rather,

Diversified called the bonds because Pennsylvania regulatory authorities had raised questions regarding the legality of Diversified's sale of bonds to Pennsylvania residents.

i. Within approximately one month, several of the Pennsylvania investors reinvested their returned capital and some later invested additional funds.

2. <u>Misrepresentations Concerning Diversified's Use of Industry Experts and Technologies</u>

a. In business plans distributed to prospective investors between 2006 and 2011, Diversified stated, "Diversified will from time to time retain the advice and recommendation of experts based on the prospects we are looking at. ... [T]he company will look to hire the best qualified individuals to evaluate each new prospect before we make an investment."

b. In business plans distributed to prospective investors between at least 2009 and 2011, Diversified stated, "[t]he key is working with *our geologists* and industry partners to find the best prospects that meet the companies risk to reward ratio." (emphasis added).

c. Diversified's website stated that its business strategy includes, among other things, acquiring "proven producing properties which meet the standards of management and *our* independent reservoir engineering firm." (emphasis added).

d. In several 2009 and 2010 versions of Diversified's investor power point presentations, shown at investor summits in various cities and led by Havanich, DellaSala, and Welch, Diversified included the names of an independent geologist and a reservoir engineering firm as part of its "independent team."

e. In a business plan provided to a mid-2009 investor, Diversified stated, "[w]e utilize advanced 3-D seismic imaging, drilling and completion technologies to systematically evaluate domestic onshore oil and natural gas reserves." Later Diversified business plans utilized similar language until late 2010 when the language was ultimately changed to read, "...Diversified Energy Group focuses its acquisition and development activities in provinces where we believe technology and the knowledge of our technical staff can effectively maximize return and reduce risk...."

f. Diversified stated in each of its marketing brochures that it had "[a]n Experienced Location and Acquisition Team boasting a proven track record with such companies as Chesapeake Energy, Marathon Oil, Union Pacific, Hess and Torch Energy, to name a few."

g. The foregoing statements were false and misleading. In fact:

i. Diversified did not hire geologists or a reservoir engineering firm as represented to evaluate the oil and gas wells in which it invested. Diversified made at least 93 separate investments in at least 44 oil and gas prospects between 2006 and 2011, the majority of which were in producing oil and gas wells. While Diversified did retain a geologist in early 2007, that geologist only provided Diversified with 15 reports related to *non-producing* oil and gas prospects and it did not retain an independent reservoir engineering firm in connection with any of its investments;

ii. Diversified never had 3-D seismic imaging, drilling and completion technologies;

iii. Diversified did not have a technical staff; and,

iv. DellaSala, Havanich, and Welch were the sole members of Diversified's "location and acquisition team" and they had never worked with any of the major energy companies listed in the brochures.

H. HAVANICH, DELLASALA, AND WELCH TOUTED THEIR AFFILIATION WITH ST. VINCENT

1. In September 2006, shortly before the start of Diversified's capital raising activities, Havanich and DellaSala created St. Vincent. St. Vincent has no relationship to the St. Vincent de Paul Catholic voluntary organization.

2. In Diversified's business plans, Diversified described St. Vincent as "a non-profit corporation to benefit children in need around the world," and described DellaSala and Havanich as officers and directors of St. Vincent, and Welch as member of St. Vincent's board.

3. St. Vincent never raised any money for children or had any substantive charitable activities.

I. VIOLATIONS

1. As a result of the conduct described above, Welch violated Sections 5(a) and (c) of the Securities Act, which makes it unlawful for any person, directly or indirectly, to sell or to offer to sell a security for which a registration statement is not filed or not in effect or there is not an applicable exemption from registration.

2. As a result of the conduct described above, Welch violated Section 17(a) of the Securities Act and 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.

V.

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

Accordingly, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Welch cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act and Sections 10(b) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent Welch shall, within 30 days of the entry of this Order, pay (a) disgorgement of $276,000, which represents profits gained as a result of the conduct described herein, and (b) prejudgment interest of $15,521.14, and (c) civil money penalty of $150,000 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 Matthew D. Welch as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew Schiff, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

C. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

VI.

It is further Ordered that, solely 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9792 / May 26, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75044 / May 26, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16354

In the Matter of **David B. Havanich, Jr., Carmine A. DellaSala, Matthew D. Welch, Richard Hampton Scurlock, III, RTAG Inc. d/b/a Retirement Tax Advisory Group, Jose F. Carrio, Dennis K. Karasik, Carrio, Karasik & Associates, LLP, and Michael J. Salovay,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AGAINST CARMINE A. DELLASALA 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 to issue this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Against Carmine A. DellaSala pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order").

II.

Carmine A. DellaSala ("DellaSala") has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept.

III.

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, and except as provided herein in Section VI,

Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Against Carmine DellaSala Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.[1]

IV.

On the basis of this Order and Respondent's Offer, the Commission finds that:[2]

A. RESPONDENTS

1. Havanich is 48 years old and resides in Jupiter, Florida. He was the co-founder, president, and director of Diversified Energy Group, Inc. ("Diversified") and is the president and director of St. Vincent de Paul Childrens Foundation Inc. ("St. Vincent"), a non-operating, non-profit corporation.

2. DellaSala is 54 years old and resides in Jupiter, Florida. DellaSala was the co-founder, vice president of business development, and director of Diversified and is the vice president and director of St. Vincent. DellaSala previously held a series 3 commodities license at various times between 1988 and 2002 while associated with 10 different commodities firms. In addition, DellaSala previously was a registered representative of SEC-registered broker dealers Meyers Pollock Robbins, Inc. and Joseph Charles & Assoc., Inc. between February 1997 and May 1997. The state of Kansas issued a cease-and-desist order against DellaSala as president of Apex Petroleum, Inc. ("Apex") in December 1995 in connection with the offer and sale of Apex securities. In the Matter of Apex Petroleum, Inc., et. al, Docket No. 96E046 (December 20, 1995).

[1]On January 23, 2015, the Commission instituted public administrative and cease-and-desist proceedings pursuant to:

(a) Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against DellaSala and co-respondents David B. Havanich, Jr. ("Havanich") and Matthew D. Welch ("Welch");

(b) Sections 15(b) and 21C of the Exchange Act against co-respondents Jose F. Carrio ("Carrio"), Carrio, Karasik & Associates, LLP ("CKA"), and Michael J. Salovay ("Salovay");

(c) Sections 15(b) and 21C of the Exchange Act and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against co-respondents Richard Hampton Scurlock, III ("Scurlock") and Dennis K. Karasik ("Karasik"); and,

(d) Sections 15(b) and 21C of the Exchange Act and Section 203(e) of the Advisers Act against co-respondent RTAG Inc. d/b/a Retirement Tax Advisory Group ("RTAG").

[2]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. Welch is 34 years old and resides in Gainesville, Florida. He was the vice president of investor relations of Diversified and is a board member of St. Vincent. Welch previously held a series 3 commodities license from approximately 2000-2002.

4. Scurlock is 37 years old and resides in Lexington, Kentucky. Scurlock is the owner and president, and therefore an associated person of, RTAG, a Kentucky registered investment adviser. Between 1999 and 2005, in ascending order, Scurlock was a registered representative of SEC-registered broker-dealers IDS Life Insurance Company ("IDS Life"), Ameriprise Financial Services, Inc., Ameritas Investment Corp., and Synergy Investment Group, LLC.

5. RTAG is a Kentucky corporation and a Kentucky registered investment adviser. Scurlock is the owner and president of RTAG.

6. Carrio is 49 years old and resides in York, Pennsylvania. He is the co-founder and 50% owner of CKA, a limited liability partnership doing business in Baltimore County, Maryland. Carrio was not registered as a broker-dealer nor associated with a registered broker-dealer during the relevant period. Between 1989 and 2006, in ascending order, Carrio was a registered representative of SEC-registered broker-dealers First Investors Corporation, The Prudential Insurance Company of America, Pruco Securities Corporation, Equity Services, Inc., and New England Securities. On April 1, 2014 the Securities Division of the Office of the Maryland Attorney General ("Maryland AG") issued a consent order against Carrio in connection with his offer and sale of Diversified's bonds ordering that he cease and desist from violating certain of Maryland's anti-fraud and registration statutes and that he pay a $1,499,315.87 penalty which was waived based on his sworn financial statements. The consent order also permanently barred Carrio from engaging in the securities or investment advisory business in Maryland. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).

7. Karasik is 59 years old and resides in Reisterstown, Maryland. He is the co-founder and 50% owner of CKA. Between 1984 and 2013, in ascending order, Karasik was a registered representative of SEC-registered broker-dealers NEL Equity Services Corporation, MML Investors Services, Inc., VIP Financial Companies, Inc., Equity Services Inc., New England Securities, Multi-Financial Securities Corporation, and H. Beck, Inc. Between 2009 and 2013, Karasik was an investment adviser representative of, and associated with, first Multi-Financial Securities Corporation and later H. Beck, Inc, both dually registered as broker-dealers and investment advisers. Karasik was also a party to the Maryland AG consent order and received the same sanctions and waiver of penalty as Carrio and CKA. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).[3] On July 8, 2014, by consent, FINRA imposed a bar from association with any FINRA member firm against Karasik in connection with Karasik's offer and sale of Diversified's bonds. Dennis Keith Karasik, Letter of Acceptance, Waiver and Consent, No. 2012034750401 (Jul. 8, 2014).

8. CKA is a limited liability partnership doing business in Baltimore County, Maryland. CKA states it is an independent financial services firm for wealth management issues.

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[3] In addition, the Maryland consent order revoked Karasik's Maryland investment adviser representative registration.

Carrio and Karasik each own 50% of CKA. CKA was not registered as a broker-dealer or an investment advisor during the relevant period. CKA was also a party to the Maryland AG consent order and received the same sanctions and waiver of penalty as Carrio and Karasik. In the Matter of Jose F. Carrio et al. (Case No. 2012-0463).

9. Salovay is 43 years old and resides in Pittsburgh, Pennsylvania. Salovay's current employment status is unknown. Between 1997 and 2007, in ascending order, Salovay was a registered representative of SEC-registered broker-dealers IDS Life, American Express Financial Advisors Inc., Metropolitan Life Insurance Company, Metlife Securities Inc., First Security Investments, Inc., Midsouth Capital, Inc., Nations Financial Group, Inc. and Natcity Investments, Inc. In October 2008, he settled an action with FINRA related to his failure to disclose material information on a Form U4 by agreeing to a nine-month suspension and a $5,000 fine.

B. OTHER RELEVANT ENTITIES

1. Diversified was a Delaware corporation founded by Havanich and DellaSala in 2006 and located in Tequesta, Florida. Diversified was dissolved on April 28, 2014. Diversified represented that it was primarily engaged in the business of buying and selling fractional interests in oil and gas producing properties and commodities trading in the futures market. Diversified filed nine Form Ds with the Commission between 2007 and 2012 claiming exemptions under Rules 504 and 506 of the Securities Act for approximately $19 million in stock and bonds in nine purportedly separate offerings but did not file Forms D for an additional $8 million in stock and bonds in five other purported separate offerings. Diversified has never been registered with the Commission nor registered any offering of securities under the Securities Act or a class of securities under the Exchange Act.

C. SUMMARY

1. Between 2006 and 2012, Diversified and its principal officers, Havanich, DellaSala, and Welch, raised at least $17.4 million from approximately 440 investors nationwide through a series of fraudulent, unregistered offerings of stock and bonds. Diversified represented that it was primarily engaged in the business of buying and selling fractional interests in oil and gas producing properties and also engaged in commodities trading in the futures market. Ultimately, as its disclosed use of proceeds expanded, Diversified used a portion of the investor funds to buy fractional interests in oil and gas wells, cattle, a hydrogen device that purported to increase gas mileage on vehicles, trade commodities contracts, and invest in real estate. Diversified, Havanich, DellaSala, and Welch made material misrepresentations and omissions about Diversified's financial performance and use of industry experts and technologies in Diversified's offering material and correspondence to investors. Havanich, DellaSala, and Welch also touted their affiliation with a charity organization in Diversified's offering materials but that charity never had any substantive charitable activities.

2. Starting in 2009, Diversified also hired unregistered sales agents to sell Diversified's bonds paying them commissions of 5% or 10% of the investor proceeds. Diversified and DellaSala employed the unregistered sales agents to raise money for Diversified even after receiving an email and other correspondence from Diversified's outside counsel detailing the limits

on Diversified's use of unregistered sales agents. Diversified's top grossing independent sales agents were (1) Scurlock and his state registered investment advisory firm RTAG, (2) Carrio, Karasik, and their limited liability partnership CKA, and (3) Salovay. Collectively, they earned approximately $985,000 in transaction-based compensation in connection with their sales activities.

D. OFFER AND SALE OF SECURITIES IN UNREGISTERED TRANSACTIONS

1. Beginning in 2006 and continuing through approximately 2008, Diversified submitted to potential investors one or more versions of a private placement memoranda ("PPM"), offering to sell Diversified common stock at per share prices ranging from 20 cents to $1.55 (the "Stock Offerings").

2. As a result of the Stock Offerings, Diversified raised approximately $910,304 from 160 investors both inside and outside the State of Florida.

3. No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the Stock Offerings.

4. No exemption from registration existed with respect to the Stock Offerings.

5. Between 2006 and 2008, there was no period of six months or more in which there was no offer or sale of Diversified's stock.

6. Beginning in approximately 2009 and continuing through 2012, Diversified submitted to potential investors various versions of a brochure, PPM, and business plan as part of offers to sell Diversified bonds with maturities between 12 and 24 months and paying annual interest rates between 8% and 10.25% (the "Bond Offerings"). Some of the bonds included an option to purchase Diversified common stock.

7. As a result of the Bond Offerings, Diversified raised approximately $16.5 million from 280 investors both inside and outside the State of Florida.

8. No registration statement was filed or in effect with the Commission pursuant to the Securities Act with respect to the Bond Offerings.

9. No exemption from registration existed with respect to the Bond Offerings.

10. Between 2009 and 2012, there was no period of six months or more in which there was no offer or sale of Diversified's bonds.

11. DellaSala, Havanich, and Welch participated in the Stock Offerings and the Bond Offerings by undertaking the offerings, by drafting and reviewing the brochures and business plans, reviewing and approving the PPMs, engaging sales agents to sell the bonds, facilitating Diversified's website, participating in presentations to potential investors, and soliciting potential investors for at least one stock offering using "lead lists." In addition, Havanich and DellaSala

touted Diversified's securities on radio broadcasts, where Havanich appeared under his own name and DellaSala appeared under the alias "Jim Clark."

E. DIVERSIFIED AND DELLASALA'S USE OF UNREGISTERED SALES AGENTS

1. Starting in April 2009, Diversified had a formal contract, titled Finder's Fee Agreement ("Finders agreement") that it used to employ unregistered sales agents to act as commissioned sales agents.

2. The unregistered sales agents solicited investors and received a commission of either 5% or 10% from Diversified based on the amount invested.

3. Diversified participated in the unregistered sales agents' solicitation of investment in Diversified bonds by entering into written agreements with the unregistered sales agents, paying them a commission, and supplying them with brochures, PPMs, and business plans relating to Diversified bonds. DellaSala participated in the unregistered sales agents' solicitation of investment in Diversified bonds by paying them commissions in his role as a principal of Diversified.

4. In connection with their efforts to obtain purchasers for Diversified bonds, the unregistered sales agents used the mails or means or instrumentality of interstate commerce.

5. The unregistered sales agents were either not associated with any registered brokers or dealers or were engaged in sales activities that occurred outside and without the knowledge of the broker-dealers with which they were associated.

F. THE UNREGISTERED SALES AGENTS' INVOLVEMENT IN THE SALE OF DIVERSIFIED'S BONDS

1. Scurlock and RTAG

a. Scurlock entered into a Finders agreement with Diversified in December 2009. That agreement stated Scurlock would be paid a 5% commission for each investor that purchased Diversified's bonds although in practice he was actually paid a 10% commission.

b. While RTAG did not enter into a Finders agreement with Diversified, starting in February 2012, Diversified paid commissions to RTAG instead of directly to Scurlock.

c. Between January 2010 and March 2012, Scurlock recommended Diversified's bonds to RTAG's clients and other investors, provided and discussed offering materials with prospective investors, highlighted the risks associated with the Diversified investment to prospective investors, assisted prospective investors with completing paperwork necessary for an investment in Diversified bonds, fielded investor inquiries, and handled investor funds.

d. Scurlock and RTAG collectively received approximately $448,000 in transaction-based compensation for selling Diversified bonds to approximately 50 investors while not registered as a broker-dealer or associated with a registered broker-dealer.

2. Carrio, Karasik, and CKA

a. In November 2009, Carrio entered into a Finders agreement with Diversified that paid him a 10% commission for each investor that purchased Diversified's bonds.

b. While Karasik and CKA did not enter into Finders agreements with Diversified, starting in December 2010, Carrio and CKA began equally sharing Diversified commissions. Karasik received either all or a supermajority of the Diversified commissions paid to CKA as some of the commissions were used to pay CKA expenses.

c. Between December 2009 and March 2012 Carrio, Karasik, and CKA recommended the bonds to CKA clients, provided prospective investors with offering documents, discussed the returns of the bond offerings with prospective investors, weighed in on the merits of the bond investment, provided and directed prospective investors to complete the paperwork necessary for an investment in the bonds, and, as to Karasik and CKA, handled investor funds.

d. Carrio, Karasik, and CKA collectively received approximately $434,974 in transaction-based compensation for selling Diversified's bonds to approximately 40 investors.

e. Between December 2009 and March 2012, Carrio and CKA were not registered as broker-dealers or associated with a registered broker-dealer.

f. Between December 2010 and March 2012, Karasik's activities occurred outside and without the knowledge of the broker-dealers with which he was associated during the relevant time.

3. Salovay

a. Salovay entered into a Finders agreement with Diversified in July 2009. That agreement provided that Salovay would be paid a 10% commission for each investor that purchased Diversified bonds.

b. Between August 2009 and March 2012, Salovay recommended Diversified's bonds to his insurance clients, provided and discussed offering materials with prospective investors, highlighted the risks associated with the Diversified investment to prospective investors, assisted prospective investors with completing paperwork necessary for an investment in the bonds, fielded investor inquiries, and handled investor funds.

c. Salovay received approximately $101,790 in transaction-based compensation for selling Diversified's bonds to approximately 20 investors while not registered as a broker-dealer or associated with a registered broker-dealer.

G. MISREPRESENTATIONS AND OMISSIONS TO INVESTORS

During the course of the Bond Offerings, Diversified, Havanich, DellaSala, and Welch made numerous false and misleading statements and omissions, many of which are described below. At the time these statements and omissions were made, Diversified. Havanich, DellaSala, and Welch either knew, or should have known, or were severely reckless in not knowing their false and misleading nature.

1. Misrepresentations and Omissions Concerning Diversified's Financial Performance

a. The PPMs Respondents distributed beginning in 2009 and continuing through 2010 list "Operating Deficits" as one of several risk factors, stating: "The expenses of operating the Company may exceed its income, thereby requiring that the difference be paid out of the Company's capital, reducing the Company's investments and potential for profitability." Diversified omitted disclosures regarding Diversified's current or past profitability, stating only that "[a]dditional financial information is available on a confidential basis upon request." In fact, Diversified's incurring of losses was not a mere contingency. To the contrary, Diversified had suffered steadily rising losses from its inception, as described below:

YEAR	NET INCOME (LOSS)
2006	(31,200)
2007	(257,975)
2008	(564,347))
2009	(672,749)
2010	(1,114,901)

b. While Diversified's October 2011 PPM disclosed that Diversified had recently sustained losses, it omitted the five-year history of losses.

c. In addition, Diversified's brochures paint a rosy picture of the company, claiming consistently over a three-year period of deepening insolvency that its bonds would produce "reliable monthly cash flow," were backed by "continually growing" assets, and were "[s]uperior to traditional fixed income instruments," while omitting that Diversified's survival depended upon its ability to borrow greater and greater sums.

d. In a brochure distributed in 2009 to prospective bond purchasers:

i. Diversified claimed one of Diversified's "Revenue Sources" was a "Hedge Account (for asset protection)," which earned an average monthly return on investment of 14.73%.

ii. Diversified represented that as of June 2009, Diversified had $2,126,269 in "Oil and Gas Assets," and that its "Asset Allocation" was 39% "Oil and Gas Acquisition" and 61% "Hedging Portfolio," implying that its Hedging Portfolio was worth $3,325,703.

iii. Diversified presented a bar chart comparing the three year returns of the "Trading Strategy History" with the returns on the "S&P." According to the chart, the trading strategy returned 82.70% in 2006, 138.70% in 2007, and 29.4% in 2008, for a three year average of 83.60%.

e. In brochures distributed in 2010, Diversified included a chart showing Diversified's "4 YR Average Strategy History" producing an average annual return of 90.9%.

f. In brochures distributed in 2010 and 2011, Diversified included a chart showing Diversified's "5 YR Average Strategy History" producing an average annual return of 79.4%.

g. As Diversified, Havanich, DellaSala, and Welch knew, the representations in the brochures distributed in 2009 and 2010 were false and misleading as to material matters. In fact, in 2006 and 2007, Diversified had no hedging assets and had engaged in no commodities trading. In 2008, Diversified never had more than $6500 in hedging assets and Diversified's portfolio had an annual return of -95%. During June 2009, Diversified had far less than $3,325,703 in its hedging portfolio—during this period the value of the Diversified portfolio ranged from $38,000 to $75,000.

h. On March 30, 2010, Welch signed and sent to at least 9 individuals in Pennsylvania who had bought Diversified bonds a letter stating: "Due to the tremendous demand for [Diversified] Bonds, and the favorable financial position in which the company finds itself, management has decided to 'call' the existing bonds and is providing you a complete repayment" of principal and interest. This statement was false and misleading:

i. as of March 30, 2010, Diversified was not in a "favorable" financial condition but had been suffering significant and increasing losses since its inception;

ii. Diversified was not calling all of its bonds, as the letter implied, but rather was only calling bonds sold to some Pennsylvania investors; and

iii. Diversified's motivation for calling the bonds was not related to the demand for Diversified's bonds or Diversified's financial condition; rather,

Diversified called the bonds because Pennsylvania regulatory authorities had raised questions regarding the legality of Diversified's sale of bonds to Pennsylvania residents.

i. Within approximately one month, several of the Pennsylvania investors reinvested their returned capital and some later invested additional funds.

2. Misrepresentations Concerning Diversified's Use of Industry Experts and Technologies

a. In business plans distributed to prospective investors between 2006 and 2011, Diversified stated, "Diversified will from time to time retain the advice and recommendation of experts based on the prospects we are looking at. ... [T]he company will look to hire the best qualified individuals to evaluate each new prospect before we make an investment."

b. In business plans distributed to prospective investors between at least 2009 and 2011, Diversified stated, "[t]he key is working with *our geologists* and industry partners to find the best prospects that meet the companies risk to reward ratio." (emphasis added).

c. Diversified's website stated that its business strategy includes, among other things, acquiring "proven producing properties which meet the standards of management and *our* independent reservoir engineering firm." (emphasis added).

d. In several 2009 and 2010 versions of Diversified's investor power point presentations, shown at investor summits in various cities and led by Havanich, DellaSala, and Welch, Diversified included the names of an independent geologist and a reservoir engineering firm as part of its "independent team."

e. In a business plan provided to a mid-2009 investor, Diversified stated, "[w]e utilize advanced 3-D seismic imaging, drilling and completion technologies to systematically evaluate domestic onshore oil and natural gas reserves." Later Diversified business plans utilized similar language until late 2010 when the language was ultimately changed to read, "...Diversified Energy Group focuses its acquisition and development activities in provinces where we believe technology and the knowledge of our technical staff can effectively maximize return and reduce risk...."

f. Diversified stated in each of its marketing brochures that it had "[a]n Experienced Location and Acquisition Team boasting a proven track record with such companies as Chesapeake Energy, Marathon Oil, Union Pacific, Hess and Torch Energy, to name a few."

g. The foregoing statements were false and misleading. In fact:

i. Diversified did not hire geologists or a reservoir engineering firm as represented to evaluate the oil and gas wells in which it invested. Diversified made at least 93 separate investments in at least 44 oil and gas prospects between 2006 and 2011, the majority of which were in producing oil and gas wells. While Diversified did retain a geologist in early 2007, that geologist only provided Diversified with 15 reports related to *non-producing* oil and gas prospects and it did not retain an independent reservoir engineering firm in connection with any of its investments;

ii. Diversified never had 3-D seismic imaging, drilling and completion technologies;

iii. Diversified did not have a technical staff; and,

iv. DellaSala, Havanich, and Welch were the sole members of Diversified's "location and acquisition team" and they had never worked with any of the major energy companies listed in the brochures.

H. HAVANICH, DELLASALA, AND WELCH TOUTED THEIR AFFILIATION WITH ST. VINCENT

1. In September 2006, shortly before the start of Diversified's capital raising activities, Havanich and DellaSala created St. Vincent. St. Vincent has no relationship to the St. Vincent de Paul Catholic voluntary organization.

2. In Diversified's business plans, Diversified described St. Vincent as "a non-profit corporation to benefit children in need around the world," and described DellaSala and Havanich as officers and directors of St. Vincent, and Welch as member of St. Vincent's board.

3. St. Vincent never raised any money for children or had any substantive charitable activities.

I. VIOLATIONS

1. As a result of the conduct described above, DellaSala violated Sections 5(a) and (c) of the Securities Act, which makes it unlawful for any person, directly or indirectly, to sell or to offer to sell a security for which a registration statement is not filed or not in effect or there is not an applicable exemption from registration.

2. As a result of the conduct described above, DellaSala violated Section 17(a) of the Securities Act and 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.

3. As a result of the conduct described above, DellaSala caused the unregistered sales agents' violations of Section 15(a) of the Exchange Act, which makes it

unlawful for any broker or dealer to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered or associated with a registered broker-dealer.

V.

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

Accordingly, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent DellaSala cease and desist from committing or causing any violations and any future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder.

B. Respondent DellaSala shall, within 30 days of the entry of this Order, pay (a) disgorgement of $603,000, which represents profits gained as a result of the conduct described herein, and (b) prejudgment interest of $33,910.31, and (c) civil money penalty of $150,000 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 Carmine DellaSala. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew Schiff, Division of Enforcement, Securities and Exchange Commission, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

C. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the 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 Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

VI.

It is further Ordered that, solely 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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75046 / May 26, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16558

In the Matter of **ANTH1, Inc.,** **Ares Global Assets, Inc.,** **Asat Holdings Ltd.,** **Asia Quest Ventures, Inc.,** **Aux (USA), Inc., and** **Barton Solar Acquisition, 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 ANTH1, Inc., Ares Global Assets, Inc., Asat Holdings Ltd., Asia Quest Ventures, Inc., Aux (USA), Inc., and Barton Solar Acquisition, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. ANTH1, Inc. (CIK No. 1429336) is a delinquent Colorado corporation located in Thornton, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). ANTH1 is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q/A for the

period ended September 30, 2008, which reported a net loss of $1,785 for the prior nine months.

2. Ares Global Assets, Inc. (CIK No. 1181276) is a forfeited Delaware corporation located in Aberdare, Wales, United Kingdom with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Ares Global 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, 2003, which reported a net loss of $124 from the company's July 16, 2002 inception to September 30, 2003.

3. Asat Holdings Ltd. (CIK No. 1102384) is a Cayman Islands corporation located in George Town, Grand Cayman, Cayman Islands with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Asat Holdings 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 April 30, 2008, which reported a net loss of over $24.9 million for the prior twelve months.

4. Asia Quest Ventures, Inc. (CIK No. 1433566) is a forfeited Delaware corporation located in Saranac, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Asia Quest 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, 2008, which reported a net loss of $3,134 from the company's July 24, 2008 inception to December 31, 2008.

5. Aux (USA), Inc. (CIK No. 1289277) is a forfeited Delaware corporation located in Ningbo, Zhejiang Province, China with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Aux (USA) is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2005, which reported a net loss of $29,716 from the company's June 17, 2003 inception to March 31, 2005.

6. Barton Solar Acquisition, Inc. (CIK No. 1372334) is a permanently revoked Nevada corporation located in Detroit, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Barton Solar is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2007, which reported a net loss of $8,350 from the company's June 8, 2006 inception to June 30, 2007.

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

Commissioner Gallagher
Commissioner Piwowar
Dissented as to penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75040 / May 26, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16557

In the Matter of

DEUTSCHE BANK AG,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Deutsche Bank AG ("Deutsche Bank" 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 Civil Penalties ("Order"), as set forth below.

III.

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

A. SUMMARY

1. This matter relates to Deutsche Bank's overvaluation of certain Leveraged Super Senior ("LSS") trades during the height of the global financial crisis which resulted in misstatements to Deutsche Bank's financial statements for year end 2008 and the first quarter of 2009. The LSS trades at issue had a notional value of C$120 billion, or approximately $98 billion[1], reflecting credit protection Deutsche Bank purchased from Canadian counterparties. Initially, the trades were leveraged approximately eleven times which meant that the Canadian counterparties posted collateral of approximately 9% of the notional value of the trades or approximately $8.5 billion. Following a restructuring, finalized in early 2009, the trades were partially deleveraged by the addition of collateral (bringing the collateral total to $16.6 billion, plus additional margin funding from Deutsche Bank of approximately $2.0 billion). The fact that the trades were leveraged created the risk that Deutsche Bank's value of the full notional trade would exceed the value of the collateral and thus expose Deutsche Bank to "Gap Risk." As such, Gap Risk, a key component in the valuation of the LSS trades, required consideration.

2. As a protection buyer, Deutsche Bank's LSS trades increased in value as markets deteriorated during the global financial crisis. However, as the value of these trades increased, so did Deutsche Bank's Gap Risk in the LSS trades. Deutsche Bank used a variety of methods to attempt to measure the Gap Risk throughout the period. From the beginning of 2008, Deutsche Bank's changing methodologies for measuring the Gap Risk in the LSS trades all had the impact of steadily reducing the value Deutsche Bank assigned to it. And, beginning in October 2008, Deutsche Bank stopped adjusting the value of the LSS trades for Gap Risk—essentially measuring the Gap Risk at $0. Deutsche Bank's deficient internal accounting controls contributed to Deutsche Bank's failure to adequately assess the Gap Risk, resulting in the misstatement of its financial statements.

B. RESPONDENT

3. **Deutsche Bank AG,** a German corporation based in Frankfurt, Germany, offers a wide variety of investment, financial and related products and services around the world. Deutsche Bank is a foreign private issuer whose stock is registered under Section 12(b) of the Exchange Act and trades on the New York Stock Exchange.

[1] Canadian dollar amounts in this Order have been converted to U.S. dollars based on the December 31, 2008 exchange rate.

C. FACTS

Deutsche Bank's Synthetic LSS CDOs

4. From 2005 to 2006, Deutsche Bank purchased credit protection from certain Canadian conduits (the "Conduits"). The credit protection took the form of bespoke synthetic collateralized debt obligations ("CDOs"), essentially swap agreements based on specified pools of corporate credit default swaps. These CDOs provided payments to the purchasers of such credit protection in the event that a set amount of credit default losses occurred in a certain pool of reference securities comprised primarily of corporate credit default swaps. Deutsche Bank purchased approximately $98 billion of leveraged super senior tranches of over thirty CDOs (collectively, the "LSS Positions"), representing over 50% of the Canadian LSS market. Deutsche Bank was required to account for its LSS Positions as derivative instruments measured at fair value under International Financial Reporting Standards.

5. Owning protection on the super senior tranches meant that Deutsche Bank would receive a payout if there were significant credit default losses in the underlying reference securities. In essence, Deutsche Bank's credit protection from the LSS Positions would increase in value if the market took a downturn.

Deutsche Bank's Gap Risk

6. Deutsche Bank's ultimate counterparties on these transactions were asset-backed commercial paper ("ABCP") investors, essentially protection sellers, whose investments were used to purchase the collateral underlying the LSS Positions. The fact that the transactions were leveraged meant that the collateral posted for these positions by the sellers of protection was only a fraction of the total $98 billion of sold protection, typically around 9%. Deutsche Bank paid a premium for this credit protection.

7. The leverage in the transactions exposed Deutsche Bank to the risk that the market value of its protection, which Deutsche Bank recognized in its financial statements as the market value rose, could at some point exceed the available collateral (the "Gap Risk"). In essence, Gap Risk was the risk that the value of the LSS Positions would increase to a point where it exceeded the value of the collateral and no new collateral was posted by the protection sellers. In such instance, the LSS Position would provide protection to Deutsche Bank only up to the collateral level, rather than the full amount of the market value of its credit protection.

8. To protect itself against the Gap Risk, Deutsche Bank had the ability to request that additional collateral be posted at certain specified "trigger" points. The original triggers at which Deutsche Bank could call for additional collateral occurred when the value of the LSS Position increased to a set percentage of the posted collateral, typically around 50% ("Original Triggers"). For example, if one LSS Position had a notional amount of $1 billion, and was 10 times leveraged with $100 million in collateral, Deutsche Bank could call for additional collateral to be provided by the protection sellers when the value of Deutsche Bank's LSS Position reached $50 million. At that point the protection sellers could choose to post additional collateral or not. If the protection

sellers posted additional collateral, which would allow them to avoid an unwind, the LSS Position would remain in effect. If the protection sellers decided not to post additional collateral then the transactions would unwind, and Deutsche Bank would keep the lesser of the posted collateral or the fair value equivalent of a fully-collateralized LSS Position.

9. The decision to post additional collateral or unwind the trade belonged solely to the protection seller. This meant that Deutsche Bank had no control over whether additional collateral was posted or whether the protection seller chose to walk away.

10. The structure of the Original Triggers minimized the Gap Risk, because Deutsche Bank could call for additional collateral early enough that there was a cushion between the value of the LSS Position and the amount of existing collateral.

The ABCP market freezes in August 2007

11. During the week of August 13, 2007, there was a freeze in the Canadian ABCP market. This occurred as investors stopped buying new ABCP, and ABCP holders ceased rolling their existing ABCP. As a result, as the ABCP became due, the Conduits were unable to fund repayments to the ABCP investors through new issuances or replacement notes.

The Montreal Accord introduces new terms to the LSS Positions

12. The August 2007 market freeze was addressed with a proposed restructuring of the LSS Positions known as the Montreal Accord. The Conduits holding the collateral entered into informal standstill agreements where the Conduits agreed not to exercise their right to call for liquidity funding from Deutsche Bank and other protection buyers[2], and the protection buyers, including Deutsche Bank, agreed not to enforce collateral calls when the Original Triggers were hit. There were a series of standstill agreements which were continually renewed during the negotiations. In December 2007, the tentative Montreal Accord framework agreement was signed by the parties.

13. Under the December 2007 agreement, all of the ABCP issued by the Conduits were to be replaced by new notes with maturity dates that matched the longer duration of the underlying assets in the Conduits. The Montreal Accord benefitted Deutsche Bank by making available additional collateral. Specifically, the total collateral for Deutsche Bank's LSS Positions increased from approximately \$8.5 billion to approximately \$16.6 billion, plus additional margin funding from Deutsche Bank of approximately \$2.0 billion. However, conversely, the triggers for making additional collateral calls were moved to more remote levels and their structure was changed ("New Triggers"). The New Triggers allowed Deutsche Bank to call for additional collateral when certain credit index spreads and losses in the underlying reference portfolio occurred.

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2 It is not unusual in these types of structures to have banks such as Deutsche Bank, even as protection buyers, provide a standby credit facility to meet the cash needs of their counterparties if the Conduit is not able to issue ABCP on any given day.

14. As previously mentioned, the Original Triggers, hit when the value of the LSS Positions was at approximately 50% of the collateral, provided protection to Deutsche Bank by allowing for the posting of additional collateral or an unwind at a point when there likely was sufficient collateral to cover the value of the LSS Positions. The New Triggers, referencing market credit indices and underlying losses in the reference LSS portfolios, however, were riskier to Deutsche Bank than the Original Triggers. Moving the triggers out, although decreasing the likelihood of a trigger being reached, increased the risk that the collateral posted would be insufficient to pay Deutsche Bank the full fair value of the LSS position in the event the trades were unwound.

15. Indeed, in a March 2008 report on the restructuring, a major investment bank, acting as an advisor to the Pan-Canadian Investor Committee for Third-Party Structured Asset-Back Commercial Paper on the restructuring, emphasized the negative impact that changing the triggers would have on Deutsche Bank and other protection buyers. The report noted that moving the triggers further out, "increase[s] the likelihood of both having a larger Collateral Call, and not having the collateral to meet it when called," and "increases the portion of risk borne by Asset Providers[3], as it increases the probability of losses in an unwind scenario."

16. The investment bank advisor's report made clear that changing the triggers increased the Gap Risk for Deutsche Bank and other protection buyers. Specifically, the report stated that"[t]he introduction of Spread-Loss Triggers only further add to the 'Gap Risk' Asset Providers are assuming." The report also noted that "Asset Providers have taken on more Gap Risk at a future point in time when credit spreads may be significantly wider."

17. A Deutsche Bank employee involved in the restructuring analyzed the New Triggers and recognized the potential problem if the triggers were reached, concluding that " in most circumstances D[eutsche] B[ank] would expect that if the index triggers are breached, the [value] of DB's [LSS Position] will exceed the total amount of collateral posted to DB." Thus, moving the trigger out meant that if a trigger was hit, the existing collateral could easily have been exceeded by the value of the LSS Position before Deutsche Bank could call for more collateral – meaning there would exist an actual "gap," not just the risk of a gap.

18. By April 2008, 96% of the ABCP investors had approved of the Montreal Accord, but the remaining ABCP investors challenged the Montreal Accord in Canadian courts. On June 5, 2008, the Ontario Superior Court approved of the Montreal Accord restructuring. The decision was appealed to the Ontario Court of Appeal, which turned down the appeal in August 2008. The remaining ABCP investors further appealed the decision to the Supreme Court of Canada.

19. In September 2008, the Supreme Court of Canada declined to hear the ABCP investors' appeal. However, during this same period, market conditions further deteriorated beginning with the collapse of Lehman Brothers. While the Supreme Court's decision ended the appellate process, the market turmoil led to additional negotiations relating to the Montreal Accord.

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[3] Here the "Asset Providers" are Deutsche Bank and the other protection buyers.

20. On December 24, 2008, after further negotiations, Deutsche Bank and the other protection buyers secured an additional approximately \$3.6 billion in collateral for the LSS Positions from the federal and certain provincial Canadian governments. Notably, however, the final Montreal Accord also included an 18-month moratorium on any collateral calls. During the moratorium, Deutsche Bank and other protection buyers were unable to call for additional collateral even if the New Triggers were hit. As such, if credit spreads widened during the period of the moratorium, and if the value of the LSS Positions approached or exceeded the collateral levels, Deutsche Bank was exposed to significant Gap Risk because of the leveraged nature of the LSS Positions. The renegotiated agreement was signed in early January 2009.

Relevant accounting standard

21. Deutsche Bank was required to record its investment in the LSS Positions at fair value in accordance with International Accounting Standard 39 ("IAS 39"). Under IAS 39 during the relevant periods, fair value was defined as "the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction." IAS 39 required Deutsche Bank to consider all relevant available market information and to assess the factors that market participants would view as important in assigning a value to its LSS Positions.

22. For assets like the LSS Positions, for which there was not an active market, valuation techniques or models may be used to measure fair value. However paragraphs AG75 and AG76 of IAS 39 provide that such techniques should maximize the use of observable market inputs and models, and, if used, should be periodically calibrated to observable market information, in part, to ensure that the model reflects current market conditions. Further a valuation technique should incorporate all factors that a market participant would consider in setting the price.

Deutsche Bank's changing valuation methodologies

23. From the end of 2007 through 2008, in a time frame slightly over one year, Deutsche Bank employed five different approaches to measuring the Gap Risk in valuing the LSS Positions. These methodologies included taking a percentage haircut on the value of the LSS Positions, applying a static valuation adjustment, and using a model. However, each change in methodology had the effect of decreasing the amount that Deutsche Bank assigned to the Gap Risk in its LSS Positions during this time period.

24. Initially when Deutsche Bank entered into the trades, Deutsche Bank measured the Gap Risk by taking a 15% haircut from the value of the LSS Positions. For the first quarter of 2008, Deutsche Bank froze the haircut at its December 31, 2007 amount and used a static valuation adjustment of \$200 million for the Gap Risk.

25. Beginning in January 2008, Deutsche Bank's Market Risk Management group ("MRM") worked to develop a dynamic model that could value the Gap Risk more accurately than the static haircut approach. As part of their effort, in March 2008, MRM developed an initial version of a model, the MRM Model, to measure the Gap Risk on the LSS Positions. At the time

MRM's proposal was submitted for consideration in March, the MRM Model had been tested on a few LSS Positions and calibrated to observable market data. MRM found the model to show promising results and recommended it for use in measuring the Gap Risk.

26. At the same time, the trading desk developed a model, the Desk Model. Because Deutsche Bank determined to pursue development of the Desk Model, the MRM Model was never fully developed or adopted for use. Accordingly, for the second quarter of 2008, Deutsche Bank used the Desk Model, which measured the Gap Risk at $20 million. The Desk Model was not calibrated to market data.

27. In mid-September 2008, following the collapse of Lehman Brothers, the Desk Model valuation for the Gap Risk was $78 million. At that point, Deutsche Bank reevaluated whether to continue to use the Desk Model for risk management and valuation. While Deutsche Bank reevaluated its approach for the Gap Risk, it froze the Gap Risk measurement calculated by the Desk Model. Accordingly, for the third quarter of 2008, Deutsche Bank used a static valuation adjustment of $78 million for the Gap Risk.

28. In the fourth quarter of 2008, Deutsche Bank turned off the Desk Model and took no further valuation adjustment for the Gap Risk, effectively valuing the Gap Risk at $0. For risk purposes, Deutsche Bank implemented a macro hedging strategy by purchasing S&P put options.

29. Significantly, while credit spreads widened throughout 2008 and the likelihood of defaults rose, Deutsche Bank's valuation of its LSS Positions increased. However, Deutsche Bank's valuation of the Gap Risk in the LSS Positions, which if valued accurately would have generally increased directionally with the LSS Positions, in fact, decreased from $200 million at the end of 2007 to $0 at the end of 2008.

Deutsche Bank stops measuring the Gap Risk in valuing the LSS Positions

30. In the fall of 2008, as the credit markets started to deteriorate and spreads widened, the calculations for Deutsche Bank's Gap Risk generated by the Desk Model increased significantly from $20 million to $78 million in the middle of September 2008. Effective October 1, 2008, Deutsche Bank stopped using the Desk Model. Rather than completing work on models that may have been able to measure the Gap Risk or considering other alternative methodologies, Deutsche Bank instead measured its Gap Risk at $0 as of October 2008, for year-end reporting as of December 31, 2008, and for the quarter ended March 31, 2009.

31. Although after September 30, 2008, Deutsche Bank ceased measuring the Gap Risk in its LSS Positions for financial reporting purposes, it estimated Gap Risk for other purposes in December 2008 in connection with the ongoing Montreal Accord negotiations.

32. On December 14, 2008, Deutsche Bank ran the Desk Model to quantify its Gap Risk. Deutsche Bank wanted to use its calculation of the Gap Risk as leverage in its renegotiations of the Montreal Accord with the Canadian governments. The Desk Model measured Deutsche Bank's Gap Risk at approximately $1.5 billion on December 14, 2008. The Desk Model, created

prior to the renegotiation of the Montreal Accord, did not take into account in calculating the Gap Risk the moratorium on collateral calls.

33. In addition, on December 15, 2008, in an attempt to quantify for negotiation purposes the impact of the moratorium on the Gap Risk, Deutsche Bank employees used a Black-Scholes methodology to calculate this risk. The Black-Scholes methodology measured the Gap Risk in the LSS Positions at $3.3 billion.

34. Deutsche Bank provided the Black-Scholes calculation in connection with the negotiations of the restructuring, to argue that the moratorium increased the Gap Risk.

Deutsche Bank did not comply with IAS 39

35. When it ceased to measure the Gap Risk in valuing the LSS Positions, Deutsche Bank failed to measure the fair value of the LSS Positions in compliance with IAS 39.

36. In particular, market participants would have considered market conditions that would affect the Gap Risk at the end of 2008 and the first quarter of 2009 when measuring the fair value of the LSS Positions. Market volatility, reflected in rapidly widening credit spreads after Lehman Brothers' collapse, increased the value of CDO positions like the LSS Positions. As the value of the LSS Positions increased, generally so did the Gap Risk -- the risk that the value of the LSS Positions could exceed the existing collateral. Market participants would have factored such a risk into the value of the LSS Positions.

37. Deutsche Bank recognized in its financial statements the increasing value of the LSS Positions driven principally by increasing credit spreads and their increased volatility, but, at the same time, did not take into account the impact of this same market information when measuring the Gap Risk in its LSS Positions.

38. In addition, a market participant would have considered, not only the positive, but also the adverse, terms of the Montreal Accord when measuring the fair value of the LSS Positions. In particular, a market participant would have taken into account the impact of the New Triggers and the moratorium in measuring the fair value of the LSS Positions.

The values of the LSS Positions were overstated

39. Given the prevailing market conditions at the time, Deutsche Bank's failure to take Gap Risk into account in valuing the LSS Positions, essentially measuring the Gap Risk at $0 at year end 2008 and for the first quarter of 2009, was not reasonable. In just one year, from December 31, 2007 to December 31, 2008, the value of Deutsche Bank's LSS Positions, driven by the disruption in the markets, had quadrupled in value from $2.63 billion to $10.65 billion. By the end of the first quarter of 2009, the LSS Positions were valued at $9.72 billion. In accounting for these positions, Deutsche Bank incorporated the gains resulting from these increases in value into its financial statements. However, Deutsche Bank's measurement of its Gap Risk, which should

have moved in the same direction as the LSS Positions' fair value, went from $200 million to $0 during the same period.

40. Deutsche Bank's rationale for ceasing to measure the Gap Risk was that there was no reliable method for measuring its Gap Risk on the LSS Positions, which were valued using significant unobservable inputs. While the valuation of assets like the LSS Positions is complex, and there was not an industry standard for modeling Gap Risk, it was unreasonable for Deutsche Bank to simply no longer consider Gap Risk for financial reporting purposes. There were methods that could estimate Gap Risk. For example, as discussed above, the MRM Model was potentially capable of dynamically calculating Gap Risk in light of available market inputs. However, the MRM model was never approved or implemented for financial reporting purposes. A recreation of that model run by an outside valuation expert retained by the SEC staff for purposes of this investigation calculated a value for Deutsche Bank's Gap Risk of at least $1.5 billion for year end 2008 and during the first quarter of 2009.

41. Further, as discussed above, Deutsche Bank quantified the Gap Risk outside of its financial reporting calculations, as part of the Montreal Accord negotiations, and acknowledged the significance of its impact. Most notably, a separate group of Deutsche Bank employees working on the Montreal Accord negotiations analyzed the effect of the New Triggers and the moratorium on its Gap Risk. During these negotiations, Deutsche Bank estimated the Gap Risk to be in the range of $1.5 billion to $3.3 billion.

42. The range of estimates generated by these different approaches, although not for financial reporting purposes, should have indicated to Deutsche Bank that its Gap Risk was significant and not $0. For the fiscal year 2008 and the first quarter of 2009, a full consideration of the potential range of estimates under prevailing market conditions would have generated a measure of Gap Risk that would have materially affected the value of the LSS Positions as reported in Deutsche Bank's financial statements.

43. By failing to properly assess Gap Risk in accordance with IAS 39, Deutsche Bank overstated the fair value of the LSS Positions, resulting in misstatements that were material to its financial statements filed with its Form 20-F for fiscal year end 2008 (filed March 24, 2009) and Form 6-K filed April 28, 2009 reporting the results of operations for the quarter ended March 31, 2009. Deutsche Bank's books and records were also inaccurate from at least October 1, 2008 through March 31, 2009.

Deutsche Bank's inadequate internal accounting controls

44. Because the LSS Positions were illiquid assets, it was necessary for Deutsche Bank to use a valuation technique and reasonable management judgment in determining the fair value of the LSS Positions. Because areas of complex valuation, such as these, require the exercise of judgment, they also necessitate strong internal accounting controls in order to arrive at reasonable valuations for financial reporting purposes.

45. Proper internal accounting controls serve to ensure that the appropriate factors are

considered in assigning valuations, that the suitable individuals are involved in decision making, and that there exist checks and balances throughout the process. However, Deutsche Bank lacked adequate internal accounting controls to ensure that it was appropriately measuring the Gap Risk in valuing the LSS Positions in accordance with IAS 39.

Deutsche Bank's Changing Valuation Methodology

46. In its changing approaches to measuring the Gap Risk, Deutsche Bank failed to ensure that the views of certain groups or individuals whose roles were to serve a control function were given adequate consideration or that they participated meaningfully in the decision making.

47. The freezing of the 15% haircut at its December 31, 2007 amount was done without consultation with MRM, and, when notified, MRM expressed concern about both the freezing of the amount and whether the 15% haircut was conservative enough.

48. MRM was also concerned that there had not been any analysis to justify the $200 million amount that Deutsche Bank had used to measure the Gap Risk in valuing the LSS Positions. No analysis was performed in response to MRM's concerns.

49. As discussed, on or around September 16, 2008, Deutsche Bank froze the value of the measurement that the Desk Model was assigning to Deutsche Bank's Gap Risk, and shortly thereafter, effective October 1, 2008, stopped using the Desk Model. Rather than implementing a model or any other methodology to measure the inherent Gap Risk in its LSS Positions, Deutsche Bank instead measured its Gap Risk at $0.

50. When Deutsche Bank stopped using the Desk Model and assigned a value of $0 to its Gap Risk, certain individuals were not included in the decision making process, including individuals who served in important internal control capacities and should have been involved in determining whether Deutsche Bank was adequately measuring the Gap Risk in its LSS Positions.

51. For example, the Models & Methodologies department, the internal control function within the finance department responsible for ensuring proper methods for making any valuation adjustments, was not included in the decision to stop valuing the Gap Risk in the LSS Positions. In fact, when the head of Models & Methodologies learned that Deutsche Bank was not assigning any amount to the Gap Risk, he expressed concern regarding "whether we have sufficient reserves to reflect the [G]ap [R]isk we hold and how we monitor going forward."

52. Similarly, although required by its policies and procedures, Deutsche Bank did not contemporaneously document its rationale and analysis relating to the decisions to change how it assessed the Gap Risk.

53. For example, no concurrent written analysis was done to explain the basis for changing the various methodologies, including the decision to stop measuring the Gap Risk in October 2008. With respect to the decision to stop measuring the Gap Risk, the finance department and MRM attempted to document later in the fourth quarter of 2008 and in January

2009 the basis for Deutsche Bank's decision to stop valuing the Gap Risk. However, the lack of controls surrounding the decision created confusion in reconstructing what decisions had been made with respect to the measurement of the Gap Risk, who was responsible for the decisions, and what the rationale was for the decisions.

Deutsche Bank's IPV Process

54. In addition, Deutsche Bank's internal controls for independently assessing its valuation of the LSS Positions and the Gap Risk were inadequate.

55. One tool which should have served as a check on whether Deutsche Bank was appropriately measuring the Gap Risk was Deutsche Bank's Independent Price Verification ("IPV"), a division of Deutsche Bank's Business Area Control. The role of IPV was to verify the valuations generated by the trading desk. Any discrepancies between the Desk's and IPV's valuations could suggest issues requiring further inquiry.

56. In September 2008, Deutsche Bank classified the LSS Positions as "unverified." This meant that only minimal, if any, testing was performed on the LSS Positions by IPV to ensure that Deutsche Bank was appropriately valuing them.

57. Deutsche Bank's IPV function was performing no testing with respect to Deutsche Bank's Gap Risk in the LSS Positions. Indeed, as early as July 2008, IPV's monthly control report noted that "LSS gap [risk] [is] not price tested. Methodology is under review." Throughout the remainder of 2008 and the first quarter of 2009, Deutsche Bank's Gap Risk in the LSS Positions remained untested by IPV.

58. As a result of the above, from at least January 2008 through at least March 2009, Deutsche Bank's internal accounting controls were inadequate.

59. Deutsche Bank cooperated with the SEC staff's investigation, including sharing the findings of its internal investigation and making overseas witnesses available for interviews.

D. VIOLATIONS

60. As a result of the conduct described above, Deutsche Bank violated Section 13(a) of the Exchange Act and Rules 13a-1, 13a-16, and 12b-20 thereunder.

61. As a result of the conduct described above, Deutsche Bank violated Section 13(b)(2)(A) of the Exchange Act which requires reporting companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of assets.

62. As a result of the conduct described above, Deutsche Bank violated Section 13(b)(2)(B) of the Exchange Act which requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance

with generally accepted accounting principles or any other criteria applicable to such statements.

IV.

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

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Deutsche Bank 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, 13a-1, and 13a-16 thereunder.

B. Respondent shall, within 30 days of the entry of this Order, pay a civil money penalty in the amount of $55,000,000 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 Deutsche Bank 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 Laura B. Josephs, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 75054 / May 27, 2015

Admin. Proc. File No. 3-15601

In the Matter of the Application of

MITCHELL H. FILLET
Rockville, MD

For Review of Disciplinary Action Taken by

FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION — REVIEW OF DISCIPLINARY PROCEEDINGS

Material Misstatements and Failure to Disclose Material Information

Conduct Inconsistent with Just and Equitable Principles of Trade

Former general securities representative and principal of member firm appeals from a FINRA action finding that he made material misstatements and failed to disclose material information to an investor in connection with the sale of a security, falsified his firm's books and records, and provided falsified records to FINRA during an examination. *Held*, FINRA's findings of violations are sustained in part and set aside in part and its assessment of sanctions is sustained in part and set aside and remanded in part.

APPEARANCES:

Mitchell F. Fillet, pro se.

Robert L.D. Colby, *Alan Lawhead*, and *Jennifer C. Brooks* for the Financial Industry Regulatory Authority, Inc.

Appeal filed: November 1, 2013
Last brief received: March 31, 2014

Mitchell H. Fillet, former general securities representative and principal of The Riderwood Group Inc. ("Riderwood" or the "Firm"), formerly a FINRA member, appeals from a two-count FINRA disciplinary action. FINRA found that Fillet "made material misrepresentations and omissions in connection with the sale of securities to an investor" in violation of Section 10(b) of the Securities Exchange Act of 1934, Exchange Act Rule 10b-5(b), NASD Conduct Rules 2120 and 2110, and IM-2310-2.[1] FINRA also found that Fillet violated NASD Conduct Rules 3110 and 2110[2] by falsifying Riderwood customer-related records and providing these falsified records to FINRA during an examination. FINRA imposed a $10,000 fine and an eighteen-month suspension for the fraud violations and a $10,000 fine and a two-year suspension for the violations of NASD Rules 3110 and 2110, ordering that Fillet serve the suspensions consecutively.[3]

On appeal, Fillet primarily challenges FINRA's findings that he made material misstatements and failed to disclose material information in an offering document used to solicit an investor in a private placement offering. Although Fillet admits that he drafted the offering document for his customer's use in the offering in question, he contends that he cannot be held liable for the fraud violations because the document was only a preliminary draft and he did not give the document to the investor. Fillet does not contest FINRA's findings that he falsified various variable annuity records of Firm customers, but he challenges the sanctions imposed for this misconduct.

Following our independent review, we sustain FINRA's findings that Fillet's material misstatements and failures to disclose material information violated NASD Rules 2120 and 2110 and IM-2310-2. We also sustain FINRA's findings that Fillet's failure to disclose material information violated Section 10(b) of the Exchange Act, and Rule 10b-5(a) and (c) thereunder. But we find that FINRA failed to establish that Fillet violated Exchange Act Rule 10b-5(b), and we dismiss these findings of violation. As a result, we set aside the sanctions FINRA imposed for the fraud violations and remand for its reconsideration of these sanctions in light of the

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1 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5; NASD Conduct Rules 2120 and 2110; and IM-2310-2. Since the time of the alleged misconduct, FINRA has renamed NASD Rules 2120 and 2110 as FINRA Rules 2020 and 2010, respectively, without substantive change, and IM-2310-2 has been subsumed within the supplementary material to FINRA Rule 2110. *Order Approving FINRA's Adoption of Certain FINRA Rules in the Consolidated Rulebook*, 73 Fed. Reg. 57,174 (Oct. 1, 2008). We apply the rules and regulations in effect at the time of the alleged misconduct.

2 NASD Conduct Rule 3110; NASD Conduct Rule 2110. NASD Rule 3110 is now FINRA Rule 4511. *Order Approving Proposed Rule Change Adopting FINRA Rules Regarding Books and Records in the Consolidated FINRA Rulebook*, 76 Fed. Reg. 5,850 (Feb. 2, 2011).

3 FINRA also ordered Fillet to pay administrative costs. FINRA's sanctions have been stayed pending Fillet's appeal to the Commission.

dismissed charges. Finally, we sustain the violations for the falsification of Firm records and the sanction FINRA imposed for these violations.[4]

I. BACKGROUND

Fillet, an experienced securities professional, entered the industry in 1972. In 2004, Fillet joined Riderwood, a registered broker-dealer that provided various investment-banking services to its customers, including assistance in private placements, mergers, and acquisitions. In 2007 and 2008, the period relevant to this proceeding, Fillet held an ownership interest in the Firm and was Riderwood's chief executive officer, president, and senior investment banker.[5]

A. Fillet provided private placement services to FAO Sweet Shoppes, Inc., and Catering Acquisition Corp.

FINRA's fraud allegations arise out of Fillet's communications to an investor concerning a private placement offering by FAO Sweet Shoppes, Inc. ("Sweet Shoppes") and Catering Acquisition Corp. ("CAC"), two shell companies run by Allan Sloan ("Sloan"), their principal and founder. Sloan formed Sweet Shoppes to operate a retail café that would sell toys, food, and party facilities in close alignment with and under a "global license" from FAO Schwarz, Inc. ("FAO"), the national toy retailer. Sloan formed CAC to acquire food service companies to produce and supply food for the Sweet Shoppes cafés.[6]

In June 2007, Sloan hired Riderwood to provide CAC with "advisory, investment banking, and placement services" for CAC's "acquisition of a series of food-related enterprises." On behalf of Riderwood, Fillet executed the engagement agreement (the "Engagement Agreement"), agreeing to conduct due diligence, draft transactional documents, identify prospective investors, and act as a placement agent for CAC's securities offering. According to Fillet, CAC paid Riderwood a total of $20,000 to $30,000 for its services. Riderwood also had the potential under the Engagement Agreement to earn five percent of the outstanding and voting common shares of CAC within ten days of the closing of any offering and a percentage of the gross proceeds raised in the offering.

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4 Fillet included in his opening brief a "motion to dismiss the charge of securities fraud" and a "motion to reduce the severity of the sanctions." Fillet's "motion[s]" are arguments against sustaining FINRA's findings of violation and sanctions determination, which we address below. Fillet has also moved to dismiss the proceedings based on the erroneous assumption that FINRA untimely filed its opposition brief on February 28, 2014. FINRA's opposition brief was not due until March 1, 2014, and thus was timely filed. *See Extension Order*, Exchange Act Release No. 71277, 2014 WL 97132, at *1 (Jan. 9, 2014).

5 Riderwood withdrew its FINRA membership in February 2009, after which Fillet became associated with another FINRA member until December 2009. Fillet is not currently associated with a FINRA member; the record indicates he is engaging in consulting work.

6 Sloan did not testify before the FINRA Hearing Panel.

1. Fillet drafted the Term Sheet for the Sweet Shoppes/CAC offering.

Pursuant to the Engagement Agreement, Fillet drafted various documents for the Sweet Shoppes/CAC offering, including a Confidential Term Sheet (the "Term Sheet").[7] According to the Term Sheet, the offering totaled $3,000,000 and consisted of twenty investment units at $150,000 per unit. Each unit was comprised of an $80,000 CAC "Series A 10% Corporate Note," a $70,000 Sweet Shoppes "Series A 10% Corporate Note," and detachable warrants to purchase shares of Sweet Shoppes and CAC common stock. The Term Sheet identified Riderwood as the "sole marketing agent," Fillet as a person to contact for the offering, and Sloan as the CEO for both issuers in the offering.

It is uncontested that the Term Sheet that Fillet drafted contained representations about Sweet Shoppes and CAC that were inaccurate as of the date on the Term Sheet, January 14, 2008. The Term Sheet stated that CAC "was founded in 2007 to create a vertically-integrated, brand name food service company that started in New York City but became national in scope." It also stated that Sweet Shoppes "is closely aligned with FAO" and operates under "a global license from FAO Schwarz and the FAO Family Trust." Fillet conceded in his hearing testimony that, as of January 14, 2008, CAC was neither an operating company with any assets, nor "national in scope," and Sweet Shoppes had not secured "a global license from FAO and FAO Family Trust."

2. Fillet communicated with potential investor PM.

The record shows that at least one person, PM, invested in the Sweet Shoppes/CAC offering. PM testified that he became interested in Sweet Shoppes/CAC through his friend Edward Schmults, then the CEO of FAO.[8] According to PM, in late 2007, Schmults asked him to speak with Sloan about investing in Sweet Shoppes/CAC, describing Sloan as an "experienced food [services] operator" who would be running Sweet Shoppes for FAO. After PM had several phone conversations with Sloan, Sloan invited him to meet with Fillet.

a. Fillet met with PM to discuss investment in CAC/Sweet Shoppes.

On January 16, 2008 (two days after the date of the Term Sheet), Fillet and Sloan met with PM at PM's office. PM testified that although he had several subsequent telephone conversations with Fillet, this was the only time he met with Fillet in person. PM believed that Sloan arranged the meeting with Fillet because Fillet was an investment banker and would "add credibility to Sloan" and the investment. During the meeting, Fillet discussed the business plans of Sweet Shoppes and CAC, the terms of the offering, PM's qualifications as an accredited investor, and PM's potential investment of $150,000. PM understood from his discussions with Sloan and Fillet that the Sweet Shoppes/CAC business venture was developing, that CAC was on the verge of acquiring a large catering business, and that "there already was a commissary, going

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7 In addition to the Term Sheet, Fillet drafted the promissory notes, subscription agreement, and business and investment summary for the offering.

8 Schmults did not testify at the hearing.

business, . . . providing the food that would be used in the[] different [Sweet Shoppes stores]." PM testified that he was not given a copy of the Term Sheet at the January 16th meeting.

b. PM received the Term Sheet and invested in CAC/Sweet Shoppes.

The record indicates that PM received the Term Sheet along with other offering documents sometime between January 16 and February 21, 2008. But the record is unclear as to the exact date or the identity of the person who provided the Term Sheet to PM. Fillet has maintained throughout the proceeding that the Term Sheet and other offering documents he drafted were "just drafts," which he gave to Sloan and Sloan's lawyer to review. Fillet testified that he never gave PM the Term Sheet, stating that "I'm not really sure [who gave PM a copy] but it was not from Riderwood" because "[PM] had very little contact with Riderwood." Fillet acknowledged that he later became aware that the Term Sheet had been provided to PM and there is no evidence that he sought to correct any of the statements in it.

PM could not recall who gave him the Term Sheet, testifying that the offering documents "were delivered to my office but I don't . . . remember anybody physically delivering them to me." On February 21, 2008, PM returned a signed subscription agreement to Sloan and gave him a $150,000 check that was payable to CAC and noted "re notes and warrants" in the memo portion of the check.

3. PM sought reimbursement for his investment after discovering Sloan's criminal history.

In the months after PM's investment, the Sweet Shoppes/CAC business venture unraveled. According to PM, a few months after investing he voiced his concerns about the deal to Sloan, who told him that he could have his money back. PM then spoke with Schmults, who informed PM that FAO recently had terminated its business arrangement with Sloan. When PM asked Schmults why, Schmults told him that he could not say but that PM could "Google Sloan and find out [for himself]." Soon after the conversation, PM had one of his employees conduct a search of Sloan, which found that Sloan had an extensive criminal and civil record and had been disbarred as an attorney.

Public records searches of Sloan (under "Alan Sloan" and aliases "Allen Sloan" and "Allan Gerald Slotnick") show two criminal convictions, disbarment, personal bankruptcy, and eighty-seven tax and judgment liens against him. Sloan was convicted and sentenced to one to three years' imprisonment in 1987 for submitting a false affidavit to a New York court. Shortly thereafter, the State of New York disbarred Sloan based on his 1987 conviction and for converting client funds, issuing bad checks, and refusing to return client funds. Sloan also was convicted in 2003 and sentenced to three to six years' imprisonment for possession of stolen property (a rental car). None of Sloan's legal history was disclosed in the Term Sheet or any other offering document.

At FINRA's hearing, Fillet admitted that he knew about Sloan's 2003 criminal conviction, testifying that he learned about the conviction in late 2007 while conducting his due diligence of CAC. Fillet testified that Sloan thereafter provided him with a letter from Sloan's criminal defense attorney in which the attorney described the stolen property prosecution as "absurd," despite Sloan's conviction. Fillet claimed that he did not disclose the information in the Term Sheet or directly to PM because he had told Sloan to disclose it. Although there is no evidence that Fillet was aware of Sloan's other legal problems during the relevant period, the record demonstrates that the background search of Sloan by Riderwood at the time was flawed. As Fillet concedes, the Firm searched only under the name "*Alan* Sloan" and not under Sloan's other aliases, even though "Allan" was used in the Engagement Agreement and "Allen" was the name listed on Sloan's 2003 conviction.[9]

PM's discovery of Sloan's criminal past prompted him to seek rescission from Sloan and Fillet. According to PM, Sloan agreed to reimburse PM but on three separate occasions gave PM a check that bounced. Fillet disclaimed any responsibility for returning the funds, informing PM that he was only Sloan's agent and reminding him that he had paid Sloan the money. PM testified that, had he known about Sloan's criminal past, he "never would have made this investment." PM never recovered any of his money. He filed a complaint with FINRA, prompting an investigation.

B. Fillet backdated certain firm records and provided those records to FINRA during an examination.

FINRA's second cause of action concerns Fillet's conduct during FINRA's routine examination of Riderwood's main office in Maryland, the underlying facts of which are undisputed. During this examination, a FINRA examiner requested to review Riderwood's variable annuity transactions for suitability. The Firm conducted most of its variable annuity business in its branch offices in Michigan and Indiana, but Fillet supervised these transactions from his office in Maryland. Fillet told the examiner that a branch office completed the relevant forms and then faxed them to Fillet, who would sign and date the documents after completing his supervisory review. Fillet told the examiner that he then returned the forms to the branch offices where the documents were kept.

While the FINRA examiner waited in a Riderwood conference room for the Firm to produce the variable annuity transaction documents for review, he discovered documents arriving by fax from Riderwood's branch offices. The documents included customer-account forms, applications, and acknowledgment forms related to ten variable annuity transactions for seven Riderwood customers. They lacked Fillet's supervisory signatures. Fillet, meanwhile, was unaware of the examiner's discovery. About an hour later, according to the examiner, Fillet handed these same documents to the examiner, but only after Fillet had signed and dated them as

9 The letter from Sloan's criminal defense attorney, which Fillet reviewed, also used the name "Allen" Sloan.

though he had reviewed them near the time the Indiana branch office had completed them.[10] Suspecting that Fillet had backdated the documents, the examiner requested that the Indiana branch office resend the documents and, when it did, the documents contained none of Fillet's signatures.

Thereafter, FINRA staff conducted an examination of Riderwood's Indiana branch office and obtained copies of the documents that had been transmitted during the examination. None of the documents contained Fillet's signatures.

In his correspondence with FINRA and during his on-the-record ("OTR") testimony, Fillet denied FINRA's charges that he had backdated the documents.[11] But at the hearing, after the FINRA examiner involved testified, Fillet admitted that he had signed and dated the relevant documents during the examination. As Fillet conceded, "[H]ad I personally had any inkling that this was such a big deal . . . , I would not have done what I did."

C. FINRA found that Fillet violated the Exchange Act's antifraud provisions and FINRA rules and imposed sanctions.

After a one-day hearing, a FINRA Hearing Panel found Fillet liable on both counts charged in FINRA's complaint: (i) that Fillet made material misrepresentations and misleading omissions in connection with his sale of securities by CAC and Sweet Shoppes in violation of Exchange Act Section 10(b), Exchange Act Rule 10b-5, NASD Rules 2120 and 2110, and IM-2310-2; and (ii) that Fillet falsified Firm records and submitted these false records to FINRA during an examination in violation of NASD Rules 3110 and 2110. The Hearing Panel suspended Fillet for six months and fined him $10,000 for the fraud violations and suspended him for two years and fined him $10,000 for violating NASD Rules 3110 and 2110.

On appeal, FINRA's National Adjudicatory Council ("NAC") affirmed the Hearing Panel's findings that Fillet violated Exchange Act Section 10(b), Exchange Act Rule 10b-5, NASD Rules 2120 and 2110, and IM-2310-2 by drafting the misleading Term Sheet and failing to disclose Sloan's criminal past. But the NAC modified the Hearing Panel's sanctions for these violations by increasing the suspension from six to eighteen months, while sustaining the $10,000 fine for these violations. The NAC also sustained the findings of violations and sanctions imposed for Fillet's violations of NASD Rules 3110 and 2110. This appeal followed.

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10 Fillet signed and dated the documents as far back as December 2007, often using a date that was approximately one week after the registered representative signed the document.

11 Fillet stated in his OTR testimony, dated February 20, 2009, "To the best of my knowledge, I never backdated a file during the whole time I was at Riderwood." He also gave various excuses for the discrepancies in the documents sent by the branch office and those he supplied to FINRA, including that the documents "got lost in the mail."

II. ANALYSIS

A. Standard of Review

Pursuant to Section 19(e) of the Exchange Act, in reviewing a FINRA disciplinary action, we determine whether the member or associated person engaged in the conduct found by FINRA, whether the conduct violated the securities laws or rules found by FINRA, and whether those rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[12] In conducting our *de novo* review, we apply a preponderance of evidence standard to determine whether the record supports FINRA's findings.[13]

B. Fillet's violations of FINRA's antifraud provisions.

NASD Conduct Rule 2120, FINRA's antifraud rule, prohibits FINRA members and their associated persons from effecting "any transaction in, or induc[ing] the purchase or sale of, any security by means of any manipulative, deceptive or other fraudulent device or contrivance." NASD Conduct Rule 2110 requires adherence to "high standards of commercial honor and just and equitable principles of trade." Moreover, IM 2310-2 imposes on members and registered representatives the "'fundamental responsibility for fair dealing,' which is '[i]mplicit in all [their] relationships' with customers."[14] IM 2310-2 identifies several activities that "clearly violate" this responsibility, including "non-disclosure or misstatement of material facts."[15]

FINRA found that Fillet violated NASD Rules 2120 and 2110 and IM-2310-2 by drafting the Term Sheet for the Sweet Shoppes/CAC offering that "contained inaccurate information" and by "fail[ing] to disclose to an investor the criminal history of [Sloan, who was] instrumental to the offering." As FINRA found, Fillet had a "duty not to mislead [PM] in connection with the CAC and Sweet Shoppes offering," which he violated when he, "acting with scienter, induced

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12 15 U.S.C. § 78s(e); *see, e.g., Joseph Abbondante*, Exchange Act Release No. 53066, 2006 WL 42393, at *6 (Jan. 6, 2006), *petition denied*, 209 Fed. App'x 6 (2d Cir. 2006). The rules at issue are consistent with the Exchange Act. *See, e.g., Scott Epstein*, Exchange Act Release No. 59328, 2009 WL 223611, at *12 (Jan. 30, 2009) (applying IM-2310-2 in sustaining FINRA action); *Nat'l Assoc. Sec. Dealers, Inc.*, Exchange Act Release No. 2211, 1939 WL 36389, at *3 (Aug. 7, 1939) (approving prior versions of NASD's Rules 2110 and 2120); *Adoption of Exchange Act Rule 10b-5*, Exchange Act Release No. 3230, 1942 WL 34443, at *1 (May 21, 1942) (adopting Rule 10b-5 by authority granted under Exchange Act Section 10(b));.

13 *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *9 (May 27, 2011) (citing *Seaton v. SEC*, 670 F.2d 309, 311 (D.C. Cir. 1982) (upholding preponderance of evidence standard in FINRA (then NASD) disciplinary proceeding)), *aff'd*, 693 F.3d 251 (1st Cir. 2012). Fillet claims a different standard of proof applies, citing *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308 (2007). But *Tellabs* involved "the pleading requirements" for "private securities fraud actions," not FINRA disciplinary actions.

14 *Epstein*, 2009 WL 223611, at *12 (quoting NASD Rule IM 2310-2).

15 NASD Rule IM 2310-2.

[PM's] purchase of a security by means of fraud and deception." Based on our review of the record, we agree with FINRA and conclude, as set forth below, that Fillet violated NASD Rules 2120 and 2110 and IM-2310-2.

1. Fillet violated FINRA Rules 2120 and 2110, and IM-2310-2 by inducing PM's purchase by means of false statements.

a. The Sweet Shoppes/CAC private placement involved the sale of a security.

We find that the Sweet Shoppes/CAC private placement offering involved the sale of a security. Both Section 2(a)(1) of the Securities Act of 1933 and Section 3(a)(10) of the Exchange Act define a "security" to include "any . . . warrant" to purchase stock.[16] The Term Sheet and subscription agreement to the offering made clear that, upon investing in the enterprise, investors would receive "detachable warrants" to purchase Sweet Shoppes/CAC common stock at a fixed price in the future.[17]

Fillet contends that PM's payment to Sloan was merely a "loan" and not a securities investment. But, other than his self-serving testimony, there is no basis for this finding. The Term Sheet he drafted described the offering as "a high risk transaction [that] can only be purchased by an accredited investor as defined under the Securities Act." And the subscription agreement, which he also drafted, required PM's acknowledgement that the units being sold were "restricted securities under the 1933 Act." Further, Fillet does not dispute that PM paid Sloan the price for one unit in the offering ($150,000) or that PM gave Sloan a check that stated that payment was for "notes and warrants."[18] We thus find the preponderance of evidence establishes that the transaction involved the sale of a security.

b. The misstatements in the Term Sheet were material.

Fillet does not dispute that the Term Sheet that he drafted contained misstatements of fact. The Term Sheet stated that CAC was a "food service company that started in New York City but became national in scope," that "Sweet Shoppes is closely aligned with FAO," and that

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16 15 U.S.C. §§ 77b, 78c(a)(10); *see also Kusner v. First Pa. Corp.*, 531 F.2d 1234, 1237 (3d Cir. 1976) ("[T]he warrants here . . . are securities within the meaning of both the Securities Act and Securities Exchange Act."); *Investors Funding Corp. Sec. Litig.*, 523 F. Supp. 550, 556 n.3 (S.D.N.Y. 1980) ("[W]arrants are no less securities than common stock[.]").

17 FINRA did not address whether the offering's notes were also securities, but notes generally are presumed to be securities, 15 U.S.C. §§ 77b, 78c(a)(10), and the notes here appear to meet the test articulated in *Reves v. Ernst & Young*, 494 U.S. 56, 67-68 (1990) (finding that unsecured demand notes issued by a farmers' co-op to raise capital were securities).

18 The subscription agreement in the record lacks Sloan's signature, but the preponderance of the evidence, including PM's testimony and his cashed check, establish that the transaction took place as contemplated by the document.

Sweet Shoppes "operates under a global license from [FAO] and the FAO Family Trust." But none of this was true. As Fillet concedes, CAC was neither an operating company nor "national in scope." It was a shell company with no assets or operations. And Sweet Shoppes was merely a concept that never secured a licensing agreement from FAO.

We find that these misstatements were material. A fact is material if there is a substantial likelihood that a reasonable investor would have viewed it as significantly altering the total mix of information made available.[19] A reasonable investor would want to know that CAC, formed for the purpose of acquiring a series of food companies for producing Sweet Shoppes' food, was nothing more than a shell,[20] and that Sweet Shoppes, which based its business model on aligning itself with FAO, did not have a licensing agreement with FAO.[21] The licensing agreement was particularly critical to Sweet Shoppes' success, as evidenced by the demise of the business shortly after FAO terminated its licensing negotiations.[22] PM's testimony further supports our conclusion; he testified that the main reason he invested in the offering was because he believed that these misstatements were true. As a result, we find Fillet's misstatements "significantly altered the 'total mix' of information available to the investor."[23]

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19 *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)).

20 *See, e.g., Shores v. Sklar*, 647 F.2d 462, 466 (5th Cir. 1981) (deeming a misrepresentation of assets to be materially false and misleading); *Elipas v. Jedynak*, No. 07 C 3026, 2010 WL 1611024, at *2 (N.D. Ill. Apr. 20, 2010) (finding a representation that plaintiffs were investing directly in the company when they were actually purchasing equity on a secondary market was a material misrepresentation); *SEC v. Lauer*, No. 03-80612-CIV, 2008 WL 4372896, at *20 (S.D. Fla. Sept. 24, 2008) (finding it material that investors did not know their investments were actually in shell companies).

21 *See, e.g., SEC v. Reys*, 712 F. Supp. 2d 1170, 1176-77 (W.D. Wash. 2010) (finding a failure to disclose the company's inability to obtain a specially formulated compound, which was essential to the company's business, to be material); *Peritus Software Servs., Inc. Sec. Litig.*, 52 F. Supp. 2d 211, 222 (D. Mass. 1999) (finding company's recognition of revenue on fictitious licenses was a material misrepresentation); *Kevin M. Glodek*, Exchange Act Release No. 60937, 2009 WL 3652429, at *5 (Nov. 4, 2009) (finding representations about issuer's imminent listing on stock exchange when issuer had not filed necessary listing application was material), *petition denied*, 416 F. App'x 95 (2d Cir. 2011).

22 *Cf. United States v. Reyes*, 577 F.3d 1069, 1076 (9th Cir. 2009) (holding that the materiality of an issuer's "'financial condition, solvency, and profitability is not subject to serious challenge'" (quoting *SEC v. Murphy*, 626 F.2d 633, 653 (9th Cir. 1980))).

23 *Matrixx Initiatives, Inc v. Siracusano*, 131 S. Ct. 1309, 1312 (2011) (quoting *Basic Inc.*, 485 U.S. at 231-32).

c. Fillet acted with scienter.

We also find, as FINRA did, that Fillet acted with scienter, "a mental state embracing intent to deceive, manipulate, or defraud."[24] Scienter may be established by recklessness, defined as "'an extreme departure from the standards of ordinary care . . . which presents a danger of misleading buyers or sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it.'"[25] Fillet admitted that he knew when he drafted the Term Sheet that the business descriptions about Sweet Shoppes and CAC were inaccurate, but he included these facts anyway.

Fillet claims, as he testified at the hearing, that the statements in the Term Sheet were inaccurate because they were subject to contingencies—in particular, CAC's acquisition of food service companies and Sweet Shoppes' securing a licensing agreement from FAO—that had not yet occurred but that he assumed would occur before investments were made. He also claims that he provided only a preliminary "draft" of the Term Sheet to Sloan and did not intend for investors to receive it. But FINRA's Hearing Panel "did not find [this testimony] credible." We generally accord considerable weight and deference to the fact finder's credibility determination and see no reason to depart from that determination here.[26] Nothing on the face of the Term Sheet suggested it was only a draft. And Fillet has produced no evidence, documentary or otherwise, to substantiate his testimony.[27]

Even if we accept Fillet's explanation as true, we find that he acted at least recklessly when he drafted and provided an offering document to Sloan that he knew contained inaccurate statements without taking adequate precautions against its possible dissemination to investors. Although Fillet was Riderwood's senior investment banker and had almost forty years' experience, he took no steps to prevent a potential investor from being misled if the document were to be released. For example, while he claims that the statements at issue were meant to be contingent on certain events occurring, he failed to use any cautionary language alerting a potential reader to contingencies. Nor did he take the basic step of identifying the document as a "draft." Even when Fillet later learned that PM had received a copy of the Term Sheet, he did nothing to correct the misstatements. These failures were an extreme departure from the standards of ordinary care expected of brokers.[28]

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24 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

25 *Dolphin & Bradbury v. SEC*, 512 F.3d 634, 639 (D.C. Cir. 2008) (quoting *SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992)).

26 *See, e.g., Rita J. McConville*, Exchange Act Release No. 51950, 2005 WL 1560276, at *6 n. 21 (June 30, 2005) (observing that "the credibility determination of an initial fact finder is entitled to considerable weight and deference because it is based on hearing the witnesses' testimony and observing their demeanor"), *petition denied*, 465 F.3d 780 (7th Cir. 2006).

27 At the hearing, Fillet admittedly could not produce a cover letter or e-mail stating that the Term Sheet was merely a draft. He also called no witnesses that could substantiate his claim.

28 *See e.g., Robert Tretiak*, Exchange Act Release No. 47534, 2003 WL 1339182, at *7 (Mar. 19, 2003) (finding that president of member firm was at least reckless in failing to ensure

(continued...)

d. Fillet induced PM's purchase of securities.

Fillet also asserts that he never gave the Term Sheet to PM, suggesting he cannot be liable because he did not "make" the misstatements in the Term Sheet. We disagree. Unlike Exchange Act Rule 10b-5(b), which prohibits "mak[ing] any untrue statement of material fact,"[29] NASD Rule 2120 "does not require a [person] to 'make' a statement in order to be liable"[30] and thus it is not "so restricted."[31] Rather, the express language of NASD Rule 2120 turns on whether Fillet "induce[d] the purchase . . . [of] any security by means of any manipulative, deceptive or other fraudulent device or contrivance." Therefore, even if Fillet did not "make" the statements in the Term Sheet within the meaning of Rule 10b-5(b), Fillet drafted an offering document containing material misstatements that induced PM to invest. Thus, we find that, at a minimum, Fillet recklessly induced PM to purchase Sweet Shoppes and CAC securities by means of a "manipulative, deceptive, or other fraudulent device or contrivance," namely the Term Sheet, in violation of NASD Rule 2120.[32]

For all these reasons, we find that Fillet's misconduct in drafting false and misleading statements in an offering document violated NASD Rule 2120 and thereby Rule 2110.[33] Fillet also violated IM 2310-2's fair dealing requirement by failing to ensure that PM was not misled by the offering document Fillet drafted. Accordingly, we sustain FINRA's findings of violation with respect to these provisions.

(...continued)
that the prospectus he drafted accurately reflected information critical to the offering). Fillet's claim that he drafted the Term Sheet for Sloan or his attorney to review and finalize does not mitigate his culpability for drafting the deceptive device.

29 17 C.F.R. § 240.10b-5(a); *Janus Capital Grp. v. First Derivative Traders*, 131 S. Ct. 2296, 2302 (2011) (interpreting the term "make" under Exchange Act Rule 10b-5(b)).

30 *Cf. SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014) (distinguishing Securities Act Section 17(a) and Exchange Act Rule 10b-5(a) and (c) from Rule 10b-5(b) by the absence of the operative term "make" and finding no such requirement in the aforementioned provisions).

31 *Cf. Affiliated Ute Citizens of Utah v. United States*, 406 U.S.128, 152-53 (1972) (discussing three subsections of Exchange Act Rule 10b-5).

32 *Cf. Monterosso*, 756 F.3d at 1334 (finding that president's and vice president's "commission of deceptive acts as part of a scheme to generate fictitious revenue" violated Exchange Act Section 10(b), Rule 10b-5(a) and (c), and Securities Act Section 17(a)).

33 A violation of another NASD rule, such as Rule 2120, constitutes a violation of Rule 2110. *CMG Institutional Trading, LLC*, Exchange Act Release No. 59325, 2009 WL 223617, at *8 n.36 (Jan. 30, 2009)).

2. Fillet violated FINRA's antifraud provisions when he failed to disclose material information to PM.

Fillet's failure to disclose Sloan's criminal history to PM also violated NASD Rules 2120 and 2110, and IM-2310-2. The duty of fair dealing under IM-2310-2 requires securities professionals to "not merely avoid affirmative misstatements . . . [but] also [to] disclose 'material adverse facts.'"[34] Fillet admits that he first became aware of Sloan's 2003 conviction in late 2007 but never disclosed the information to PM in any of his communications with him.[35] This information was unquestionably material because it reflected on the character and integrity of a person integral to the success or failure of the enterprise.[36] A reasonable investor would have wanted to know that Sloan, the CEO and founder of both issuers, had been convicted of a felony in 2003 and served prison time.[37] PM's testimony—*i.e.*, that, had he known about Sloan's criminal history, he never would have invested in the offering—also supports this conclusion. It is also undisputed that FAO terminated its business relationship with Sloan as soon as it discovered his criminal past, further underscoring the importance of the information to investors.

We agree with FINRA's finding that Fillet acted with scienter in failing to disclose material information. Despite learning of Sloan's conviction for possession of stolen property before the offering commenced, he failed to disclose the information to PM at their January 16th meeting, in his telephone conversations with him, or in the Term Sheet. Fillet knew, or was at

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34 *Richard F. Kresge*, Exchange Act Release No. 55988, 2007 WL 1892137, at *6-7 (June 29, 2007) (finding that representatives who made unfounded claims about the merits of an investment without disclosing the poor financial condition of the companies violated federal and NASD antifraud provisions including IM-2310-2); *see also Richard H. Morrow*, Exchange Act Release No. 40392, 1998 WL 556560, at *6 (Sept. 2, 1998); *Richard J. Buck & Co.*, Exchange Act Release No. 8482, 1968 WL 86080, at *6 (Dec. 31, 1968) ("'[A] salesman must not merely avoid affirmative misstatements when he recommends the stock to a customer; he must also disclose material adverse facts of which is or should be aware.'"), *aff'd sub. nom, Hanly v. SEC*, 415 F.2d 589 (2d Cir. 1969)); NASD Rule IM 2310-2, *supra* note 15.

35 *See, e.g., Stern v. Grossman*, Fed. L. Rep. 95,482, 1990 WL 128883, at *2 (S.D.N.Y. Sept. 4 1990) (failure to disclose CEO's prior imprisonment for securities fraud in private placement memorandum); *Stylex Homes Inc.*, Exchange Act Release No. 36299, 1995 WL 579505, at *2 (Sept. 29, 1995) (failure to disclose criminal background of a director in private placement memorandum) (settled proceeding).

36 *See United States v. Hatfield*, 724 F. Supp. 2d 321, 328 (E.D.N.Y. 2010) ("It is well-settled that information impugning management's integrity is material to shareholders.").

37 *See, e.g., SEC v. Elecs. Wharehouse, Inc.*, 689 F. Supp. 53, 66 (D. Conn. 1988) ("An indictment for mail fraud of the president and founder of the issuing corporation was a fact that any reasonable investor would have considered important in making the decision to invest in [the issuer]."), *aff'd sub nom., SEC v. Calvo*, 891 F.2d 457 (2d Cir. 1989).

least reckless in not knowing, that he was withholding material information.[38] Fillet also had a financial incentive to withhold the information. As the Engagement Agreement provided, Fillet, through Riderwood, would earn a stock grant and percentage of the gross proceeds based on the success of the offering. Withholding damaging information about the issuers' CEO increased the likelihood that PM and others would invest in the offering and thereby Fillet's total compensation. That Fillet stood to gain financially from his fraudulent conduct reinforces our finding that he acted with scienter.[39]

Our finding that Fillet violated FINRA's antifraud provisions is further supported by his unreasonable failure to discover and disclose the full extent of Sloan's criminal and civil history. FINRA has reminded its members and associated persons of their long-standing obligation "to conduct a reasonable investigation of the issuer and the securities they recommend in [private placement] offerings."[40] In recommending the purchase or sale of a security, securities professionals represent "'that a reasonable investigation has been made and that [their] recommendation rests on the conclusions based on such investigation.'"[41] Fillet's and Riderwood's due diligence with respect to Sloan, consisting of an internet search that misspelled Sloan's name as "Alan Sloan" even though materials in Fillet's possession showed the correct, current spelling and other aliases, was not reasonable.[42] The discovery of Sloan's 2003 criminal conviction, alone, should have alerted Fillet of the need to conduct a more probing inquiry into

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38 *See Breard v. Sachnoff & Weaver, Ltd.*, 941 F.2d 142, 144 (2d Cir. 1991) ("[F]ailure to mention [the principal seller's] conviction in the initial offering memorandum could be considered reckless as a matter of law.").

39 *See, e.g., Guy P. Riordan*, Exchange Act Release No. 61153, 2009 WL 4731397, at *9 (Dec. 11, 2009) (finding that pecuniary motive for committing violations further establishes respondent's scienter), *petition denied*, 627 F.3d 1230 (D.C. Cir. 2010). Although Fillet claims he ceased marketing Sweet Shoppes/CAC in February 2008, he does not dispute, and the Engagement Agreement confirms, that he was acting as Sloan's agent during the times he communicated with PM.

40 FINRA Notice 10-22, *Obligation of Broker-Dealers to Conduct Reasonable Investigations in Regulation D Offerings*, 2010 WL 1625161, at *2 (Apr. 22, 2010) ("FINRA Notice 10-22") ("The [Commission] and federal courts have long held that a [broker-dealer] that recommends a security is under a duty to conduct a reasonable investigation concerning that security and the issuer's representations about it." (internal quotation marks omitted) (citing *SEC v. N. Am. Research and Dev. Corp.*, 424 F.2d 63, 84 (2d Cir. 1970); *Hanly v. SEC*, 415 F.2d 589, 595-96 (2d. Cir. 1969); *SEC v. Current Fin. Servs., Inc.*, 100 F. Supp. 2d 1, 7 (D.D.C. 2000); and *Everest Sec., Inc.*, Exchange Act Release No. 37600, 52 SEC 958, 1996 WL 487682, at *4-5 (Aug. 26, 1996), *aff'd in part and vacated in part on other grounds*, 116 F. 3d 1235 (8th Cir. 1997))).

41 FINRA Notice 10-22, 2010 WL 1625161, at *2 (quoting *Hanly*, 415 F.2d at 597).

42 The Engagement Agreement and Sloan's 2003 criminal conviction (and Sloan's attorney's explanation of it) reflected the names Allan Sloan and Allen Sloan, respectively.

Sloan's background.[43] Instead, Fillet relied on Sloan and his attorney for information regarding his past misconduct. Had Fillet conducted a public records search using the correct spelling of his name or aliases, he would have learned that Sloan had an extensive legal history, including another felony conviction and disbarment as an attorney, a recent bankruptcy filing, and hundreds of thousands of dollars in civil judgments and liens against him, all of which we find would have been material to investors.[44]

Fillet contends that Sloan was the person responsible for disclosing his legal history. But we have long held that a securities professional "has a responsibility for his own or her own actions and cannot blame others for [his or her] own failings."[45] Fillet, as discussed, had a duty to speak truthfully and completely about the transaction with PM, which included "disclos[ing] material adverse facts of which he is or should be aware.'"[46] By withholding material information from PM with scienter, Fillet induced PM's purchase of a security by means of a "manipulative, deceptive, or fraudulent" device or contrivance in violation of NASD Rules 2120 and 2110, and IM-2310-2. Accordingly, we sustain FINRA's findings in this regard.

C. Fillet's violations of Exchange Act Section 10(b) and Rule 10b-5.

FINRA also found that Fillet's misconduct violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. Section 10(b) makes it unlawful for any person "to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe."[47] Rule 10b-5 implements the Commission's authority under Section 10(b) through three subsections: Rule 10b-5(a) prohibits "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud;"[48] Rule 10b-5(b) prohibits "directly or indirectly . . . mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made . . . not misleading;"[49] and Rule 10b-5(c) prohibits "directly or indirectly . . .

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43 *Cf.* FINRA Notice 10-22, 2010 WL 1625161, at *3 ("[T]he presence of any 'red flags' also would alert the broker to the need for further inquiry." (citing *Univ. Hill Found. v. Goldman Sachs & Co.*, 422 F. Supp. 879, 898 (S.D.N.Y. 1976))).

44 *See, e.g., SEC v. Merchant Capital, LLC*, 483 F.3d 747, 770-71 (11th Cir. 2007) (finding failures to disclose management's financial problems, including personal bankruptcy, and previous cease-and-desist order, were material).

45 *Philip L. Spartis*, Exchange Act Release No. 64489, 2011 WL 1825026, at *9 (May 13, 2011) (quoting *Justine Susan Fischer*, Exchange Act Release No. 40335, 1998 WL 484111, at *5 n.4 (Aug. 19, 1998)).

46 *Hanly,* 415 F.2d at 592 (quoting *Richard J. Buck & Co.*, Exchange Act Release No. 86080, 1968 WL 86080, at *7-8 (Dec. 31, 1968)).

47 15 U.S.C. § 78j(b).

48 17 C.F.R. § 240.10b-5(a).

49 *Id.* § 240.10b-5(b).

engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."[50] Liability under these subsections requires a showing of scienter.[51]

1. Fillet's failure to disclose material information violated Exchange Act Section 10(b) and Rule 10b-5(a) and (c).

For all the reasons stated above with respect to FINRA's antifraud rule, we sustain FINRA's findings that Fillet's failure to disclose Sloan's criminal past violated Exchange Act Section 10(b) and Rule 10b-5.[52] Fillet, acting with scienter, failed to disclose material information in connection with a securities offering that he recommended to PM.[53] When he recommended the investment, Fillet had a duty as a securities professional "to speak truthfully about material issues."[54] But as found above, he deprived PM of material information necessary to make an informed investment decision, and created a false impression of fact regarding the offering, in violation of his "special duty of fair dealing" with investors.[55] Accordingly, we find that by failing to disclose Sloan's criminal past, Fillet violated Exchange Act Section 10(b) and Rule 10b-5. Specifically, Fillet's failure to disclose was a deceptive "device, scheme, or artifice to defraud" under Rule 10b-5(a) and a deceptive act that operated as a fraud on the customer under Rule 10b-5(c).[56]

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50 *Id.* § 240.10b-5(c).

51 *Hochfelder*, 425 U.S. at 194.

52 Fillet's telephone calls with PM alone meet the jurisdictional requirement of Section 10(b). *See, e.g.*, *Loveridge v. Dreagoux*, 678 F2d 870, 874 (10th Cir. 1982) (holding that interstate telephone calls are sufficient for jurisdiction under antifraud provisions).

53 The Supreme Court has broadly interpreted the "in connection with" phrase of Section 10(b). *SEC v. Zandford*, 535 U.S. 813, 819 (2002) (explaining that "the statute should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes" (internal quotation marks omitted)).

54 *Ciaola v. Citibank, N.A., New York*, 295 F.3d 312, 331 (2d Cir. 2002) (stating that broker-dealer, by "cho[osing] to discuss its hedging strategy, . . . had a duty to be both accurate and complete" about the strategy).

55 *Cf. SEC v. Hasho*, 784 F. Supp. 1059, 1107 (S.D.N.Y. 1992) (citing *Hanly*, 415 F.2d at 597 ("By making a recommendation, a securities dealer implicitly represents to a buyer of securities that he has an adequate basis for the recommendation.")); *Steven D. Goodman*, Exchange Act Release No. 43889, 2001 WL 62607, at *4 (Jan. 26, 2001) (same).

56 *Cf. Monterosso*, 756 F.3d at 1333. We note that FINRA found liability for Fillet's failures to disclose under Rule 10b-5 without specifying a subsection. We find that under these facts, Fillet's failure to disclose violated Rule 10b-5(a) and (c), distinguishing this conduct from the misstatements that FINRA analyzed under Rule 10b-5(b).

2. FINRA has not established that Fillet violated Rule 10b-5(b).

On this record, we are unable to sustain FINRA's finding that Fillet violated Exchange Act Rule 10b-5(b) by making the misrepresentations in the Term Sheet or by making oral misrepresentations to PM.[57] In *Janus Capital Group v. First Derivative Traders*,[58] the United States Supreme Court interpreted Rule 10b-5(b)'s prohibition against "mak[ing] any untrue statement of a material fact."[59] The Court held that an investment adviser who drafted misstatements that were later included in a separate mutual fund's prospectus did not "make" the statements for purposes of Rule 10b-5(b) because the mutual fund itself filed the prospectus.[60] The Court reasoned that one who merely "prepares" a statement is not its "maker," just as a mere speechwriter lacks "ultimate authority" over the contents of a speech.[61] As a result, the Court concluded that it was the mutual fund, not the mutual fund's adviser, who had "ultimate authority over the statement, including its content and whether and how to communicate it."[62]

Relying on *Janus*, FINRA concluded that Fillet had ultimate authority "over the content of the statements" because Fillet drafted the Term Sheet and was listed as the contact person on the document. But FINRA failed to address to what extent Fillet had "ultimate authority over . . . whether and how to communicate [the misstatements]."[63] Although we strongly reject Fillet's argument that he cannot be liable under Rule 10b-5(b) solely because he was not the person who provided the Term Sheet to PM, there is insufficient evidence of the communications between Fillet and Sloan, Sloan and PM, and PM and Fillet, to determine who had "ultimate authority" over the communication of the misstatements, and therefore who "made" those misstatements.[64]

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57 17 C.F.R. § 240.10b-5(b) (making it unlawful for "any person" in connection with the purchase or sale of securities to "directly or indirectly, . . . 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").

58 131 S. Ct. 2296 (2011).

59 *Id.* at 2301.

60 *Id.* at 2305.

61 *Id.* at 2302.

62 *Id.*

63 *Id.*

64 We agree with FINRA that Fillet and Riderwood were listed prominently in the Term Sheet as the sole and exclusive marketing agent of the offering and that Fillet and a managing director of Riderwood were the only contact persons listed for the offering. These facts suggest that the misstatements in the Term Sheet could be attributable to Fillet. But the evidence also shows that Fillet did not direct or control Sloan's communications with investors. To the contrary, Sloan was president and CEO of CAC and Sweet Shoppes and orchestrated the fraudulent conduct. Without more evidence concerning the communications between Fillet, Sloan, and the investor, we cannot sustain a finding that Fillet had ultimate authority over whether and how the Term Sheet was communicated to investors. *See, e.g.*, *SEC v. Pentagon Capital Mgmt.*, 725 F.3d 279, 285-86 (2d Cir. 2013) (affirming liability under Rule 10b-5(b) for

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annuity transactions that Riderwood executed for seven of its customers.[70] Fillet was responsible for conducting a supervisory review of these transactions. He intentionally backdated the documents to give the false impression he had conducted his supervisory review of the transactions closer to the time that the transactions had been executed. By knowingly falsifying customer-related records, Fillet caused Riderwood's books and records to be inaccurate in violation of NASD Rule 3110.[71]

Fillet also concedes that he violated NASD Rule 2110 by backdating customer-account records. We have held that providing misleading and inaccurate information to FINRA is conduct contrary to high standards of commercial honor and is inconsistent with just and equitable principles of trade.[72] "[A] violation of Rule 2110 does not require any showing of scienter."[73] In any event, as a principal of a registered broker-dealer with nearly forty years' securities experience, Fillet knew not to mislead regulatory authorities during an examination. In attempting to deceive FINRA with documents he deliberately falsified, Fillet acted unethically in violation of NASD Rule 2110.[74]

Accordingly, for the reasons stated above, we find that Fillet engaged in the conduct found by FINRA, that his conduct violated Rule 2110, and that Rule 2110 is, and was applied in a manner, consistent with the purposes of the Exchange Act.

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70 *See* 17 C.F.R. § 240.17a-3(17)(i)(A) and (D) (requiring brokers-dealers to make and keep current certain books and records, including, for each account with a natural person as a customer, "[a]n account record [including various personal information, such as] annual income, net worth . . . and the account's investment objectives" and those for which a "suitability determination" was conducted).

71 *Brokaw*, 2013 WL 6044123, at *15-16; *Charles E. Kautz*, Exchange Act Release No. 37072, 1996 WL 164181, at *3 (Apr. 5, 1996) ("[I]t is a violation of [FINRA] Rules to enter false information on official firm records.").

72 *Brian L. Gibbons*, Exchange Act Release No. 37170, 1996 WL 254664, at *3 (May 8, 1996); *see also Rooms v. SEC*, 444 F.3d 1208, 1214 (10th Cir. 2006) (finding bribery, backdating, and altering documents violates "the Rule 2110 requirement that the person's conduct conform to high standards of commercial honor and just and equitable principles of trade").

73 *Kirlin Sec., Inc.*, Exchange Act Release No. 61135, 2009 WL 4731652 at *14 n.87 (Dec. 10, 2009).

74 *See Rooms*, 444 F.3d at 1214; *Gen. Bond & Share Co. v. SEC*, 39 F.3d 1451, 1460 (10th Cir. 1994) ("[A]ny reasonable person would know that . . . intentional deception of [FINRA] while it is engaged in an investigation violates the prohibition against conduct contrary to high standards of commercial honor and just and equitable principles of trade.").

Therefore, under the applicable preponderance of evidence standard, we have determined that the record does not support a finding that Fillet violated Exchange Act Rule 10b-5(b) by making the misrepresentations in the Term Sheet.

FINRA also found that Fillet violated Rule 10b-5 because he made oral misrepresentations to PM during their meeting that were similar to the misrepresentations in the Term Sheet. But, based on our de novo review of the record, PM's testimony during the hearing did not establish by a preponderance of the evidence that Fillet made these oral representations to PM. Rather, PM could not recall who had made the oral misrepresentations. As a result, we have determined that the record does not support a finding that Fillet violated Exchange Act Rule 10b-5 by making such oral misrepresentations.

C. Fillet violated NASD Rules 3110 and 2110 by backdating customer-related documents and providing those materials to FINRA during an examination.

As to FINRA's second cause of action, NASD Conduct Rule 3110(a) required FINRA members to "make and preserve books, accounts, records, memoranda, and correspondence in conformity with all applicable laws, rules, regulations and statements of policy promulgated thereunder, with FINRA's Rules, and as prescribed by Exchange Act Rule 17a-3."[65] The recordkeeping rules "include[] the requirement that the records be accurate, which applies 'regardless of whether the information itself is mandated.'"[66] NASD Rule 115 made NASD's rules, including these requirements, applicable in equal force to "[FINRA] members and persons associated with a member," such as Fillet.[67] Proof of scienter is not required.[68]

Fillet does not dispute that he violated NASD Rule 3110 by backdating customer-account records and providing those documents to FINRA, and we find that sufficient evidence supports sustaining these violations.[69] The documents were records Riderwood was required to maintain, including customer-account forms, applications, and acknowledgment forms related to variable-

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late-trading scheme where defendants retained "ultimate authority" over misrepresentations when they directed brokers to communicate trade sheets containing misleading time-stamps), *cert. denied*, 2014 WL 2921728 (U.S. June 30, 2014).

65 NASD Rule 3110(a); *see also* 17 C.F.R. § 240.17a-3.

66 *Brown*, 2012 WL 625874 at *11 (quoting *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Exchange Act Release No. 33367, 1993 WL 538899 at *7 (Dec. 22, 1993)).

67 NASD Rule 0115; *see also Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 WL 6044123, at *16 (Nov. 15, 2013).

68 *Joseph G. Chiulli*, Exchange Act Release No. 42359, 2000 WL 91733, at *4 (Jan. 28, 2000) ("[NASD] Rule 3110 has no scienter requirement.").

69 Fillet acknowledges his prior admission to these charges in his reply brief on appeal, noting "[he] admitted that he was wrong" and he contests only the sanction imposed.

III. Sanctions

Pursuant to Exchange Act Section 19(e)(2), we will sustain FINRA's sanction unless we find, having due regard for the public interest and the protection of investors, that the sanction is excessive or oppressive or imposes an unnecessary or inappropriate burden on competition.[75] As part of this review, we consider any aggravating or mitigating factors and whether the sanctions imposed are remedial and not punitive.[76] Though not bound by FINRA's Sanction Guidelines, we use them as a benchmark for our review under Exchange Act Section 19(e)(2).[77]

A. FINRA's sanctions imposed for the fraud violations are remanded.

We find it appropriate to set aside and remand FINRA's imposition of sanctions for Fillet's fraud violations. FINRA aggregated its sanction for these violations, imposing an eighteen-month suspension and $10,000 fine. Because we are setting aside a portion of the fraud violations, we remand the sanctions for these violations to FINRA for reconsideration in light of this dismissal. We do not suggest any view as to the outcome of that reconsideration.

B. FINRA's two-year suspension and $10,000 fine for Fillet's books-and-records violations are not excessive or oppressive.

For his violations of NASD Rules 3110 and 2110, FINRA suspended Fillet in all capacities for two years and fined him $10,000. We sustain FINRA's sanctions because they are neither excessive nor oppressive and are in the public interest and for the protection of investors.

For violations of NASD Rule 3110, FINRA's Sanction Guidelines recommend a fine between $1,000 and $10,000 and a suspension of the responsible individual for up to thirty business days and, in egregious cases, a fine between $10,000 and $100,000 and a suspension for up to two years, or a bar.[78] For falsification of records in violation of NASD Rule 2110, the Guidelines recommend a fine between $5,000 to $100,000 and suspension of the responsible individual for up to two years and, in egregious cases, a bar.[79] The sanctions imposed are within these recommended ranges.

We agree with FINRA that Fillet's misconduct in backdating records and providing falsified records to FINRA was egregious. We have repeatedly emphasized that the

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75 15 U.S.C. § 78s(e)(2). Fillet does not claim, nor does the record show, that FINRA's action imposed an unnecessary or inappropriate burden on competition.

76 *Gregory Evan Goldstein*, Exchange Act Release No. 71970, 2014 WL 1494527, at *10 (Apr. 17, 2014).

77 *Capwest Sec., Inc.*, Exchange Act Release No. 71340, 2014 WL 198188, at *9 (Jan. 17, 2014).

78 FINRA Sanction Guidelines, *available at* http://www.finra.org/sites/default/files/Industry/p011038.pdf at 29 ("Sanction Guidelines").

79 *Id.* at 37.

recordkeeping requirements are fundamental to the regulation of the securities industry, serving as the "keystone of our surveillance of brokers and dealers."[80] The documents at issue consisted of important customer-account records related to the sale of variable annuities. Due to the complex nature of variable annuities, both Commission staff and FINRA have identified these products as particularly vulnerable to questionable sales practices and abuse, requiring broker-dealers to "provid[e] adequate supervision over salespersons, ensur[e] that adequate disclosure is made to customers, and maintain[] all required books and records" with respect to these securities.[81] Fillet signed and backdated documents to cover up his failure to supervise variable annuity transactions at one of Riderwood's branch offices.[82] His misconduct involved multiple acts of wrongdoing involving ten sets of documents for seven Riderwood customers, undermining the accuracy of the Firm's records for which Fillet was responsible.

Fillet compounded this misconduct by intentionally providing falsified documents to FINRA in an attempt to mislead a FINRA examiner, misconduct that we find aggravating. We have stated that providing truthful information to regulatory authorities is a fundamental obligation of securities professionals.[83] And we consistently have held that "deliberate deception of regulatory authorities justifies the severest of sanctions."[84] Fillet contends he "did not lie to FINRA." But there is no question that his falsification of dates in the customer records at issue constituted intentional misrepresentations to FINRA.

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80 *vFinance Invest. Inc.*, Exchange Act Release 62448, 2010 WL 2674858, at *8 (July 2, 2010) (alteration omitted).

81 Joint SEC and NASD Staff Report on Broker-Dealer Sales of Variable Insurance Products (June 2004), *available at* http://www.sec.gov/news/studies/secnasdvip.pdf (noting the importance of broker-dealers' "providing adequate supervision over salespersons, ensuring that adequate disclosure is made to customers, and maintaining all required books and records").

82 "'Assuring proper supervision is a critical component of broker-dealer operations.'" *World Trade Fin. Corp.*, Exchange Act Release No. 66114, 2012 WL 32121, at *11 (Jan. 6, 2012) (quoting *Ronald Pelligrino*, Exchange Act Release 59125, 2008 WL 5328765, at *10 (Dec. 19, 2008)), *petition denied*, 739 F.3d 1243 (9th Cir. 2014). FINRA has reminded members of their "obligation to monitor representatives in small, remote branch offices, who may find it easier 'to carry out and conceal violations of the securities laws[.]'" *vFinance*, 2010 WL 2674858, at *2 (quoting NASD Notice to Members 03-33 (July 2003)).

83 *E.g.*, *Peter J. Kisch*, Exchange Act Release No. 19005, 1982 WL 529109, at *6 n.23 (Aug. 24, 1982) ("[D]eception practiced on regulatory authorities . . . is clearly an aggravating factor to be considered in assessing appropriate sanctions."); *see also Brogan v. United States*, 522 U.S. 398, 402 (1998) ("[S]ince it is the very *purpose* of an investigation to uncover the truth, any falsehood relating to the subject of the investigation perverts that function."), *cited in Gary M. Kornman*, Advisers Act Release No. 2840, 2009 WL 367635, at *9 n.42 (Feb. 13, 2009) (barring broker and investment adviser in a follow-on proceeding for making false statements to Commission staff during an investigation), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010).

84 *Kornman*, 2009 WL 367635, at *7 (collecting cases).

FINRA also properly considered Fillet's misstatements during his subsequent OTR testimony as aggravating. Although this misconduct was outside the allegations of FINRA's complaint, FINRA may consider such evidence when assessing the appropriate sanction.[85] As the record showed, when asked by FINRA investigators if he had backdated documents in his OTR testimony, Fillet denied doing so and gave various excuses for the unsigned documents supplied by the branch office, including that the signed documents "got lost in the mail" or were contained "in different faxes."[86] These additional attempts to mislead FINRA further suggest that Fillet has a fundamental misunderstanding of his obligations as a securities professional.[87]

Fillet challenges the sanctions as excessive, claiming that the sanctions are higher than those assessed in recent FINRA cases, but he cites no cases to support his broad claim. In any event, it is well established that "[t]he appropriate sanction . . . depends on the facts and circumstances of each case."[88] FINRA's sanctions are well within the range recommended by the Guidelines and, given the egregiousness of the violations, are neither excessive nor oppressive.[89]

We also reject Fillet's claims of mitigation. Fillet claims that there was no harm to any customers and that he did not benefit from his wrongdoing. But we have long stated that "[t]he absence of monetary gain or customer harm is not mitigating, as our public interest analysis focus[es] . . . on the welfare of investors generally."[90] Fillet's deceptive acts created a danger that

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85 *Cf., e.g.*, *J. Stephen Stout*, Exchange Act Release No. 43410, 54 SEC 888, 2000 WL 1469576, at *16 & n.64 (Oct. 4, 2000) (considering as aggravating conduct respondent's post-OIP misconduct in determining that a bar was appropriate); *Joseph J. Barbato*, Exchange Act Release No. 41034, 53 SEC 1259, 1999 WL 58922, at *15 (Feb. 10, 1999) (finding respondent's improper contact with witnesses to be indicative of potential to commit future violations and thus relevant to analysis in assessing sanctions).

86 Fillet also provided a similar denial in his written correspondence at the time.

87 *See* Sanction Guidelines, *supra* note 78, at 7 (recommending consideration of "whether the respondent attempted to delay FINRA's investigation, to conceal information from FINRA, or to provide inaccurate or misleading testimony or documentary information to FINRA").

88 *World Trade Fin. Corp.*, 2012 WL 32121, at *16 (citing *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) ("The employment of a sanction within the authority of an administrative agency is thus not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases.")); *cf. Kornman*, 592 F.3d at 188 ("The Commission is not obligated to make its sanctions uniform." (quotation and citation omitted)).

89 Moreover, FINRA's application of the Guidelines ensures "greater consistency, uniformity, and fairness in the sanctions that are imposed for violations." *Richard A. Neaton*, Exchange Act Release 65598, 2011 WL 5001956, at *12 n.38 (Oct. 20, 2011).

90 *E.g.*, *Howard Braff*, Exchange Act Release No. 66467, 2012 WL 601003, at *7 (Feb. 24, 2012); *vFinance*, 2010 WL 2674858, at *17. Nor does the absence of a customer complaint preclude sanction. *Maximo Justo Guevara*, Exchange Act Release No. 42793, 54 SEC 655, 2000 WL 679607, at *6 (Mar. 18, 2000) (stating that FINRA's "power to enforce its rules is

(continued...)

investors would be harmed by his failure to supervise the transactions, depriving customers of protections accorded to them by the recordkeeping requirements.

We also reject his claim that his prior compliance with FINRA rules is mitigating. Under the Guidelines, "while the existence of a disciplinary history may serve to enhance the sanction imposed, the '[l]ack of disciplinary history is not a mitigating factor.'"[91] As we have stated, "member firms and their associated persons 'should not be rewarded for acting in accordance with [their] duties.'"[92] The record further suggests that Fillet has a history of backdating documents: Besides the documents at issue, Fillet testified that he had a "habit" of not carefully dating materials, admitting that "I think, frankly, even blotters . . . I might have reviewed them a week later, two weeks late and dated them the date of the blotter"— conduct that also violates the recordkeeping requirements.[93]

Accordingly, we find that the two-year suspension and $10,000 fine imposed were neither excessive nor oppressive but remedial. As FINRA concluded, "Fillet's backdating of Firm documents and providing these false documents to FINRA exemplifies an ethical breach[,] . . . reflect[ing] on his ability to comply with regulatory requirements necessary to the proper functioning of the securities industry and protection of the public." Facing discovery of his supervisory lapses, Fillet chose to doctor Firm records and provide those false materials to FINRA staff. This misconduct subjected Riderwood's customers to undue risk, depriving them of protections under the Exchange Act and FINRA rules.[94] Moreover, Fillet attempted to subvert a FINRA examination, reflecting an attitude toward regulatory oversight incompatible with the principles of investor protection.[95] As a result, we believe Fillet poses a threat to investors,

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(...continued)
independent of a customer's decision not to complain"), *petition denied*, 47 F. App'x 198 (3d Cir. 2000).

91 *CMG Institutional Trading, LLC*, 2009 WL 223617, at *9 (quoting *Rooms*, 444 F.3d at 1214).

92 *Id.* (quoting *Philippe N. Keyes*, Exchange Act Release No. 54723, 2006 WL 4958612, at *6 (Nov. 8, 2006)).

93 *John B. Busacca, III*, Exchange Act Release No. 63312, 2010 WL 5092726, at *6 n.26 (Nov. 12, 2010) ("Implicit in the recordkeeping rules is the precondition that information in these records be accurate." (quotation marks omitted)), *petition denied*, 449 F. App'x. 886 (11th Cir. 2011).

94 *See Schellenbach v. SEC*, 989 F.2d 907, 913 (7th Cir. 1993) ("Schellenbach's falsification of records exposed [firm's] customers to undue risk and deprived investors of the protections Congress and the executive branch have put in place." (citing *Blaise D'Antoni & Assoc. v. SEC*, 289 F.2d 276, 277 (5th Cir. 1961))).

95 *See Geoffrey Ortiz*, Exchange Act Release No. 58416, 2008 WL 3891311, at *9 (Aug. 22, 2008) ("[S]upplying false information to [FINRA] during an investigation . . . 'mislead[s] [FINRA] and can conceal wrongdoing' and thereby 'subvert[s]' [FINRA]'s ability to perform its regulatory function and protect the public interest." (quoting *Michael A. Rooms*, Exchange Act
(continued...)

warranting the suspension and fine imposed. The sanctions also serve the remedial goals of general and specific deterrence, encouraging Fillet and others to comply with recordkeeping obligations that are critical to operating in the securities industry and deterring against future attempts to mislead regulatory authorities during the course of examinations.[96]

IV. CONCLUSION

FINRA's decision is sustained in part, set aside in part, and remanded. We sustain FINRA's finding that Fillet violated NASD Rules 3110 and 2110 by falsifying records and causing his Firm's records to be inaccurate. We also sustain FINRA's determination to suspend Fillet in all capacities for two years and fine him $10,000 for these violations. We see no reason to delay imposition of these sanctions and, for purposes of Section 25(a) of the Exchange Act, deem the disposition of this portion of the case "the final order of the Commission."[97] We also sustain FINRA's findings that Fillet's misrepresentations and failure to disclose material information violated NASD Rules 2120 and 2110, and IM-2310-2. We also sustain FINRA's findings that Fillet's failure to disclose material information violated Section 10(b) of the Exchange Act, and Rule 10b-5(a) and (c) thereunder. But for the reasons given in this opinion, we set aside FINRA's findings that Fillet violated Exchange Act Rule 10b-5(b). We also set aside and remand for reconsideration the sanctions imposed for Fillet's violations of the antifraud provisions. The case is therefore remanded to FINRA for disposition consistent with this opinion.

An appropriate order will issue.[98]

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, STEIN, and PIWOWAR).

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

(...continued)
Release No. 51467, 2005 WL 742738, at *5 (Apr. 1, 2005), *aff'd*, 444 F.3d 1208 (10th Cir. 2006))).

96 "'[G]eneral deterrence is not, by itself, sufficient justification for expulsion or suspension ... [but] may be considered as part of the overall remedial inquiry.'" *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1066 (D.C. Cir. 2007) (quoting *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005)).

97 15 U.S.C. § 78y(a) (stating "[a] person aggrieved by a final order of the Commission ... may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part").

98 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75054 / May 27, 2015

Admin. Proc. File No. 3-15601

In the Matter of the Application of

MITCHELL H. FILLET
Rockville, MD

For Review of Disciplinary Action Taken by

FINRA

ORDER SUSTAINING REVIEW PROCEEDINGS IN PART, SETTING ASIDE REVIEW PROCEEDING IN PART, AND REMANDING REVIEW PROCEEDING IN PART

On the basis of the Commission's opinion issued this day, it is

ORDERED that FINRA's finding that Mitchell H. Fillet violated NASD Rules 3110 and 2110 by falsifying records and causing his Firm's records to be inaccurate and the sanctions imposed for this violation are sustained; and it is further

ORDERED that FINRA's findings that Mitchell H. Fillet's misrepresentations and failure to disclose material information violated NASD Rules 2120 and 2110, and IM-2310-2 and that Fillet's failure to disclose material information violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder are sustained; and it is further

ORDERED that FINRA's finding that Mitchell H. Fillet violated Exchange Act Rule 10b-5(b) is set aside; and it is further

ORDERED that the sanctions imposed by FINRA for the violations of NASD Rules 2120 and 2110, IM-2310-2, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder are vacated; and it is further

ORDERED that the proceeding is remanded to FINRA for reconsideration of sanctions for the violations of NASD Rules 2120 and 2110, IM-2310-2, Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder in accordance with this opinion; and it is further

ORDERED that FINRA's imposition of costs on Mitchell H. Fillet is sustained.

By the Commission.

Brent J. Fields

Secretary

By: Lynn M. Powalski
Deputy Secretary

Commissioner Aguilar
Commissioner Stein
Disapproved

DEPARTMENT OF THE TREASURY
OFFICE OF THE COMPTROLLER OF THE CURRENCY
Docket ID OCC-2013-0014

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
Docket No. OP-1465

FEDERAL DEPOSIT INSURANCE CORPORATION

NATIONAL CREDIT UNION ADMINISTRATION

BUREAU OF CONSUMER FINANCIAL PROTECTION

SECURITIES AND EXCHANGE COMMISSION
Release No. 34-75050; File No. S7-10-15

FINAL INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES

AGENCIES: Office of the Comptroller of the Currency (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); National Credit Union Administration (NCUA); Bureau of Consumer Financial Protection (CFPB); and Securities and Exchange Commission (SEC).

ACTION: Notice of final interagency policy statement; request for comments on proposed collection of information.

SUMMARY: The OCC, Board, FDIC, NCUA, CFPB, and SEC are issuing a final interagency policy statement establishing joint standards for assessing the diversity policies and practices of the entities they regulate, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

DATES: The final interagency policy statement is effective on [INSERT DATE OF PUBLICATION IN FEDERAL REGISTER]. The agencies are soliciting comments only on the collection of information. Comments must be submitted on or before [INSERT DATE 60 DAYS FROM DATE OF PUBLICATION IN THE FEDERAL REGISTER]. The effective date of the collection of information will be announced in the Federal Register following Office of Management and Budget (OMB) approval.

FOR FURTHER INFORMATION CONTACT:

OCC: Joyce Cofield, Executive Director, Office of Minority and Women Inclusion, at (202) 649-6460 or Karen McSweeney, Counsel, Law Department, at (202) 649-6295, TDD/TTY (202) 649-5597, Office of the Comptroller of the Currency, 400 7th Street, SW., Washington, DC 20219.

BOARD: Sheila Clark, Director, Office of Diversity and Inclusion, at (202) 452-2883, Katherine Wheatley, Associate General Counsel, Legal Division, at (202) 452-3779, or Alye Foster, Senior Special Counsel, Legal Division, at (202) 452-5289.

FDIC: Segundo Pereira, Director, Office of Minority and Women Inclusion, (703) 562-6090; Melodee Brooks, Senior Deputy Director, Office of Minority and Women Inclusion, (703) 562-6090; or Robert Lee, Counsel, Legal Division, (703) 562-2020, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429-0002.

NCUA: Wendy A. Angus, Acting Director, Office of Minority and Women Inclusion at (703) 518-1650, Cynthia Vaughn, Diversity Outreach Program Analyst, Office of Minority and Women Inclusion, at (703) 518-1650, or Regina Metz, Staff Attorney, Office of General

Counsel, at (703) 518-6540, National Credit Union Administration, 1775 Duke Street, Alexandria, VA 22314.

CFPB: Stuart Ishimaru, Director, Office of Minority and Women Inclusion, at (202) 435-9012, or Stephen VanMeter, Deputy General Counsel, Legal Division at (202) 435-7319, Bureau of Consumer Financial Protection, 1700 G Street, NW., Washington, DC 20552.

SEC: Pamela A. Gibbs, Director, Office of Minority and Women Inclusion, (202) 551-6046, or Audrey B. Little, Senior Counsel, Office of Minority and Women Inclusion, (202) 551-6086, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

I. Background

Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act or Act) required the OCC, Board, FDIC, NCUA, CFPB, and SEC (each, an Agency and collectively, the Agencies) to each establish an Office of Minority and Women Inclusion (OMWI) to be responsible for all matters of the Agency relating to diversity in management, employment, and business activities.[1] The Act also instructed each OMWI Director to develop standards for assessing the diversity policies and practices of entities regulated by the Agency. To facilitate the use of these standards by regulated entities that are

[1] Section 342 of the Act is codified at 12 U.S.C. 5452. The Department of Treasury, the Federal Housing Finance Agency, and the Federal Reserve Banks also have established an OMWI, but only the federal financial agencies with regulated entities have joined in issuing this Policy Statement.

subject to the regulations of more than one Agency, the Agencies worked together to develop joint standards and issue this Final Interagency Policy Statement (Policy Statement).

Prior to drafting these standards, the OMWI Directors held a series of roundtable discussions and teleconferences with representatives of a variety of regulated entities, including depository institutions, holding companies, and industry trade groups, to solicit their views on appropriate standards and to learn about the successes and challenges of existing diversity policies and programs. In addition, the OMWI Directors met with financial professionals, consumer advocates, and community representatives to gain a greater understanding of the issues confronting minorities and women in obtaining employment and business opportunities within the financial services industry. The information and feedback provided during these outreach sessions guided the development of these standards.

II. Proposed Policy Statement

On October 25, 2013, the Agencies published a Notice in the Federal Register requesting comment on a "Proposed Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies" (Proposal).[2] The comment period on the Proposal was scheduled to close on December 24, 2013, but in response to requests from members of the public, the Agencies extended it to February 7, 2014.[3]

The Proposal set out standards for assessing an entity's diversity policies and practices in the following areas: Organizational Commitment to Diversity and Inclusion; Workforce Profile

[2] 78 FR 64052.

[3] 78 FR 77792.

and Employment Practices; Procurement and Business Practices – Supplier Diversity; and Practices to Promote Transparency of Organizational Diversity and Inclusion. These proposed standards reflected the leading policies and practices for advancing workforce and supplier diversity.

The Proposal also explained the Agencies' approach to assessments, noting that the assessment envisioned by the Agencies would not be a part of the examination or supervisory process. Instead, the Proposal provided that a "model assessment" would include a self-assessment by an entity of its diversity policies and practices using the proposed standards; voluntary disclosure of the self-assessment to the appropriate Agency; and publication by the entity of its diversity efforts, in order to increase the public's awareness and understanding. The Proposal also stated that the Agencies may periodically review this public information to monitor diversity and inclusion practices and reach out to regulated entities to discuss diversity and inclusion.

In drafting the proposed standards, the Agencies recognized that each entity has unique characteristics, such as its governance structure, workforce size, total assets, contract volume, geographic location, and community characteristics. To reflect this, throughout the Proposal, the Agencies stated that the standards may be tailored and used in a manner reflective of an individual entity's size and other characteristics. In developing the Proposal, the Agencies were also mindful of section 342(b)(4) of the Act, which states that the directive to develop standards may not be construed to mandate any requirement on or otherwise affect the lending policies and practices of any regulated entity, or to require any specific action based on the findings of the assessment.

III. Comment Summary and the Agencies' Response

The Agencies collectively received more than 200 comments on the Proposal, although some commenters submitted either multiple comments or identical or substantially similar comments to multiple Agencies. The comments reflected the views of interested parties, including financial institutions, public interest organizations, trade associations and organizations, government officials, and other members of the public. In general, the commenters supported the concept of diversity and inclusion, particularly in the workforce. A number of commenters applauded the Agencies for jointly developing standards, while others commended the Proposal's flexible approach. Other commenters, however, expressed concern about the Proposal. Some urged the Agencies to withdraw the proposed standards, while others suggested specific changes to address certain issues.

The Agencies carefully considered all of these comments in formulating the final Policy Statement. The discussion below addresses significant issues that commenters raised and explains the changes to the Policy Statement.

A. General Comments

1. Legal Effect

The Agencies received several comments that interpreted the Proposal to impose new legal requirements on regulated entities or to mandate specific actions. Some commenters argued that these requirements and mandates exceeded the Agencies' statutory authority and were unlawful. For example, several commenters interpreted references to "metrics" in the Proposal to require or strongly encourage quotas in hiring and contracting. Others expressed concern that the new requirements would impose a significant compliance burden, particularly on small entities. For example, some commenters interpreted the standards to require entities to develop methods for assessing supplier diversity, and they argued that this was unduly burdensome for small entities.

Other commenters stated that the Proposal used "prescriptive" language, from which they inferred that some level of compliance with the standards would be expected from regulated entities. These commenters urged the Agencies to draft the final standards as "recommendations" and clarify that the final Policy Statement is a guidance document. Another commenter requested that the Agencies frame the final Policy Statement as a "best practices" guide with which regulated entities were not required to comply.

In contrast, some commenters stated that the inclusion of new requirements or mandates in the standards was consistent with the plain language of section 342(b)(2)(C). For example, some commenters argued that the Agencies should require the regulated entities to provide them with information about their diversity policies and practices, including assessment information. Others stated that the congressional intent of section 342 was to promote diversity and inclusion to the maximum extent possible and noted that the Proposal sets only minimum standards.

In light of these comments, it is clear that Agencies need to provide additional guidance about the intended legal effect of the final Policy Statement. To this end, the Agencies have added the following language: "This document is a general statement of policy under the Administrative Procedure Act, 5 U.S.C. 553. It does not create new legal obligations. Use of the Standards by a regulated entity is voluntary." The Agencies believe that this will clarify the confusion noted above.

2. <u>Meaning of "Diversity"</u>

Several commenters raised questions about the meaning of "diversity," which the Proposal did not define. A few commenters requested the Agencies define the term to avoid differing interpretations, with one commenter stating that the standards would not be useful in the absence of a definition. Several commenters suggested definitions, ranging from a definition limited to minorities and women to an expanded definition that would include individuals with disabilities, veterans, and lesbian/gay/bisexual/transgender (LGBT) individuals. Another commenter recommended also defining "inclusion," to make clear that the goal of diversity is not met by simply hiring a diverse group.

The Agencies agree that the term "diversity" should be defined. They also believe it should both reflect the general focus in section 342 on minorities and women and provide flexibility to regulated entities that define the term more broadly. Accordingly, the final Policy Statement provides that "diversity" refers to "minorities ... and women." For purposes of this definition, "minority" is defined as Black Americans, Native Americans, Hispanic Americans, and Asian Americans, which is consistent with the definition of "minority" in section 342(g)(3) of the Act.

The final Policy Statement also states that this definition of diversity "does not preclude an entity from using a broader definition with regard to these standards." This language is intended to be sufficiently flexible to encompass other groups if an entity wants to define the term more broadly. For example, a broader definition may include the categories referenced by the Equal Employment Opportunity Commission (EEOC) in its Employer Information Report EEO-1 (EEO-1 Report),[4] as well as individuals with disabilities, veterans, and LGBT individuals.

[4] Private employers with 100 or more employees and federal contractors and first-tier subcontractors with 50 or more employees that have a contract or subcontract of $50,000 or more, or serve as depository of Government funds in any amount, are required by Title VII of the Civil Rights Act of 1964 to collect data on employment diversity and file an EEO-1 Report with the EEOC.

The Agencies also agree that the concept of inclusion is important to include in these standards because current leading practices advocate an inclusive culture as essential in the support of diversity and inclusion programs. Therefore, the final Policy Statement defines "inclusion" to mean a process to create and maintain a positive work environment that values individual similarities and differences, so that all can reach their potential and maximize their contributions to an organization."

3. Applicability to Small Entities

Although the Proposal encouraged the use of the standards "in a manner reflective of the individual entity's size and other characteristics," the Agencies received questions and comments about how the standards apply or are relevant to small entities. Some commenters stated that the Proposal offered a "one-size fits all approach" and should be replaced with standards that reflect the unique structure of small entities. Another commenter noted that many small regulated entities do not have boards of directors, Web sites, or other attributes referenced in the Proposal. According to this commenter, even with the Proposal's caveat that the standards may be tailored for small entities, these organizations would be at a disadvantage when measuring their policies and practices in light of the proposed standards. Others suggested that the Policy Statement expressly carve out entities below a certain size, such as those with fewer than 100 employees or those that do not file EEO-1 Reports.

These comments demonstrate that the Agencies need to clarify how the standards are relevant to and may be used by small entities. Therefore, the final Policy Statement states, "The

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The EEO-1 Report defines race and ethnicity categories as Hispanic or Latino; White (Not Hispanic or Latino); Black or African American (Not Hispanic or Latino); Native Hawaiian or Other Pacific Islander (Not Hispanic or Latino); Asian (Not Hispanic or Latino); American Indian or Alaska Native (Not Hispanic or Latino); and Two or More Races (Not Hispanic or Latino). http://www.eeoc.gov/employers/eeo1survey/2007instructions.cfm.

Agencies recognize that each entity is unique with respect to characteristics such as its size, location, and structure. When drafting these standards, the Agencies focused primarily on institutions with more than 100 employees. The Agencies know that institutions that are small or located in remote areas face different challenges and have different options available to them compared to entities that are larger or located in more urban areas. The Agencies encourage each entity to use these standards in a manner appropriate to its unique characteristics."

4. Extraterritorial Application

A few commenters requested that the Agencies clarify whether the standards apply to a regulated entity's foreign operations. These commenters observed that many regulated entities operate internationally and that the concept of diversity varies from country to country. They advocated that regulated entities be allowed the flexibility to include or exclude foreign operations when conducting an assessment. In response, the final Policy Statement clarifies that the final standards address an entity's U.S. operations. This does not, however, preclude a multinational entity from also using these standards to undertake a broader assessment of its organization.

B. Comments on the Joint Standards

1. Organizational Commitment to Diversity and Inclusion

The first set of standards in the Proposal addressed the role and importance of an entity's senior leadership in promoting diversity and inclusion across an organization. These standards described the policies and practices that demonstrate the commitment of an entity's senior leadership to diversity and inclusion in both employment and contracting, as well as to fostering a corporate culture that embraces diversity and inclusion.

Commenters were generally supportive of including standards to assess an organization's commitment, with several referencing the importance of diversity and inclusion in their own organizations. Some commenters noted that an organization's commitment to diversity and inclusion can provide a competitive advantage. Another stated that, while an institution's commitment to diversity is important, each regulated entity should be allowed to demonstrate this commitment in its own way and cautioned against assuming that extensive and formalized policies demonstrate an organization's commitment to diversity. This commenter noted, as an example, that it would be more appropriate for community banks to apply their efforts to community outreach rather than to creating documentation to show compliance.

Several commenters recommended changes to these standards. One commenter suggested adding language stating that diversity and inclusion are best served when an entity assigns senior leadership to these initiatives and provides this leadership with the appropriate resources. Another commenter suggested that the standards specify the appropriate credentials for the personnel responsible for an entity's diversity efforts, such as experience, a proven track record, and the ability to help others understand and embrace diversity efforts.

The Agencies are encouraged that the commenters generally acknowledge how essential organizational commitment is to advancing diversity and inclusion. The Agencies also agree that the senior official responsible for an entity's diversity and inclusion efforts preferably should have relevant knowledge and experience, and they have revised this standard to reflect this change. Otherwise, the final standards on Organizational Commitment to Diversity and Inclusion are consistent with the Proposal.

2. <u>Workforce Profile and Employment Practices</u>

The Proposal provided examples of how an entity could promote the fair inclusion of minorities and women in its workforce and noted that many entities evaluate their business objectives using analytical tools to track and measure workforce inclusiveness. It set out standards to assess an entity's workforce profile and employment practices, which included using the data prepared in connection with EEO-1 Reports and Affirmative Action Plans (AAPs),[5] as well as other metrics. The standards also addressed whether an entity holds its management accountable for these efforts and creates diverse applicant pools for workforce opportunities when hiring from both within and outside of an organization.

Several commenters expressed concern about using the EEO-1 Report data for this purpose, pointing out that it provides a purely numerical view of workforce diversity and gives little insight into the impact of diversity efforts. One commenter suggested that EEO-1 Report data should constitute, at most, a small element of a more holistic view of an entity's diversity practices. This commenter recommended that the Agencies revise the standards to focus on an entity's diversity efforts and to take into account: industry-specific considerations; the relevant labor market; and ongoing efforts to facilitate, promote and increase diversity. Other commenters observed that EEO-1 Report data does not address concepts of diversity that are broader than gender, race, and ethnicity or the extent of diversity within an entity's management and senior management ranks.

Still other commenters were concerned that references in the Proposal to "metrics," as a tool for evaluating and assessing workforce diversity and inclusion efforts, could be interpreted to encourage or require the unlawful use of quotas, classifications, or preferences. These commenters recommended that the Agencies revise the standards to clarify that the purpose of

[5] AAPs are required of certain government contractors and monitored by the Office of Federal Contract Compliance Programs.

metrics is not to force certain outcomes and that the standards are not intended to encourage or require an entity to undertake an assessment based on numerical goals, metrics, or percentages.

Commenters also addressed the specific standard that would hold an entity's management accountable for diversity and inclusion efforts. One commenter stated that it is not clear who this standard is intended to cover and what constitutes accountability. Another commenter argued that this standard is overbroad and implies that regulated entities are required to include diversity and inclusion measurements in the performance evaluations of all management personnel. This commenter also expressed concern that this requirement could lead to unlawful employment decisions focused on achieving quotas and suggested that only the senior-level official(s) responsible for overseeing and directing diversity efforts, not all management personnel, should be held accountable. Another group of commenters observed, however, that accountability may be achieved most effectively by linking an entity's diversity and inclusion efforts to its leaders' performance assessments and compensation.

In the final Policy Statement, the Agencies have retained the reference to EEO-1 Report and AAP data. The Agencies recognize that the information generated from these sources is limited, particularly for entities with large workforces and those that broadly define diversity. However, this information may provide a baseline that a company may find useful. To address commenters who expressed concern that the data coming from these particular sources is limited or narrow, the Agencies have added a statement to encourage entities to use other analytical tools that they may find helpful. Finally, due to a change in how the Agencies organized the final standards, the discussion about EEO-1 data, AAP data, and other analytical tools is located in the introduction to this set of standards and not in the standards themselves.

With respect to references to "metrics," the Agencies continue to believe that quantitative data is valuable for evaluating diversity and inclusion but know that qualitative data and information also can provide useful material for this purpose. In order to clarify that both types of resources are important, the Agencies have revised the final standards to reflect the importance of both quantitative and qualitative measurements.

With respect to the concern expressed by some commenters that the proposed standards could be interpreted to encourage or require the unlawful use of quotas, classifications, or preferences for personnel actions, the Agencies note that they did not intend to require or encourage unlawful usage. That said, the collection and use of data on race, gender, and ethnicity for self-evaluation is not unlawful. To address this confusion, however, the Agencies added to the Policy Statement a new standard providing that the "entity implements policies and practices related to workforce diversity and inclusion in a manner that complies with all applicable laws." The final Policy Statement also includes another new standard, which provides that the "entity ensures equal employment opportunities for all employees and applicants for employment and does not engage in unlawful employment discrimination based on gender, race, or ethnicity." The Agencies believe that together, these new standards will address confusion about whether the standards encourage or require the unlawful use of quotas, classifications, or preferences.

Finally, the Agencies retained the proposed standard that referenced management accountability but have clarified that this standard applies to all levels of management. The Agencies believe that management accountability at all levels is an important factor to consider when evaluating workforce diversity and employment practices. In addition, the final standards provide an example of one manner of addressing management accountability for diversity and inclusion efforts.

3. Procurement and Business Practices – Supplier Diversity

The third set of standards included in the Proposal addressed the leading practices related to supplier diversity. These included a supplier diversity policy that provides a fair opportunity for minority-owned and women-owned businesses to compete for procurement of business goods and services; methods to evaluate and assess supplier diversity (which may include metrics and analytics); and practices that promote a diverse supplier pool.

The Agencies received many comments on this set of standards. Several commenters argued that the scope of 342(b)(2)(C) is limited to diversity in employment practices and, therefore, the Agencies exceeded their statutory authority by proposing supplier diversity standards. Others argued that these standards would unlawfully compel the use of private funds to promote diversity. Another group of commenters supported these standards and noted that entities with a commitment to diversity and inclusion often have supplier diversity programs. These commenters stated that supplier diversity can contribute to an entity's efficiency and innovation, reflect its customer base, promote growth and development, and support job creation and economic development. Additional commenters urged the Agencies to include stronger or additional standards on this topic. For example, some encouraged the Agencies to set targets for the percentage of an entity's procurement dollars that should be spent with diverse vendors and to establish other quantifiable measures to ensure the full and fair inclusion of diverse suppliers.

After careful consideration of these comments, the Agencies have elected not to make any substantive changes to the standards for policies and practices related to supplier diversity. The Agencies believe that consideration of an entity's supplier diversity policies and practices is within the scope of section 342(b)(2)(C) and is appropriate for a comprehensive self-assessment. The Agencies do not believe, however, that it is appropriate for them to dictate quantifiable targets for supplier diversity and have not included targets in the final Policy Statement.

4. <u>Practices to Promote Transparency</u>

As explained in the Proposal, transparency of an entity's diversity and inclusion program promotes the objectives of section 342. Transparency and publicity are important because they give members of the public information to assess an entity's diversity policies and practices. Accordingly, the Proposal included standards setting out the leading practices in this area, which include the entity making information about its diversity and inclusion strategic plans, commitment, and progress available to the public.

Several commenters supported the goal of transparency, arguing that it is critical to the fair and efficient manner in which our financial markets operate. They also believe that transparency provides valuable information to an entity's management, employees, prospective employees, customers, and investors, as well as to the general public. In contrast, other commenters expressed concern that these standards would be interpreted to encourage or require the release of proprietary, privileged or confidential information and compromise an entity's competitive position. This concern, they argued, would create a disincentive for an entity to conduct a self-assessment. Another commenter argued that these standards are unnecessary because regulated entities can achieve diversity and inclusion without disclosing this information, while others noted that many entities already publish information about their diversity and inclusion efforts.

The Agencies believe that the goals of section 342 can be best achieved when an entity is transparent with respect to its diversity and inclusion efforts and progress. They believe that the proposed standards accomplished this goal in the appropriate manner and have included them in the final Policy Statement with no material changes.

5. Entities' Self-Assessment

The Proposal included a section entitled "Proposed Approach to Assessment," in which the Agencies explained that in a "model assessment," a regulated entity would use the standards to undertake a self-assessment, disclose the self-assessment and other relevant information to the appropriate Agency, and share with the public its efforts to comply with the standards. The Agencies received many comments on this section.

a. Implementation Comments

A number of commenters requested more information on the frequency of self-assessments. To address this, the final Policy Statement provides that an entity with successful diversity policies and practices conducts a self-assessment annually and monitors and evaluates its performance under its diversity policies and practices on an ongoing basis. An annual review and ongoing monitoring are consistent with both leading practices and other types of business assessments.

Other commenters asked for clarification on where a regulated entity should submit its assessment data and recommended that the Agencies designate a "lead" agency for this purpose. In the final Policy Statement, the Agencies clarify that entities that choose to share their self-assessment information with their regulator may provide it to the OMWI Director of the entity's primary federal financial regulator.[6] The primary federal financial regulator will share

[6] In the case of institutions identified in 12 U.S.C. 1813(q), the primary federal financial regulator is the 'appropriate federal banking agency' identified in that section. For credit unions, the primary federal financial regulator is the NCUA. For brokers, dealers, transfer agents, investment advisers, municipal advisors, investment companies, self-regulatory organizations (including national securities exchanges, registered securities associations, registered clearing agencies, and the Municipal Securities Rulemaking Board), nationally recognized statistical rating

information with other Agencies when appropriate to support coordination of efforts and to avoid duplication.

Finally, to assist entities in viewing the final Policy Statement as an integrated whole, the model assessment concepts introduced in this section of the Proposal are now a fifth set of standards entitled "Entities' Self-Assessment."

b. Self-Assessments

The Agencies received many comments on the Proposal's description of a model assessment as a "self-assessment." Some commenters viewed a self-assessment as a reasonable interpretation of statutory intent, while others asserted that it was the only permissible interpretation. Others expressed concern with the concept of an entity conducting its own assessment and questioned whether this approach either would undermine regulatory oversight or was inconsistent with the statute. Some commenters suggested that the Agencies were required by statute to conduct the assessments.

In the final Policy Statement, the Agencies have retained the self-assessment approach to assessments. While it is clear to the Agencies that the statute contemplates that assessments will take place, they interpret the statutory language as ambiguous with respect to who should conduct the assessments or the form that assessments should take. The Agencies also believe that the entities are in the best position to assess their own diversity policies and practices and that these self-assessments can provide entities with an opportunity to focus on areas of strength and weakness in their own policies and programs.

c. Disclosure of Assessment Information to the Agencies

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organizations, securities information processors, security-based swap dealers, major security-based swap participants, security-based swap execution facilities, and securities-based swap data repositories, the primary federal financial regulator is the SEC. For any other entity that meets the definition of 'covered person' under 12 U.S.C. 5481(6), the primary federal financial regulator is the CFPB.

The Agencies received many comments about the Proposal's "disclosure" component of a model assessment. Some commenters argued that by encouraging disclosure, the Agencies would discourage candid self-assessments. Another group of commenters was concerned about protecting the confidentiality of disclosed information and recommended including a safe harbor in the final standards to protect the disclosed information from release.

Other commenters interpreted the statute to mandate disclosure and rejected the idea of a voluntary disclosure. One of these commenters argued that "voluntary disclosure" conflicted with congressional intent, as evidenced by the section 342(b)(4) statement that nothing in the directive to develop standards may be construed to require any specific action based on the findings of the assessment. This commenter argued that the phrase "findings of the assessment" in the statutory language indicates that the Agencies will obtain assessment information from the regulated entities and, therefore, the disclosure cannot be voluntary.

One commenter expressed concern that the permissiveness of voluntary disclosures would invite the regulated entities to disregard the Agencies and treat their oversight as optional and irrelevant. This commenter expressed concern that very few regulated entities would share their assessment information with the Agencies unless they were required to do so. Another commenter noted that financial institutions have been required to disclose information on lending practices, including lending by ethnic group, since 1975 pursuant to the Home Mortgage Disclosure Act and that this requirement has provided transparency without endangering the institutions.

With respect to the final Policy Statement, the Agencies view a voluntary scheme as more consistent with the framework set out by the statute, and therefore, the final Policy Statement provides for voluntary disclosure. Nevertheless, the final Policy Statement reflects leading practices with respect to transparency by encouraging the entities to disclose assessment information to the Agencies. Entities submitting information may designate such information as confidential commercial information as appropriate, and the Agencies will follow the Freedom of Information Act in the event of requests for particular submissions.

d. Entities' Disclosure of Assessment Information to the Public

Finally, the Agencies received comments about the Proposal's provision encouraging entities to disclose to the public information about their efforts to comply with the standards. Some commenters supported this public disclosure, asserting that it was necessary to increase public accountability. Others argued that an entity that elects to publish information about its diversity progress may not undertake an honest self-assessment of this progress. Other commenters stated that public disclosures which focus on metrics may have the unintended consequence of encouraging numerical targets, rather than diversity and inclusion. These commenters also stated that publicly disclosing certain information could expose an entity to potential liability or reveal trade secrets.

In the final Policy Statement, the Agencies have retained the concept of an entity publicly displaying information regarding its efforts with respect to the standards. As noted above, disclosure reflects leading practices with respect to transparency. In addition, the final Policy Statement, consistent with the Proposal, also does not specify the types of information that regulated entities might consider making publicly available. The Agencies believe the regulated entities should have discretion to decide the type of information and the level of detail to share publicly.

6. Use of Assessment Information by Agencies

In describing the model assessment, the Proposal stated that the Agencies would monitor the information submitted to them as a resource in carrying out their diversity and inclusion responsibilities. It also stated that the Agencies may periodically review entities' public information to monitor diversity and inclusion practices. The Agencies may contact entities and other interested parties to discuss diversity and inclusion practices and methods of assessment. The Agencies did not receive any specific or material comments on these statements.

In the final Policy Statement, these concepts are retained. The final Policy Statement states that the Agencies may publish information disclosed to them provided they do not identify a particular entity or individual or disclose confidential business information in an effort to balance concerns about confidentiality of information with the importance of sharing information.

Paperwork Reduction Act of 1995

The Paperwork Reduction Act of 1995 (PRA)[7] generally provides that a federal agency may not conduct or sponsor a collection of information unless the Office of Management and Budget (OMB) has approved the collection and the agency has obtained a valid OMB control number. Furthermore, no person may be subject to a collection of information unless the collection displays a valid OMB control number. These provisions apply to any collection of information, regardless of whether the responses to the collection are voluntary or mandatory.

PRA requires an agency to provide the public and other agencies with an opportunity to comment on any proposed information collection. This helps to ensure that: the public understands the agency's collection and instructions; respondents provide the requested data in the desired format; reporting burden (time and financial resources) is minimized; interested

[7] 44 U.S.C. 3501 *et seq.*

parties understand the collection instruments; and the agency can properly assess the impact of its information collection on respondents.

This Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies contains a collection of information within the meaning of the PRA. The Agencies intend to submit this new collection of information to OMB for review and approval in accordance with the PRA and its implementing regulations. For collections of information not contained in a proposed rule, the PRA requires federal agencies to publish a notice in the Federal Register concerning each proposed collection of information and to allow 60 days for public comment. To comply with this requirement, the Agencies are publishing this notice in conjunction with the issuance of this final Policy Statement.

A. Overview of the Collection of Information

1. Description of the Collection of Information and Proposed Use

The title for the proposed collection of information is:

- Joint Standards for Assessing Diversity Policies and Practices

The Joint Standards entitled "Practices to Promote Transparency of Organizational Diversity and Inclusion" contemplate that the regulated entity is transparent about its diversity and inclusion activities by making certain information available to the public annually on its Web site or in other appropriate communications, in a manner reflective of the entity's size and other characteristics. The information noted in this standard is: the entity's diversity and inclusion strategic plan; its policy on its commitment to diversity and inclusion; progress toward achieving diversity and inclusion in its workforce and procurement activities (which may include the entity's current workforce and supplier demographic profiles); and employment and procurement opportunities available at the entity that promote diversity.

In addition, the Joint Standards entitled "Self-Assessment" envision that the regulated entity uses the Joint Standards to conduct a voluntary self-assessment of its diversity policies and practices at least annually, provides to its primary federal financial regulator information pertaining to the entity's self-assessment of diversity policies and practices, and publishes information pertaining to its efforts with respect to the standards. The information provided to the Agencies would be used to monitor progress and trends among regulated entities with regard to diversity and inclusion in employment and contracting activities, and to identify and publicize promising diversity policies and practices.

2. Description of Likely Respondents and Estimate of Annual Burden

The collections of information contemplated by the Joint Standards would impose no new recordkeeping burdens as regulated entities would only publish or provide information pertaining to diversity policies and practices that they maintain during the normal course of business. The Agencies estimate that it would take a regulated entity approximately 12 burden hours on average to annually publish information pertaining to diversity policies and practices on the entity's Web site or in other appropriate communications, and retrieve and submit information pertaining to the entity's self-assessment of its diversity policies and practices to the primary federal financial regulator. The Agencies estimate the total burden for all regulated entities as follows:

<u>Information Collection</u>: Joint Standards for Assessing Diversity Policies and Practices

Estimated Number of Respondents:[8]

OCC: 215.

Board: 488.

FDIC: 398.

NCUA: 367.

CFPB: 750.

SEC: 1,250.

Frequency of Collection: Annual.

Average Response Time per Respondent: 12 hours.

Estimated Total Annual Burden Hours:

OCC: 2,580 hours.

Board: 5,856 hours.

FDIC: 4,776 hours.

NCUA: 4,404 hours.

CFPB: 9,000 hours.

SEC: 15,000 hours.

Obligation to respond: Voluntary

B. Solicitation of Public Comments

The Agencies specifically invite comment on: (a) Whether the collections of information are necessary for the proper performance of the Agencies' functions, including whether the information will have practical utility; (b) The accuracy of the Agencies'

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[8] The burden estimates are based on the average number of responses anticipated by each Agency.

estimate of the information collection burden, including the validity of the methods and the assumptions used; (c) Ways to enhance the quality, utility, and clarity of the information proposed to be collected; (d) Ways to minimize the information collection burden on respondents, including through the use of automated collection techniques or other forms of information technology; and (e) Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The Agencies will summarize the comments submitted in response to this notice and/or include them in the request for OMB approval. All comments will be a matter of public record.

Commenters may submit their comments to the Agencies at:

OCC: Because paper mail in the Washington, DC area and at the OCC is subject to delay, commenters are encouraged to submit comments by e-mail, if possible. Comments may be sent to: Legislative and Regulatory Activities Division, Office of the Comptroller of the Currency, Attention: 1557-NEW, 400 7th Street, SW., Suite 3E-218, Mail Stop 9W-11, Washington, DC 20219. In addition, comments may be sent by fax to (571) 465-4326 or by electronic mail to regs.comments@occ.treas.gov. You may personally inspect and photocopy comments at the OCC, 400 7th Street, SW., Washington, DC 20219. For security reasons, the OCC requires that visitors make an appointment to inspect comments. You may do so by calling (202) 649-6700. Upon arrival, visitors will be required to present valid government-issued photo identification and to submit to security screening in order to inspect and photocopy comments.

Board: You may submit comments, identified by OMWI Policy Statement, by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/apps/foia/proposedregs.aspx.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.

- E-mail: regs.comments@federalreserve.gov. Include OMB number in the subject line of the message.
- FAX: (202) 452-3819 or (202) 452-3102.
- Mail: Robert deV. Frierson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, N.W., Washington, DC 20551.

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

FDIC: You may submit comments on this information collection, which should refer to "Policy Statement Establishing Joint Standards for Assessing the Diversity," by any of the following methods:

Agency Web Site: http://www.fdic.gov/regulations/laws/federal/. Follow the instructions for submitting comments on the FDIC Web site.

Email: comments@FDIC.gov. Include "Policy Statement Establishing Joint Standards for Assessing the Diversity" in the subject line of the message.

Mail: Gary A. Kuiper, Counsel, MB-3074, or John Popeo, Counsel, MB-3007, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

NCUA: Interested persons are invited to submit written comments on the information collection to Jessica Khouri, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428, Fax No. 703-837-2861, E-mail: OCIOPRA@ncua.gov.

CFPB: You may submit comments, identified by the title of the information collection, OMB Control Number (see below), and docket number (see above), by any of the following methods:

- Electronic: http://www.regulations.gov. Follow the instructions for submitting comments.
- Mail: Consumer Financial Protection Bureau (Attention: PRA Office), 1700 G Street, NW, Washington, DC 20552.
- Hand Delivery/Courier: Consumer Financial Protection Bureau (Attention: PRA Office), 1275 First Street, NE, Washington, DC 20002.

SEC: Please direct your written comments to Pamela Dyson, Chief Information Officer, Securities and Exchange Commission, c/o Remi Pavlik-Simon, 100 F Street NE., Washington, DC 20549, or send an email to PRA_Mailbox@sec.gov, and include "SEC File 270-664 OMWI Policy Statement" in the subject line of the message.

Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies and Practices of Entities Regulated by the Agencies

I. Introduction

Section 342(b)(2)(C) of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) requires the Directors of the Offices of Minority and Women Inclusion (OMWI) to develop standards for assessing the diversity policies and practices of the entities regulated by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Bureau of Consumer Financial Protection, and Securities and Exchange Commission (Agencies).

To promote consistency, the Agencies worked together to develop joint standards (Standards) for assessing diversity policies and practices. This Interagency Policy Statement (Policy Statement) announces those Standards.

This document is a general statement of policy under the Administrative Procedure Act, 5 U.S.C. 553. It does not create new legal obligations. Use of the Standards by a regulated entity is voluntary. The Agencies will not use their examination or supervisory processes in connection with these Standards.

For purposes of this Policy Statement, the Agencies define "diversity" to refer to minorities, as defined in section 342(g)(3) of the Dodd-Frank Act (that is, Black Americans, Native Americans, Hispanic Americans, and Asian Americans), and women. This definition of diversity does not preclude an entity from using a broader definition with regard to these standards. In addition, as used in this Policy Statement, the Agencies define "inclusion" to mean a process to create and maintain a positive work environment that values individual similarities and differences, so that all can reach their potential and maximize their contributions to an organization. The Standards set forth below may be used to assess policies and practices that impact the inclusion of minorities and women in the regulated entity's workforce and the existence of minority-owned and women-owned businesses among a regulated entity's suppliers of products and services.

II. Joint Standards

The Agencies designed these Standards to provide a framework for an entity to create and strengthen its diversity policies and practices, including its organizational commitment to diversity, workforce and employment practices, procurement and business practices, and practices to promote transparency of organizational diversity and inclusion. The Agencies recognize that each entity is unique with respect to characteristics such as its size, location, and structure. When drafting these standards, the Agencies focused primarily on institutions with more than 100 employees. The Agencies know that institutions that are small or located in remote areas face different challenges and have different options available to them compared to entities that are larger or located in more urban areas. The Agencies encourage each entity to use these Standards in a manner appropriate to its unique characteristics. Finally, the Agencies intend that the Standards will address an entity's U.S. operations.

(1) Organizational Commitment to Diversity and Inclusion

The leadership of an organization with successful diversity policies and practices demonstrates its commitment to diversity and inclusion. Leadership comes from the governing body, such as a board of directors, as well as senior officials and those managing the organization on a day-to-day basis. These Standards inform how an entity promotes diversity and inclusion in both employment and contracting and how it fosters a corporate culture that embraces diversity and inclusion.

Standards

In a manner reflective of the individual entity's size and other characteristics,

- The entity includes diversity and inclusion considerations in both employment and contracting as an important part of its strategic plan for recruiting, hiring, retention, and promotion.

- The entity has a diversity and inclusion policy that is approved and supported by senior leadership, including senior management and the board of directors.
- The entity provides regular progress reports to the board and senior management.
- The entity regularly conducts training and provides educational opportunities on equal employment opportunity and on diversity and inclusion.
- The entity has a senior level official, preferably with knowledge of and experience in diversity and inclusion policies and practices, who oversees and directs the entity's diversity and inclusion efforts. For example, this official may be an executive-level Diversity Officer (or equivalent position) with dedicated resources to support diversity strategies and initiatives.
- The entity takes proactive steps to promote a diverse pool of candidates, including women and minorities, in its hiring, recruiting, retention, and promotion, as well as in its selection of board members, senior management, and other senior leadership positions.

(2) Workforce Profile and Employment Practices

Many entities promote the fair inclusion of minorities and women in their workforce by publicizing employment opportunities, creating relationships with minority and women professional organizations and educational institutions, creating a culture that values the contribution of all employees, and encouraging a focus on these objectives when evaluating the performance of managers. Entities with successful diversity and inclusion programs also regularly evaluate their programs and identify areas to be improved.

Entities use various analytical tools to evaluate a wide range of business objectives, including metrics to track and measure the inclusiveness of their workforce (e.g., race, ethnicity, and gender). Entities that are subject to the recordkeeping and reporting requirements of the Equal Employment Opportunity Commission (EEOC) and the Office of Federal Contract Compliance Programs currently collect and maintain data and supporting documentation that may assist in evaluating and assessing their policies and practices related to workforce diversity and inclusion. Specifically, entities that file EEO-1 Reports[9] required under Title VII of the Civil Rights Act of 1964 routinely track and analyze employment statistics by gender, race, ethnicity, and occupational group. Entities that develop and implement the affirmative action programs required under the regulations implementing Executive Order 11246 track and analyze employer-created job groups. Entities also are encouraged to use other analytical tools that they may find helpful.

Standards

In a manner reflective of the individual entity's size and other characteristics,

- The entity implements policies and practices related to workforce diversity and inclusion in a manner that complies with all applicable laws.
- The entity ensures equal employment opportunities for all employees and applicants for employment and does not engage in unlawful employment discrimination based on gender, race, or ethnicity.
- The entity has policies and practices that create diverse applicant pools for both internal and external opportunities that may include:
    - Outreach to minority and women organizations;

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[9] The Employer Information Report EEO-1 (EEO-1 Report) is required to be filed annually with the EEOC by (a) private employers with 100 or more employees and (b) federal contractors and first tier subcontractors with 50 or more employees that have a contract or subcontract of $50,000 or more or that serve as a depository of government funds in any amount.

    - Outreach to educational institutions serving significant minority and women student populations; and
    - Participation in conferences, workshops, and other events to attract minorities and women and to inform them of employment and promotion opportunities.

- The entity utilizes both quantitative and qualitative measurements to assess its workforce diversity and inclusion efforts. These efforts may be reflected, for example, in applicant tracking, hiring, promotions, separations (voluntary and involuntary), career development, and retention across all levels and occupations of the entity, including the executive and managerial ranks.
- The entity holds management at all levels accountable for diversity and inclusion efforts, for example by ensuring that such efforts align with business strategies and individual performance plans.

(3) Procurement and Business Practices—Supplier Diversity

Companies increasingly understand the competitive advantage of having a broad selection of available suppliers to choose from with respect to factors such as price, quality, attention to detail, and future relationship building. A number of entities have achieved success at expanding available business options by increasing outreach to minority-owned and women-owned businesses.

As in the employment context, entities often use metrics to identify the baseline of how much they spend procuring and contracting for goods and services, how much they spend with minority-owned and women-owned businesses, and the availability of relevant minority-owned and women-owned businesses, as well as changes over time. Similarly, entities may use outreach to inform minority-owned and women-owned businesses (and affinity groups representing these constituencies) of these opportunities and of the procurement process.

In addition, entities' prime contractors often use subcontractors to fulfill the obligations of various contracts. The use of minority-owned and women-owned businesses as subcontractors provides valuable opportunities for both the minority-owned and women-owned businesses and the prime contractor. Entities may encourage the use of minority-owned and women-owned subcontractors by incorporating this objective in their business contracts.

Standards

In a manner reflective of the individual entity's size and other characteristics,

- The entity has a supplier diversity policy that provides for a fair opportunity for minority-owned and women-owned businesses to compete for procurement of business goods and services. This includes contracts of all types, including contracts for the issuance or guarantee of any debt, equity, or security, the sale of assets, the management of the entity's assets, and the development of the entity's equity investments.
- The entity has methods to evaluate its supplier diversity, which may include metrics and analytics related to:
    - Annual procurement spending;
    - Percentage of contract dollars awarded to minority-owned and women-owned business contractors by race, ethnicity, and gender; and
    - Percentage of contracts with minority-owned and women-owned business sub-contractors.
- The entity has practices to promote a diverse supplier pool, which may include:

- Outreach to minority-owned and women-owned contractors and representative organizations;
- Participation in conferences, workshops, and other events to attract minority-owned and women-owned firms and inform them of contracting opportunities; and
- An ongoing process to publicize its procurement opportunities.

(4) Practices to Promote Transparency of Organizational Diversity and Inclusion

Transparency and publicity are important aspects of assessing diversity policies and practices. Greater awareness and transparency give the public information to assess those policies and practices. Entities publicize information about their diversity and inclusion efforts through normal business methods, which include displaying information on their Web sites, in their promotional materials, and in their annual reports to shareholders, if applicable. By making public an entity's commitment to diversity and inclusion, its plans for achieving diversity and inclusion, and the metrics it uses to measure success in both workplace and supplier diversity, an entity informs a broad constituency of investors, employees, potential employees, suppliers, customers, and the general community about its efforts. The publication of this information can make new markets accessible for minorities and women and illustrate the progress made toward an important business goal.

Standards

In a manner reflective of the individual entity's size and other characteristics, the entity is transparent with respect to its diversity and inclusion activities by making the following information available to the public annually through its Web site or other appropriate communication methods:

- The entity's diversity and inclusion strategic plan;
- The entity's policy on its commitment to diversity and inclusion;
- The entity's progress toward achieving diversity and inclusion in its workforce and procurement activities (which may include the entity's current workforce and supplier demographic profiles); and
- Opportunities available at the entity that promote diversity, which may include:
    - Current employment and procurement opportunities;
    - Forecasts of potential employment and procurement opportunities; and
    - The availability and use of mentorship and developmental programs for employees and contractors.

(5) Entities' Self-Assessment

The Agencies interpret the term "assessment" to mean self-assessment. Entities that have successful diversity policies and practices allocate time and resources to monitoring and evaluating performance under their diversity policies and practices on an ongoing basis. Entities are encouraged to disclose their diversity policies and practices, as well as information related to their assessments, to the Agencies and the public. Entities submitting information may designate such information as confidential commercial information as appropriate, and the Agencies will follow the Freedom of Information Act in the event of requests for particular submissions.

Standards

In a manner reflective of the individual entity's size and other characteristics,

- The entity uses the Standards to conduct self-assessments of its diversity policies and practices annually.
- The entity monitors and evaluates its performance under its diversity policies and practices on an ongoing basis.
- The entity provides information pertaining to the self-assessments of its diversity policies and practices to the OMWI Director of its primary federal financial regulator.
- The entity publishes information pertaining to its efforts with respect to the Standards.

III. Use of Assessment Information by Agencies

The Agencies may use information submitted to them to monitor progress and trends in the financial services industry with regard to diversity and inclusion in employment and contracting activities and to identify and highlight those policies and practices that have been successful. The primary federal financial regulator will share information with other agencies when appropriate to support coordination of efforts and to avoid duplication. The OMWI Directors will also continue to reach out to regulated entities and other interested parties to discuss diversity and inclusion practices and methods of assessment. The Agencies may publish information disclosed to them, such as best practices, in any form that does not identify a particular entity or individual or disclose confidential business information.

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "FINAL INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES"]

Dated: May 22, 2015

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Thomas J. Curry
Comptroller of the Currency

BILLING CODE: OCC4810-33-P

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "FINAL INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES"]

By order of the Board of Governors of the Federal Reserve System, June 3, 2015.

Margaret McCloskey
Shanks,
Deputy Secretary of the
Board.

BILLING CODE: FRB 6210-01-P

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "FINAL INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES"]

Dated at Washington, D.C., this 21st of May, 2015.
Federal Deposit Insurance Corporation.

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Robert E. Feldman,
Executive Secretary.

BILLING CODE: FDIC 6741-01-P

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "FINAL INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES"]

By the National Credit Union Administration Board on May 26, 2015.

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John H. Brolin
Senior Staff Attorney

BILLING CODE: NCUA 7590-01 P

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "FINAL INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES"]

Dated: May 18, 2015.

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Richard Cordray,
Director, Bureau of Consumer Financial Protection.

BILLING CODE: CFPB 4810-AMP

[THIS SIGNATURE PAGE RELATES TO THE JOINT NOTICE ENTITLED "FINAL INTERAGENCY POLICY STATEMENT ESTABLISHING JOINT STANDARDS FOR ASSESSING THE DIVERSITY POLICIES AND PRACTICES OF ENTITIES REGULATED BY THE AGENCIES"]

By the Securities and Exchange Commission.

Brent J. Fields
Secretary.

Date: May 27, 2015

BILLING CODE: SEC 8010-01-C

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75055 / May 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16559

In the Matter of **America West Resources, Inc., Sonoma Valley Bancorp, and WorldStar Energy, Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents America West Resources, Inc., Sonoma Valley Bancorp, and WorldStar Energy, Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. America West Resources, Inc. (CIK No. 867687) is a Nevada corporation located in Salt Lake City, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). America West Resources is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2012, which reported a net loss of $16,859,828 for the prior six months. As of May 18, 2015, the company's stock (symbol "AWSRQ") was quoted on OTC Link (previously, "Pink Sheets") operated by OTC Markets Group, Inc. ("OTC Link"), had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Sonoma Valley Bancorp (CIK No. 1120427) is a California corporation located in Sonoma, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Sonoma Valley Bancorp 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, 2010, which reported a net loss of $721,361 for the prior six months. As of May 18, 2015, the company's stock (symbol "SBNK") was quoted on OTC Link, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

3. WorldStar Energy, Corp. (CIK No. 1093677) is a revoked Nevada corporation located in Hong Kong with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). WorldStar Energy 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 $18,538 for the prior three months. As of May 18, 2015, the company's stock (symbol "WSTR") was quoted on OTC Link, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

4. 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.

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

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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9795 / May 28, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75066 / May 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16178

In the Matter of **Gregory T. Bolan, Jr. and Joseph C. Ruggieri,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AS TO GREGORY T. BOLAN, JR.**

I.

On September 29, 2014, the Securities and Exchange Commission ("Commission") instituted public administrative and cease-and-desist 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"), against Respondents, including Gregory T. Bolan, Jr. ("Bolan" or "Respondent Bolan").

II.

Bolan 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, Bolan consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933 ("Order"), as set forth below.

III.

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

A. SUMMARY

1. These proceedings involve Bolan, a research analyst at Wells Fargo Securities, LLC ("Wells Fargo"), who, in words or in substance, provided notice of at least one forthcoming ratings change to Joseph C. Ruggieri ("Ruggieri"), a trader at Wells Fargo. In March of 2010, Ruggieri traded ahead of a ratings change by selling stock short ahead of one downgrade by Bolan. Ruggieri generated gross profits for Wells Fargo by trading ahead of that ratings change authored by Bolan.

2. By virtue of his conduct, Bolan violated Section 17(a)(3) of the Securities Act.

B. RESPONDENT BOLAN

3. Bolan, age 37, was a research analyst in Wells Fargo's research department in Nashville, Tennessee from June 2008 to April 2011, and was promoted to director in March 2011. Bolan, who was a registered representative at Wells Fargo, focused his research on three sub-sectors of the health care industry: contract research organizations, health care information technology, and life science tools. His ratings changes consistently moved the stock prices of the companies being analyzed. Bolan resigned in April 2011. Prior to joining Wells Fargo in June 2008, Bolan was an associate in the research department at Jefferies & Co., Inc. and a trader at various institutions, including First New York Securities, LLC and Opus Trading Fund LLC.

C. RELEVANT INDIVIDUALS AND ENTITY

4. Ruggieri, age 35, was a senior trader of health care stocks in Wells Fargo's trading department in New York, New York from August 2009 to April 2011. As a senior trader, Ruggieri, who was a registered representative at Wells Fargo, executed customer transactions and placed principal trades on behalf of Wells Fargo.

5. Wells Fargo is a registered broker-dealer headquartered in Charlotte, North Carolina. Wells Fargo provides a broad range of brokerage services to retail and institutional customers, including institutional equities trading and equity research.

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

D. ALLEGATIONS

Bolan Communicated Material Nonpublic Information to Ruggieri

6. Bolan, in words or substance, provided notice to Ruggieri about at least one Bolan ratings change before it was made public. For example, in March of 2010, Bolan, in words or in substance, provided notice to Ruggieri about Bolan's ratings change downgrade of Parexel International Corp. ("PRXL") before that downgrade was made public. When this rating change was made public, it impacted the stock price and volume of PRXL. After receiving notice regarding Bolan's upcoming downgrade of PRXL, Ruggieri sold short PRXL stock ahead of Bolan's downgrade. Ruggieri then closed his overnight positions in PRXL shortly after Bolan's ratings change was made public and the stock price had moved.

7. Ruggieri generated profits in his account at Wells Fargo from trading ahead of Bolan's PRXL ratings change. Wells Fargo has agreed to place the amount it received from Ruggieri's trading in reserve pending the adjudication of this matter and has agreed to pay that amount if there is an order requiring the payment of disgorgement.

Parexel International Corp.

8. In late March and early April 2010, Ruggieri traded ahead of Bolan's April 7, 2010 downgrade of PRXL. Bolan's research report, entitled "PRXL: Downgrading to Market Perform Optimism Running High and Valuation Running Even Higher," was published before the market opened on April 7, 2010. Bolan changed his rating from outperform or buy to market perform or hold.

9. After the publication of the PRXL downgrade, PRXL's stock price decreased 3.20% at the market open and was down 4.34% at the market close. On the same day, PRXL's trading volume increased 163% relative to PRXL's average daily trading volume on the thirty days surrounding the PRXL downgrade.

10. After drafting the PRXL downgrade on March 29, 2010, Bolan provided notice of, in words or substance, material nonpublic information about the PRXL downgrade to Ruggieri who then established a short position in PRXL stock. For example, Bolan spoke with Ruggieri before the market opened on March 30, 2010 and again on the morning of March 31, 2010. Ruggieri was a net seller of PRXL stock in his Wells Fargo trading account on both March 30, 2010 and March 31, 2010, ending the day on March 31, 2010 short 10,550 shares. On April 5, 2010, Ruggieri once again was a net seller of PRXL stock, ending the day short 27,750 shares. Ruggieri and Bolan then spoke on the evening of April 5, 2010. On April 6, 2010, Ruggieri sold short additional PRXL stock, ending the day short 52,500 shares. Although Ruggieri previously traded PRXL stock, he had held only three overnight positions in PRXL stock consisting of 54, 5,000, and 10,000 shares during the six months before his trading ahead of the PRXL downgrade. Before the market opened on April 7, 2010, Wells Fargo published Bolan's market-moving report containing

his PRXL downgrade. Later that day, Ruggieri covered his entire short position in PRXL stock, generating gains of $24,944.

Bolan Was a Respected Analyst in the Sub-Sectors That He Covered.

11. Market professionals were aware of the significance of Bolan's research reports, as evidenced by the Institutional Investor publication naming Bolan the "Best up and Comer" in the Health Care Technology and Distribution sectors for 2010.

12. In Bolan's director nomination form, Bolan's manager stated that Bolan "is viewed by most within the department as a rising star. His efforts lift the entire group and his best practices lead others to follow his example."

Bolan Benefitted from Providing Information to Ruggieri

13. Bolan benefitted from his providing information to Ruggieri by virtue of his friendship with Ruggieri. Within months of Ruggieri joining Wells Fargo, Bolan and Ruggieri had established a strong relationship and rapport.

14. Additionally, Ruggieri, and his managers at Wells Fargo, provided positive feedback to Bolan's managers at Wells Fargo. This feedback helped Bolan to be promoted from vice president to director at Wells Fargo. In fact, in Bolan's director nomination form, Bolan's manager stated "Greg is among the best analysts in the department in terms of his dialogue with trading. We consistently hear from trading that Greg provides great information flow to the desk and they are able to monetize his efforts. They often hold [him] out as the standard."

Bolan Was Aware of the Relevant Wells Fargo Policies.

15. Wells Fargo's research department held annual compliance meetings, before which a PowerPoint presentation was circulated to members of the research department, including Bolan. The presentation for the annual compliance meetings in 2009 and 2010 stated that there should be "no previewing research/opinion/estimates," and that research analysts should have "no discussions on timing and views of reports with anyone outside of research." Bolan received the 2009 and 2010 presentations by email and attended some or all of the annual compliance meetings for these years.

Bolan Acted with the Requisite State of Mind

16. Bolan, for his direct or indirect benefit and in breach of a duty to Wells Fargo, knew or should have known that he was providing notice to Ruggieri, in words or in substance, of material nonpublic information concerning forthcoming ratings changes that he had authored.

E. VIOLATIONS

17. As a result of the conduct described above, Bolan violated Section 17(a)(3) of the Securities Act, which prohibits, directly or indirectly, in the offer or sale of securities, engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.[2]

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, it is hereby ORDERED that:

A. Respondent Bolan cease and desist from committing or causing any violations and any future violations of Section 17(a)(3) of the Securities Act;

B. Respondent Bolan shall pay a civil penalty of $75,000, to the Securities and Exchange Commission for transfer to the general fund of the United States Treasury in accordance with Section 21F(g)(3) of the Exchange Act. Payment shall be made in the following installments: $25,000 shall be due within 14 days of this Order, $25,000 shall be paid within 90 days of this Order and the remaining $25,000 shall be paid in 180 days of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

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

(2) Respondent Bolan 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] Scienter is not required to prove a violation of Section 17(a)(3)." *Aaron v. SEC*, 446 U.S. 680, 697 (1980). Instead, a violation of this section may be established by showing negligent conduct. *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997).

(3) Respondent Bolan 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 Bolan 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 Sanjay Wadhwa, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, New York, New York, 10281.

C. Respondent Bolan is ordered to pay $24,944, plus $4,827.66 prejudgment interest, for a total of $29,231.66, which shall be deemed satisfied by Wells Fargo's payment of that amount to the Commission for transfer to the general fund of the United States Treasury in accordance with Section 21F(g)(3) of the Exchange Act.

V.

It is further Ordered that, solely 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 Bolan, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent Bolan 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
Commissioner Piwowar
Dissented as to Municipal
Advisor and NRSRO bars

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75062 / May 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16561

In the Matter of **CHRISTOPHER C. WEIDES,** **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 Christopher C. Weides ("Weides" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the 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. Weides, 61, is a resident of Rogers, Minnesota. Weides is not, and was not during the relevant period, registered as a broker-dealer or associated with a broker or dealer registered with the Commission.

2. On April 7, 2015, a judgment was entered by consent against Weides, permanently enjoining him from future violations of Section 15(a) of the Exchange Act, in the civil action entitled Securities and Exchange Commission v. Collyard, et al., Civil Action No. 11-cv-3656, in the United States District Court for the District of Minnesota.

3. The Commission's complaint alleged that, from approximately 2003 to 2006, Weides solicited investors for Bixby Energy Systems, Inc. ("Bixby"), a privately held Delaware corporation with its principal place of business in Ramsey, Minnesota. Specifically, the Commission's complaint alleged that Weides sold over $1.9 million in Bixby securities to at least 28 investors. As compensation for his sale of these securities, Weides received at least $177,000 in transaction-based cash commissions. Furthermore, the complaint alleged that in or around 2010, Weides also acted as an intermediary in the sale of Bixby securities in several secondary market transactions. Finally, the complaint alleged that Weides, while acting as a broker or dealer, effected transactions in, and induced and attempted to induce the purchase or sale of securities, when he was not registered with the Commission as a broker or dealer or associated with an entity registered with the Commission as a broker or dealer.

IV.

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

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

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

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

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9794 / May 28, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75061 / May 28, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16560

In the Matter of **William Quigley,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against William Quigley ("Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

1. This matter involves a fraudulent offering scheme conducted by three brothers, William Quigley, Michael Quigley and Brian Quigley. During the relevant period, William Quigley was Director of Compliance at a registered broker-dealer located in New York, on Long Island.

2. Two of the brothers, Michael Quigley and Brian Quigley, directly solicited investors to purportedly invest in various securities, including well known "blue chip" issuers as well as "start-up" companies that supposedly were on the verge of going public. Michael Quigley and Brian Quigley never purchased any of the offered securities for the

investors, and the claims of imminent public offerings were lies. All of the investors' funds were misappropriated by the Quigleys, including William Quigley.

3. As part of the scheme, the investors were instructed to wire their investment funds to U.S. bank and brokerage accounts that William Quigley had set up and controlled. Certain investors were issued phony brokerage statements showing that they had growing investment balances. When investors tried to liquidate the securities they had been led to believe they owned, they were given one excuse after another as to why their funds, which had already been stolen, could not be returned to them.

A. RESPONDENT

4. **William Quigley** was Director of Compliance of Trident Partners Ltd., a registered broker-dealer in Long Island, New York, from June 2004 through September 2005 and again from October 2007 until September 2014. During the relevant period, William Quigley was also the firm's Anti-Money Laundering officer. Respondent, 50 years old, is a resident of Seaford, New York.

B. OTHER RELEVANT ENTITIES AND INDIVIDUALS

5. **Trident Partners Ltd.** ("Trident"), is a broker-dealer registered with the Commission since 1996. Trident's principal place of business is located in Woodbury, New York. Trident terminated Quigley as its Director of Compliance in September 2014.

6. **Brian Quigley** is 42 years old, and is currently believed to reside in the Philippines. Although he never was associated with Trident, he was a registered representative associated with Fleet Securities, Inc., a registered broker-dealer, from July 1995 through April 1999. While at Fleet, he had reportable disclosures involving allegations of conversion, unsuitable investments, and churning. He is Respondent's younger brother.

7. **Michael Quigley** is 45 years old. He is currently believed to reside in the Philippines. He is also a younger brother of Respondent.

C. THE SCHEME TO DEFRAUD INVESTORS

Overview of the Scheme

8. From at least 2003 through 2012, Michael Quigley and Brian Quigley repeatedly duped at least four unsophisticated foreign investors into sending funds to various U.S. bank and brokerage accounts, for purported investments in the securities of publicly-traded companies, investment funds and private start-up companies supposedly slated to go public. The Quigleys claimed to be associated with numerous non-existent entities, including fictional broker-dealers, and claimed to have various colleagues at these firms (with names including James Morris and Kevin Turner) who appear to have been invented as well.

9. Michael Quigley and Brian Quigley used virtually every "trick in the book" to defraud investors, sending phony account statements; using a fake firm name similar to the name of an existing firm; making numerous excuses for their failure to return funds; manufacturing stock certificates; claiming on various occasions to be helping the investor recover previous losses; requiring payment of bogus transfer agent fees in order to obtain the investors' stock certificates; and so on. Indeed, Brian Quigley and Michael Quigley expertly managed to extract funds from these same four investors for over a decade, by creating new stories and schemes.

10. For example, one investor ("Investor A") was persuaded by Michael Quigley to open an account at the fictitious "Trident Partners Investment Group" and even received phony account statements reflecting non-existent holdings and claiming that Trident Partners Investment Group was a "Member NASD, SIPC, MSRB." Michael Quigley told Investor A that to purchase shares of companies supposedly going public shortly and shares of various blue-chip companies, Investor A needed to send his funds to an account in the United States specified by Michael Quigley. One of Michael Quigley's phony pitches to Investor A followed an email from William Quigley to Michael Quigley suggesting that pushing a certain blue chip investment fund "Should be an easy sell." The account specified by Michael Quigley was an account set up and controlled by William Quigley. Investor A sent money for these purported investments to that account, and all of his funds were then stolen by the Quigley brothers.

11. Another investor ("Investor B") also sent funds to a U.S. account set up by William Quigley for the purchase of securities, and those funds were also stolen by the Quigleys. William Quigley knew that Investor B was the source of the funds. On one occasion in May 2010, William Quigley emailed Trident's clearing firm, saying that his "client is looking for an incoming wire transfer from the Bank of Ireland for approx. $2,000.00 sent several days ago." When the clearing firm asked him who the originator was, William Quigley identified Investor B.

12. Yet another investor ("Investor C") who was duped into sending money for the purchase of securities to one of the U.S. accounts set up by William Quigley ultimately reached out to him in 2011, because the account name -- "Trident Partners Investment Group" -- was confusingly similar to that of the Trident, the actual firm where William Quigley worked. To further the fraud, William Quigley told Investor C that "Trident Partners Ltd. has no affiliation whatsoever with Trident Partners Investment Group" and pretended to have no knowledge of the account at issue, *even though, as set out in more detail below, William Quigley was the one who set up and controlled the account.*

13. The final investor ("Investor D") was victimized by Brian Quigley, who solicited investments in companies that were purportedly on the verge of going public. Investor D wired funds to an account set up and controlled by William Quigley. Investor D was also told that he owned shares of the same blue chip investment fund purportedly invested in by Investor A.

14. When the investors tried to get their money back, Michael Quigley and Brian Quigley made many excuses. Brian Quigley even told one investor that the fictitious

"James Morris" had died in a motorcycle accident and could not be contacted about the investor's investment. By about 2012, Michael Quigley and Brian Quigley completely broke off contact with these investors.

William Quigley's Participation In the Scheme

15. From at least 2006 on, William Quigley participated in the scheme in numerous ways. Most importantly, he opened three brokerage accounts that he and his brothers used to misappropriate investor funds, including one account at Trident; kept Trident from learning about the account that was located there; funneled money from the accounts to his brothers; and even, on at least one occasion, gave his brother Michael Quigley an idea for a phony sales pitch to investors. When William Quigley became aware of investor concerns, he falsely claimed to have no knowledge of the relevant accounts or the subject of the investor's complaints.

16. As part of the Quigleys' scheme to defraud investors, the investors were instructed to wire their investment funds to U.S. bank and brokerage accounts that William Quigley created and controlled. These accounts were used to obtain, funnel, dissipate, and otherwise steal investor funds, and the accounts had no purpose other than to further the fraudulent scheme.

17. One of the three accounts at issue was in the name of Funding Group, Inc., and was kept at Trident; the other two (one in the name of Funding Group, the other in the name of Trident Partners Investment Club) were opened at a discount brokerage firm.

William Quigley Opens Phony Accounts at a Discount Brokerage Firm

18. In late 2005, William Quigley opened a post office box, P.O. Box 265, at a UPS Store in Wantagh, New York. In early 2006, William Quigley used false information to open an online account at a discount brokerage firm in the name of "Trident Partners Investment Club" ("TPIC") with the address of the same Wantagh UPS Store and "Suite 265." TPIC was a fictitious entity that had nothing to do with Trident, beyond the fact that William Quigley purposely used the name Trident to create the false impression that TPIC was affiliated with an actual broker-dealer. From at least June 2006 through May 2008, approximately $195,000 of fraudulently obtained investor funds was deposited into this account. Nearly all the account funds were withdrawn within two weeks after deposit, and often with days. Much of the funds deposited were used to pay various bills associated with Michael Quigley, and some were sent directly to Brian Quigley or were diverted to other Quigley family members.

19. William Quigley also opened an account at the discount brokerage firm in the name of Funding Group, a defunct entity that had previously had an account at Trident. The phony Funding Group account at the discount brokerage firm was opened on March 29, 2010 from Trident's office via fax, from a number issued to a fax machine in William Quigley's office and to which only he had access. From April 2010 through October 2012, almost a quarter of a million dollars of illegally obtained investor funds were deposited in this account. The account was initially funded with a cashier's check purchased by

William Quigley with funds withdrawn from his personal bank account. In addition, the discount brokerage's account log-in information shows that this account was accessed online from both the Trident office where William Quigley worked and from the Philippines.

20. Investor funds deposited into the Funding Group account were almost immediately wired out to a bank in the Philippines, where both Brian Quigley and Michael Quigley were apparently both living at the time. Other investor funds deposited into the Funding Group account were withdrawn via ATM transactions near William Quigley's house.

William Quigley Opens a Phony "House Account" at Trident

21. William Quigley also opened a phony "Funding Group" account at Trident. In November 2009, William Quigley purchased a second post office box, P.O. Box 299, at the same Wantagh UPS store. In December 2009, William Quigley opened an account in the name of Funding Group at Trident and listed the account holder's address as P.O. Box 299.

22. William Quigley used a post office box as the address for the Funding Group account he opened at Trident even though Trident's internal rules and guidelines forbade the opening of accounts without a street address. As Director of Compliance, it was William Quigley's responsibility to ensure that all accounts were opened properly or, if not, were reported to the appropriate authorities. It was also his responsibility to oversee and monitor opening of accounts at Trident. William Quigley failed to discharge these responsibilities.

23. William Quigley designated the Funding Group account at Trident as a "house account." This was a special designation at Trident for accounts that had been frozen, abandoned, or were otherwise subject to some kind of significant restriction. House accounts were supposed to be inactive. As Director of Compliance, William Quigley was responsible for the designation of accounts as house accounts, and for ensuring that these house accounts did not have inappropriate activity. William Quigley failed to discharge these responsibilities. Instead, he used the Funding Group account to further the scheme to steal money from investors.

24. Because the Funding Group account at Trident was designated as an inactive house account, no registered representative aside from William Quigley was assigned to handle it, removing an additional layer of scrutiny, and facilitating William Quigley's misuse of the account to wrongfully obtain money from investors and commit fraud.

25. Shortly after opening the account, William Quigley obtained a box of checks and a debit card for the account that were mailed to P.O. Box 299 in Wantagh. House accounts were not supposed to issue debit cards and checks. It was William Quigley's responsibility, as Director of Compliance, to ensure that house accounts complied with this restriction. William Quigley failed to do so.

The Use of the Three Accounts To Obtain and Steal Investor Funds

26. Hundreds of thousands of dollars of investor funds were deposited in the three accounts described above. A significant portion of investor funds were subsequently transferred to Brian Quigley and Michael Quigley in the Philippines, much of it via electronic transfers. As Director of Compliance, it was William Quigley's job to monitor all wires to and from Trident, to ensure that they were for proper purposes, and to report any suspicious transfers. William Quigley failed to do so. Instead, he secretly used the Funding Group "house account" at Trident to further the scheme to obtain and steal money from investors.

27. Investors were instructed to wire funds to all three of the subject accounts supposedly for the purchase of securities, but no investments were ever made. Instead, all of the money deposited into these accounts was almost immediately wired out to a bank in the Philippines, otherwise diverted for the benefit of other Quigley family members or else quickly withdrawn in small amounts (almost always in increments of $500) from ATM machines in the vicinity of William Quigley's home and office.

William Quigley's Theft of Trident Assets and Other Misconduct

28. Between 2005 and 2007, William Quigley stole commission checks made out to his employer Trident and deposited them in the discount brokerage account in the name of TPIC. These checks had been mailed to Trident, and as Director of Compliance, it was William's Quigley's job to open and properly route all incoming mail.

29. As Director of Compliance, it was William Quigley's obligation to report violations and suspected violations of the securities laws, rules and regulations. This included reporting a transaction if he knew or suspected that it involved funds derived from illegal activity, or was intended or conducted to hide or disguise funds derived from illegal or has no business or apparent lawful purpose. Despite this obligation and his knowledge of the relevant facts, William Quigley failed to report or file required reports regarding, *inter alia*, wire transfers of the stolen investor funds, his improper diversion and deposits of the commission checks, his inappropriate designation of an account as a house account, or the diversion of investors' stolen funds through various accounts.

30. It was also William Quigley's obligation to help ensure that all the books and records of Trident were accurate and not to engage in conduct that would render them inaccurate. Despite this obligation and his responsibilities as Director of Compliance, William Quigley failed to, among other things, preserve receipts and disbursements of cash and all other debits and credits in connection with his theft of firm checks, to keep proper records regarding the beneficial owners of accounts, and to preserve originals of all communications received and sent relating to the business of Trident.

D. Violations

31. As a result of the conduct described above, Respondent willfully, in furtherance of a scheme to defraud investors, committed fraudulent and deceptive acts, and engaged in acts, practices or courses of business that operated as a fraud upon other

persons, in violation of Section 10(b) of the Exchange Act and Rules 10b-5(a) and (c) thereunder, which prohibit such fraudulent conduct in connection with the purchase or sale of securities.

32. As a result of the conduct described above, Respondent willfully employed a device, scheme, or artifice to defraud in the offer or sale of securities, and wrongfully engaged in transactions, practices, or a course of business which operated as a fraud or deceit, in violation of Sections 17(a)(1) and (3) of the Securities Act. In addition, Respondent wrongfully obtained money and property by means of materially false and misleading statements in violation of Section 17(a)(2) of the Securities Act.

33. As a result of the conduct described above, Respondent was a cause of, and willfully aided and abetted, violations by Michael Quigley and Brian Quigley of Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, including their violations of Rule 10b-5(b), and Section 17(a) of the Securities Act, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

34. As a result of the conduct described above, Respondent was a cause of, and willfully aided and abetted, violations by Trident of Section 17(a) of the Exchange Act and Rule 17a-8 thereunder, which requires reporting a transaction if a broker-dealer knows or suspects that it involves funds derived from illegal activity; or was designed to evade any requirements of the Bank Secrecy Act; or is intended or conducted to hide or disguise funds derived from illegal activities; or has no business or apparent lawful purpose; or involved use of the broker-dealer to facilitate criminal activity.

35. As a result of the conduct described above, Respondent was a cause of, and willfully aided and abetted, Trident's violations of the books and records provisions of Section 17(a) of the Exchange Act and Rules 17a-3(a)(1), 17a-3(a)(9) and 17a-3(a)(17) thereunder, which require broker-dealers to make and retain certain books and record.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act, and whether Respondent should be ordered to pay disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. 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 10(b) of the Exchange Act and Rules 10b-5 thereunder, Section 17(a)(1), (2) and (3) of the Securities Act, Section 17(a) of the Exchange Act and Rules 17a-8, Rule 17a-3(a)(1), 17a-3(a)(9) and 17a-3(a)(17) thereunder; and 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 Act, 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

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Piwowar
Dissented as to the
Municipal Advisor and
NRSRO Bars

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 75077 / May 29, 2015

ADMINISTRATIVE PROCEEDING
File No. 3-16562

In the Matter of

Michael W. Zirinsky,

Respondent.

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

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Michael W. Zirinsky ("Respondent").

II.

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

III.

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

1. Zirinsky, age 41, is a resident of Schwenksville, Pennsylvania. From 1995 to 2012, Zirinsky was a registered representative associated with Ameriprise Financial Services, Inc., a broker-dealer registered with the Commission.

2. On May 11, 2015, a final judgment was entered by consent against Zirinsky, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Timothy J. McGee, et al., Civil Action Number 2:12-cv-01296 (TJS), in the United States District Court for the Eastern District of Pennsylvania.

3. The Commission's amended complaint alleged that Zirinsky engaged in unlawful insider trading by purchasing the common stock of Philadelphia Consolidated Holdings Corp. ("Philadelphia Consolidated) in advance of the company's July 23, 2008 public announcement of its sale to Tokio Marine Holdings, Inc. Zirinsky's friend, colleague, and co-defendant in the case identified in paragraph 2 above, Timothy McGee, in breach of a duty of trust or confidence he owed to an insider at Philadelphia Consolidated, misappropriated material nonpublic information regarding the impending sale of the company and tipped Zirinsky. On July 17, 2008, based on the tip from McGee, Zirinsky traded on behalf of himself and his wife, mother, father, sister, and grandmother, for whom he was a broker. When the merger was publicly announced, Zirinsky made $46,396 in ill-gotten gains on his unlawful trading.

IV.

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

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Zirinsky 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 Zirinsky 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
Commissioner Piwowar
Dissented as to
Municipal Advisor
and NRSRO Bars

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 9798 / May 29, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75076 / May 29, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31657 / May 29, 2015

Admin. Proc. File No. 3-15015

In the Matter of

RALPH CALABRO,
JASON KONNER, and
DIMITRIOS KOUTSOUBOS

CORRECTED OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Churning of Customer Accounts

Respondents, who were associated with a registered broker-dealer, each willfully violated Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder by churning the account of a customer. *Held*, it is in the public interest to enter an order imposing industry bars against Respondents; to issue cease-and-desist orders; to impose third-tier civil money penalties; and to order disgorgement plus prejudgment interest.

APPEARANCES

Adam D. Cole of Cousins Chipman & Brown, LLP, for Ralph Calabro.

Eric S. Hutner of Hutner Klarish LLP for Jason Konner.

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Paul J. Bazil and *Michael D. Mattia* of Pickard and Djinis LLP for Dimitrios Koutsoubos.

Edward G. Sullivan, *W. Shawn Murnahan*, and *Natalie Brunson* for the Division of Enforcement.

Appeals filed: November 27, 2013
Last brief received: April 18, 2014

I.

Respondents Ralph Calabro, Jason Konner, and Dimitrios Koutsoubos, former registered representatives at J.P. Turner & Co. ("J.P. Turner"), appeal from an administrative law judge's initial decision[1] finding that they each churned a customer account in violation of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder.[2] The law judge barred Respondents from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. The law judge also ordered Respondents to cease and desist from further violations; to disgorge certain ill-gotten gains, as well as pay prejudgment interest; and to pay third-tier civil money penalties. Upon our de novo review of the record, we find each Respondent liable for churning and order remedial sanctions. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.[3]

II.

A broker violates Exchange Act Section 10(b) and Rule 10b-5, as well as Securities Act Section 17(a), by churning.[4] "'Churning' is a shorthand expression for a type of fraudulent conduct in a broker-customer relationship where the broker 'overtrades' a relying customer's account to generate inflated sales commissions."[5] Churning has been recognized as a

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1 *Michael Bresner*, Initial Decision Release No. 517, 2013 WL 5960690 (Nov. 8, 2013).

2 15 U.S.C. §§ 77q(a), 78j(b); 17 C.F.R. § 240.10b-5.

3 The Division did not appeal the law judge's findings that Respondents did not churn the accounts of five additional J.P. Turner customers. In addition, Michael Bresner, a respondent below, did not appeal the law judge's finding that he failed reasonably to supervise Konner and Koutsoubos or the related sanctions the law judge imposed.

4 *Donald A. Roche*, Exchange Act Release No. 38742, 53 SEC 16, 1997 WL 328870, at *5 (June 17, 1997) (finding that respondent "wilfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, by churning [customer] accounts").

5 *Craighead v. E.F. Hutton & Co., Inc.*, 899 F.2d 485, 489 (6th Cir. 1990).

manipulative and deceptive device within the meaning of Section 10(b) and Rule 10b-5.[6] "Churning occurs when a securities broker enters into transactions and manages a client's account for the purpose of generating commissions and in disregard of his client's interests."[7] "Churning is commonly said to have three elements: (1) control of the customer's account by the broker, either explicit or de facto; (2) excessive trading in light of the customer's investment objectives; and (3) scienter — the required state of mind for liability under Section 10(b) and Rule 10b-5."[8]

Under this standard, we conclude, based on a preponderance of the evidence,[9] that each Respondent churned a customer account he controlled.[10] In Section III.A. below we set out the facts relevant to the charges against Calabro, who managed J.P. Turner's Parlin, New Jersey office. Based on those facts, we conclude in Section III.B. that Calabro churned the account of Dudley Wayne Williams, an elderly retired client who paid nearly $300,000 in commissions over the relevant period. In Section IV.A., we address the facts relevant to Konner, who worked in J.P. Turner's Brooklyn office, and we conclude in Section IV.B. that he churned the account of James Carlson, a self-employed Iowa farmer who paid nearly $90,000 in commissions in 2009. In Section V.A., we address the facts relevant to Koutsoubos, who split time between J.P. Turner's Brooklyn and Fort Lauderdale offices, and we conclude in Section V.B. that he churned the account of Teddy Dale Bryant who paid nearly $50,000 in commissions in 2009. As explained in the applicable legal analysis sections, each Respondent's trading surpassed relevant guideposts we have considered indicative of excessive trading, including by as much as nine times the benchmark, and each Respondent acted with scienter.

Section VI sets forth our findings with respect to remedial sanctions necessary to protect the investing public. For the reasons explained in Section VI.A., we impose industry bars on all Respondents prohibiting their association with any broker, dealer, investment adviser, municipal

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6 *Armstrong v. McAlpin*, 699 F.2d 79, 91 (2d Cir. 1983); *accord David Wong*, Exchange Act Release No. 45426, 55 SEC 602, 2002 WL 200089, at *4 n.20 (Feb. 8, 2002); *see also Carras v. Burns*, 516 F.2d 251, 258 (4th Cir. 1975) (recognizing that churning "is a deceptive device made actionable by § 10(b) of the Securities Exchange Act and S.E.C. Rule 10b-5").

7 *William J. Murphy*, Exchange Act Release No. 69923, 2013 WL 3327752, at *15 (July 2, 2013) (quoting *Roche*, 1997 WL 328870, at *4), *petition denied sub nom., Birkelbach v. SEC*, 751 F.3d 472 (7th Cir. 2014); *see also Al Rizek*, Exchange Act Release No. 41725, 54 SEC 261, 1999 WL 600427, at *5 (Aug. 11, 1999) ("Churning occurs 'when a securities broker buys and sells securities for a customer's account, without regard to the customer's investment interests, for the purpose of generating commissions.'" (quoting *Olson v. E.F. Hutton & Co.*, 957 F.2d 622, 628 (8th Cir. 1992))), *aff'd*, 215 F.3d 157 (1st Cir. 2000).

8 *SEC v. Rizek*, 215 F.3d at 162 (citations omitted).

9 *See Rita J. McConville*, Exchange Act Release No. 51950, 58 SEC 596, 2005 WL 1560276, at *14 (June 30, 2005) ("[I]t is well settled that the applicable standard . . . is preponderance of the evidence." (citing *Steadman v. SEC*, 450 U.S. 91, 102 (1981))), *petition for review denied*, 465 F.3d 780 (7th Cir. 2006).

10 *See infra* Sections III (Calabro), IV (Konner), V (Koutsoubos).

securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization. In Section VI.B., we explain our basis for ordering all Respondents to cease and desist from committing or causing any violations or future violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5. And we require each Respondent to pay disgorgement and pre-judgment interest, and each to pay a single maximum third-tier civil money penalty, for the reasons set forth in Sections VI.C. and VI.D., respectively.

III.

A. Facts relating to Ralph Calabro

Ralph Calabro began working in the securities industry in 1995 and holds Series 7, 24, and 63 licenses. In early 2004, Calabro opened J.P. Turner's small Parlin, New Jersey office, joining the firm as a principal and registered representative.[11] While at J.P. Turner, Calabro's compensation consisted largely of commissions, rather than a fixed salary.[12]

1. For over fifteen years, Dudley Wayne Williams, a retired professor, followed a conservative investment strategy relying entirely on his broker.

At the time he opened his J.P. Turner account, Dudley Wayne Williams was 70 years old and had been retired from his job as a university professor for approximately twelve years. Williams holds graduate and undergraduate degrees in business administration and, before retirement, taught statistics and various business-related courses, none of which involved finance. Williams is not computer-savvy, has no mobile phone, and has never had an email address. Williams does not consider himself to be a sophisticated investor.

Williams opened a Smith Barney account in 1991, which he held until 2008. Williams relied entirely on his broker to select transactions for him and never bought or sold options or commodities or traded on margin. Instead, Williams invested in securities that he considered "good stuff that [he] could rely on." He held his securities for an average of ten years.

2. In October 2007, Williams opened a J.P. Turner account with Calabro, which he funded from his Smith Barney account.

In October 2007, Williams opened an account with Calabro, following a telephone introduction from a friend of more than 40 years. By that time, Williams's longtime representative at Smith Barney had retired, and no one else had stepped forward to handle his account. Williams funded his J.P. Turner account through the proceeds of the Smith Barney account, which Williams had told Calabro was worth approximately $1.5 million.

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11 J.P. Turner is a registered broker-dealer headquartered in Atlanta, Georgia. During 2008 and 2009, J.P. Turner had approximately 500 registered representatives working in 180 to 200 branch offices, most of which were small or one-person offices.

12 Calabro also received a $9 share of per transaction "ticket charges" and 0.1% of daily margin balance.

Williams signed a six-page account application to open his J.P. Turner account. The second page of the application, which Williams was not required to sign or initial, listed a number of pre-printed investment objectives with small boxes next to them. Calabro typed, or caused to be typed, the numerals 1, 2, and 3, next to, respectively, "Speculation," "Trading Profits," and "Capital Appreciation." Nothing was typed next to "Preservation of Capital," "Income," or "Other." On the same page, across from "Risk Tolerance," Calabro also typed, or caused to be typed, an "X" in the small box next to "Aggressive." The boxes next to the other options ("Conservative," "Moderate," and "Combination") were not marked. Calabro says that he completed these sections before Williams signed the application.

In contrast, Williams testified that the selections regarding risk tolerance and his account objectives were "absolutely wrong" and had not been completed when he signed the document. Had Williams completed the form, he would have specified "Preservation of Capital," "Income," and "Capital Appreciation" as investment objectives (in that order) and would have selected a risk tolerance of conservative or moderate. Put differently, Williams explained that he had the same objective in investing with J.P. Turner as he did with Smith Barney: to earn "a fair return." Williams also testified that Calabro never asked Williams how much he was willing to risk or what his investment objectives were and did not go over the account application with him. Instead, Calabro told Williams that all he needed to do was to sign and return the form to Calabro, which Williams did.

3. Calabro briefly took long positions in Williams's account but soon transitioned to shorting and options trading.

Calabro initially took long positions in Williams's account. But in November 2007, Calabro took a negative view on economic prospects and began to sell securities short.[13] Although Williams "basically" understood that "in a slipping economy, you could sell the stock now" through shorting and "buy it back later at a reduced price," he did not "fully understand how you can do that."[14]

By February 2008, Williams believed that Calabro had exaggerated the gains in Williams's account. So Williams prepared and sent Calabro what Williams termed a "quick analysis" of his account's 2007 performance. Williams calculated gain and loss from particular securities transactions but did not purport to evaluate the appropriateness of transactions or

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13 "A short sale is the sale of a stock that an investor does not own or a sale which is consummated by the delivery of a stock borrowed by, or for the account of, the investor. Short sales are normally settled by the delivery of a security borrowed by or on behalf of the investor. The investor later closes out the position by returning the borrowed security to the stock lender, typically by purchasing securities on the open market." Short Sales, http://www.sec.gov/answers/shortsale.htm (last visited May 28, 2015).

14 "Investors who sell stock short typically believe the price of the stock will fall and hope to buy the stock at the lower price and make a profit." *Id.* But "[i]f the price of the stock rises, short sellers who buy it at the higher price will incur a loss." *Id.*

critique Calabro's strategy. Williams attached his analysis to a handwritten note to Calabro stating that he hoped the "'short' gods w[ould] turn in our favor in the not too distant future."

In September 2008, Calabro began to trade options in Williams's account. At Calabro's behest, Williams signed two J.P. Turner account documents relating to that trading. As with the account application, Williams testified that the documents contained incorrect statements regarding his investment objectives and experience, which he believed were not present when he signed them.[15] Williams signed the documents based on Calabro's representations that he was expert and experienced in options trading and would use it to reduce risk. But Calabro did not identify any risks of options trading and told Williams only that "it would provide an insurance on a trade and that, if the trade went the right way, that there would be profit involved." Despite his professed experience, Calabro had not used options before in J.P. Turner customer accounts.

In early 2009, after Calabro's supervisors took note of the volume of trades in Williams's account, Calabro requested that Williams sign two additional documents that the firm used with "actively traded" accounts to confirm the customer had authorized the trading. One of these documents, the Active Account Suitability Questionnaire ("AASQ"), purported to state a preference for speculation and identified a trade frequency of "3-6 a month."[16] Williams testified that this and other statements on the form were incorrect and that he believed that they were not present on the form when he signed it. For his part, Calabro concedes that he completed the portions of the AASQ stating Williams's investment preferences—as he did with other account forms—but asserts that he added the information before Williams signed it, not after.

J.P. Turner's policies dictated that if a customer failed to return a signed AASQ, the customer's account would be placed on restriction and no additional purchases would be permitted, even if they were necessary to close open short positions such as those in Williams's account. Calabro testified that he explained this risk when he asked Williams to sign the AASQ.

4. Calabro dictated and unilaterally implemented the trading strategy for Williams's account and also made unauthorized trades in it.

Throughout the period that Williams maintained a J.P. Turner account, Calabro dictated and unilaterally implemented the trading strategy for it. Virtually all of the transactions in Williams's account over the relevant period were marked as "solicited" in his account statements. But Calabro's conversations with Williams regarding these recommendations were one-sided. Rather than seek Williams's input, Calabro called Williams periodically to tell him which transactions would take place. Because Williams did not believe himself to be qualified, he accepted Calabro's recommendations and did not independently research them. And when

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15 Under the heading "Investment Objectives," in the Options Suitability Questionnaire, Calabro circled "Speculation" and "Growth" but not "Income" or "Safety of Principal." Williams testified that if he had completed the form himself, he would have selected Safety of Principal and Income.

16 The other account document was an Active Account Suitability Supplement ("AASS"), which contained various boilerplate risk disclosures regarding active trading.

Williams occasionally brought concerns to Calabro about stocks going "the wrong way," Calabro reassured Williams that things would turn around. Williams always relied on Calabro's recommendations and never told Calabro to purchase or sell particular stocks.

Separate from this course of dealing, Williams noticed at some point in 2009 that Calabro had executed trades without his knowledge. Although Calabro generally would call Williams before opening short positions, Calabro made many fewer advance calls before closing them. In addition, on one occasion, Calabro told Williams that he had netted $100,000 in profit through an options trade in J.P. Morgan securities that Williams had never authorized. But upon receiving a trade confirmation, Williams discovered that the trade had made no money.

5. Williams's account declined dramatically between December 2008 and November 2009, during which time he paid J.P. Turner nearly $300,000 in commissions and fees in connection with Calabro's frequent trading.

Calabro frequently traded in Williams's account between December 2008 and November 2009, executing 271 purchases and sales (a monthly average of over 22.5 trades). The Division's expert witness, Louis Dempsey, calculated a turnover rate of eight and a cost-to-equity ratio of 22.9% over this period, which he opined each exceeded levels of excessive trading. This trading was far more frequent than that in Williams's prior Smith Barney account. And, although Calabro had specified "3-6" trades a month on the AASQ he completed in March 2009, he executed between thirty and sixty-eight trades in each of April, May, and June 2009.

At the same time, Williams's account value fell from approximately $2 million to about $550,000, and the vast majority of the decline was attributable to trading losses, rather than withdrawals. During the relevant period, Williams paid $297,515 in fees and commissions to J.P. Turner, of which Calabro received over $247,945.

6. Williams closed his J.P. Turner account in 2010, and Calabro left J.P. Turner the following year.

Williams closed his J.P. Turner account in mid-2010. In all, Williams had deposited over $1.7 million with J.P. Turner. Calabro left J.P. Turner in 2011 and joined another firm. Calabro currently is not registered with FINRA and maintains that he has "left the brokerage industry."

B. Based on our analysis of the facts, we conclude that Calabro churned Williams's account between December 2008 and November 2009.

As explained below, we find that, between December 2008 and November 2009, Calabro (1) exercised de facto control over Williams's account, (2) excessively traded it, and (3) acted with scienter in doing so. We accordingly find that Calabro churned Williams's account in violation of Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5.

1. Calabro exercised de facto control over Williams's account.

a. Factors applicable to control

In the absence of formal discretionary authority, a broker's de facto control over an account "may be established when the customer relies on the representative such that the representative controls the volume and frequency of transactions."[17] Alternatively, de facto control exists where a customer routinely follows a registered representative's recommendations.[18] In that context, we have considered whether the customer had "sufficient understanding to make an independent evaluation" of the broker's recommendations.[19] Finally, we also have recognized that a broker's unauthorized transactions support a finding of control.[20]

b. The facts establish that Calabro controlled Williams's account.

We find that Calabro controlled Williams's account. First, the record establishes that Williams relied on Calabro in determining the frequency and volume of transactions and, as Williams testified, "trusted [Calabro] up until the very end." Calabro dictated the strategy for the

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17 *Richard G. Cody*, Exchange Act Release No. 64565, 2011 WL 2098202, at *12 (May 27, 2011) (citing *Clyde J. Bruff*, Exchange Act Release No. 40583, 53 SEC 880, 1998 WL 730586, at *2 (Oct. 21, 1998), *petition denied*, 198 F.3d 253 (9th Cir. 1999) (Table), *Stephen Thorlief Rangen*, Exchange Act Release No. 38486, 52 SEC 1304, 1997 WL 163991, at *4 (Apr. 8, 1997), and *John M. Reynolds*, Exchange Act Release No. 30036, 50 SEC 805, 1991 WL 288500, at *2 (Dec. 4, 1991)), *aff'd*, 693 F.3d 251 (1st Cir. 2012).

18 *Roche*, 1997 WL 328870, at *7 n.14 ("De facto control of an account may be established where the client habitually follows the advice of the broker."); *see also Mihara v. Dean Witter & Co., Inc.*, 619 F.2d 814, 821 (9th Cir. 1980) ("[T]he requisite degree of control is met when the client routinely follows the recommendations of the broker."); *Cody*, 2011 WL 2098202, at *12 ("A representative also exercises de facto control if the customer 'relied heavily on and followed [the representative's] advice.'" (quoting *Rangen*, 1997 WL 163991, at *5, and citing additional authority)).

19 *Eugene J. Erdos*, Exchange Act Release No. 20376, 47 SEC 985, 1983 WL 33908, at *4 (Nov. 16, 1983), *aff'd*, 742 F.2d 507 (9th Cir. 1984); *see also Cody*, 2011 WL 2098202, at *12 n.34 (citing *Erdos*).

20 *See Sandra K. Simpson*, Exchange Act Release No. 45923, 55 SEC 766, 2002 WL 987555, at *15 (May 14, 2002) (finding that, among other things, the "many unauthorized transactions" executed by broker supported a finding of de facto control); *Roche*, 1997 WL 328870, at *5 n.14 (same); *cf. Frederick C. Heller*, Exchange Act Release No. 31696, 51 SEC 275, 1993 WL 8588, at *2 & n.7 (Jan. 7, 1993) (finding "control" when a registered representative "exercised de facto discretionary control" over customers' account, as evidenced by the fact that customers "were not consulted, nor typically even made aware of, the particular trades executed in their account until well after the fact"). Where a broker engages in unauthorized transactions, he operates as though he has been delegated discretionary authority (and thus formal control) by the client, although he has not been.

account, which diverged substantially from Williams's account history over the prior fifteen years, and implemented it unilaterally. Calabro also vastly exceeded the number of monthly trades specified in Williams's AASQ, which Calabro testified represents "the only time" J.P. Turner documents "the amount of trades" that "the client feels comfortable with."[21] Nonetheless, Calabro executed, in at least one month, over ten times the maximum number of trades specified in the AASQ, and, on average, more than three times the maximum. Because Calabro controlled the frequency and volume of transactions, and did so in a way that conflicted with what he documented as his customer's objective, we find that he exercised control over Williams's account.[22]

Second, we also find that Calabro exercised de facto control over Williams's account because Williams routinely followed Calabro's recommendations.[23] Williams deferred to Calabro with respect to establishing (and altering) account strategy, selecting securities, and determining when and in what quantities to trade them. When Calabro informed Williams of transactions that Calabro selected or had already implemented, Williams felt he could not object to them because of his lack of knowledge and expertise.[24] We find this evidence particularly compelling in light of the law judge's determination that, based on his demeanor, Williams was an "especially credible" witness with respect to "his dealings with Calabro."[25]

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21 This statement belies Calabro's contention in his brief that the AASQ was merely intended to reflect the historical level of trades in the account.

22 *See Rangen*, 1997 WL 163991, at *4 (finding control where respondent "used his influence over his customers' accounts to pursue an aggressive, short-term trading strategy that was inconsistent with his customers' objectives"); *see also Cody*, 2011 WL 2098202, at *12 (finding control where respondent "controlled the volume and frequency of trading in the Customer accounts").

23 *See Roche*, 1997 WL 328870, at *7 n.14 (concluding that "[t]he evidence strongly show[ed] Roche exercised de facto control of trading . . . , as the customers routinely followed his recommendations"); *Michael David Sweeney*, Exchange Act Release No. 29884, 50 SEC 761, 1991 WL 716756, at *4 (Oct. 30, 1991) (finding control where customers routinely followed broker's recommendations); *see also Cody*, 2011 WL 2098202, at *12 (finding that respondent "maintained de facto control because the Customers did not independently evaluate his recommendations but rather acquiesced in his trades"); *Joseph J. Barbato*, Exchange Act Release No. 7638, 53 SEC 1259, 1999 WL 58922, at *12 (Feb. 10, 1999) (concluding that respondent exercised de facto control where client "testified that he placed his trust and confidence in [respondent] and allowed him to decide what to buy or sell in the account").

24 *See Arceneaux v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 767 F.2d 1498, 1502 (11th Cir. 1985) (sustaining jury finding of control where, although the plaintiff, "apparently discussed his account frequently with [broker], the jury could have concluded from [plaintiff's] testimony that he was somewhat intimidated by his broker and reluctant to make suggestions or contradict any suggestions that [broker] made").

25 *Cf. Newburger, Loeb & Co. v. Gross*, 563 F.2d 1057, 1070 (2d Cir. 1977) (noting that "determination of whether [client] exercised control over the account involved a question of fact,

(*continued . . .*)

Calabro's trading without obtaining Williams's prior permission further supports our finding that Calabro controlled the account.[26] Williams consistently testified that Calabro executed trades without advance permission, and Calabro could not definitively deny trading without authorization. Even though Calabro asserted that his "practice" was to "get prior authorizations" from his clients before he "d[id] anything," Calabro could not "remember 100 percent" whether he ever traded without prior authorization. Indeed, Calabro asserted that, given that "[t]hings [we]re very volatile," there were times he would have to "protect" Williams. Calabro also testified that he considered an opening and closing of a short position to be a single "connected" trade, consistent with a view that he did not need authorization to close a position. Weighing Williams's consistent testimony against Calabro's qualified denials, we reject Calabro's assertion that he did not make unauthorized trades.

Nor are we persuaded by Calabro's limited attempts to minimize the importance of his unauthorized trades. Calabro simply ignores Williams's testimony that Calabro closed short positions without seeking authorization and instead focuses on a specific unauthorized trade in JP Morgan securities that Williams referenced at the hearing. Calabro asserts that Williams's only concern regarding that trade was a discrepancy in the amount of profit from the sale. But Williams was concerned both that Calabro reported a fictional profit where there was none *and* that he learned of the trade only after it was made.[27] In any event, although Williams eventually learned of the bulk of Calabro's unauthorized trades from trade confirmations, such after-the-fact knowledge does not demonstrate that Williams approved those transactions *before* Calabro made them.[28] Accordingly, Williams's subsequent knowledge of Calabro's trading does not negate Calabro's control of the account.[29]

(. . . *continued*)
which turned largely upon the court's assessment of the witnesses' credibility and its judgment" regarding client's abilities).

26 *See supra* note 20.

27 Calabro's unauthorized transactions distinguish this case from *M & B Contracting Corp. v. Dale*, in which the court concluded that there was no "usurpation of control by [the broker], since he always had [the corporate client's] prior approval" of trades and "[a]t no time was a trade made without consultation." 601 F. Supp. 1106, 1111 (E.D. Mich. 1984).

28 *See Simpson*, 2002 WL 987555, at *13 (rejecting argument that customers who "received monthly statements and other forms notifying them of [unauthorized] transactions but filed no complaints" ratified the trades because, among other things, "after-the-fact 'acceptance' of an unauthorized trade does not transform that transaction into an authorized trade"); *Neil C. Sullivan*, Exchange Act Release No. 33613, 51 SEC 974, 1994 WL 46344, at *2 & n.1 (Feb. 10, 1994) (finding that applicant made unauthorized trades and noting that "[t]he fact that a customer ultimately accepts an unauthorized trade does not transform it into an authorized purchase").

29 *Cody*, 2011 WL 2098202, at *13 ("Cody argues that the Customers' review of confirmations and statements demonstrates their control, but we have rejected claims that the receipt of such post-trade notice amounts to control over accounts."); *see also* 1 Stuart C. Goldberg, *Fraudulent Broker–Dealer Practices* § 2.8[b][1][G] (1978) ("The arrogance of a

(*continued . . .*)

We also are not persuaded by Calabro's argument that Williams retained control over his own account because he was a sophisticated investor who taught statistics and various business courses as a university professor for many years and held an MBA. Unlike the customers in cases on which Calabro relies, Williams was not an active participant in Calabro's trading and did not suggest or reject any trades.[30] We also find it compelling that before Calabro became his broker, Williams had never invested in options, commodities, or traded on margin,[31] and his account had been invested in long positions (selected by his prior broker) that were held for many years.[32] Moreover, Williams lacked access to, and facility with, computerized sources of data necessary to effectively monitor the complex, shorting strategy that Calabro employed.[33]

(. . . *continued*)
registered representative making unauthorized purchases or sales for a non-consenting investor, followed by the obtaining of the investor's consent after the fact, is probably the most cogent evidence of control possible.").

30 *See, e.g.*, *Follansbee v. Davis, Skaggs & Co.*, 681 F.2d 673, 674-78 (9th Cir. 1982) (finding that client took "many positive steps . . . to insure that his account was actively traded," including active trading prior to introduction to defendant broker, participation in weekly financial seminar led by broker, regular review of investment literature, suggestion of investment prospects to broker, and enthusiasm for "active pursuit of the quick profit"); *Newburger*, 563 F.2d at 1070 (noting that client spent "over $100 per month on investment advisory services, in addition to subscribing to various financial journals" and initiated at least 10% of account transactions); *Morris v. CFTC*, 980 F.2d 1289, 1296 (9th Cir. 1992) (finding that client "took the time to independently monitor the gold and silver markets," "ma[d]e time to speak with [broker] about [his] account virtually 'on a daily basis,'" and "actually rejected a number of [broker's] suggestions"); *Xaphes v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 632 F. Supp. 471, 483-84 (D. Maine 1986) (determining that client "took an active role in the management of his account" and citing his rejection of broker recommendations).

31 *See Cody*, 2011 WL 2098202, at *12 (rejecting broker's assertion that customers "were sufficiently sophisticated to control their own accounts," because customers "had little if any experience evaluating individual bonds or short-term bond trading, and relied heavily on Cody's recommendations"); *see also Rizek*, 1999 WL 600427, at *6 (rejecting respondent's assertion that he lacked control because, among other factors, his customers "were self-employed businessmen accustomed to making business and financial decisions," where "customers placed their reliance on Rizek's supposed expertise, and almost invariably followed his recommendations").

32 We reject Calabro's assertion that Williams's alleged sophistication is evident because he "repeatedly boasted to having more than 30 years of investment experience" in signed account documents. Williams consistently testified that these statements regarding his purported investment experience were incorrect. In any event, as stated above, during the over fifteen years Williams maintained his Smith Barney account, he relied entirely on his broker to select transactions for him in a buy-and-hold strategy. He was not a sophisticated investor.

33 *See Carras*, 516 F.2d at 259 (considering "whether or not the customer, based on the *information available to him* and his ability to interpret it, can independently evaluate his broker's suggestions" (emphasis added)); *Rizek*, 1999 WL 600427, at *6 (finding control where

(*continued . . .*)

We also reject Calabro's argument that Williams was a sophisticated investor because he prepared an analysis of 2007 trading profits in his account. This analysis shows (at most) that Williams could arrive at the gain and loss from transactions through simple arithmetic.[34] It does not establish that Williams understood the risks associated with the trading strategy that Calabro devised or the factors that dictated Calabro's choices, or that Williams was capable of selecting or weighing in on the merits of the trades at issue.[35] Indeed, Williams's reference to "short gods" in the cover note to his analysis is further evidence that he lacked a detailed understanding of Calabro's trading.[36] And, although Williams knew that a short sale was a way to profit from a decline in a stock's price, that basic understanding does not demonstrate that Williams had sufficient knowledge and investment experience to evaluate Calabro's recommendations[37] and to reject trades he thought unsuitable.[38] Accordingly, for the reasons explained above, we find that Williams could not "independently evaluate his broker's suggestions" "based on the information available to him and his ability to interpret it,"[39] and was not a sophisticated investor who exercised control over his account.[40]

(. . . *continued*)
"[t]he information that [broker] supplied did not cure or alleviate his customers' lack of understanding"); *cf.* Securities and Exchange Commission, 96th Cong., 1st Sess., Report of the Special Study of the Options Markets, 440 (Comm. Print 1978) (finding that due to "option's short life and the complexity of options trading," "many customers rely heavily on their registered representatives for options trading decisions," that "[t]his reliance, in many cases, is so great that registered representatives can effectively control all trading in these customers' options accounts," and that "problems can arise" as a result of this control).

34 Nonetheless, Calabro identified errors in Williams's computations.

35 For example, with respect to options trading, Williams testified "I would not be able to do it because, let me see, if you do this, then what happens here? . . . I may be stupid but when I think about these things and how you would use them, my brain doesn't absorb that."

36 Williams also prepared a handwritten analysis of a J.P. Turner account for the friend who referred him to Calabro. Like the analysis of Williams's own account, this document did not purport to critique Calabro's trading or suggest alternative strategies or trades.

37 Rather, this basic knowledge is analogous to an investor's understanding that, in a long strategy, a customer hopes to profit from an increase in a stock's price.

38 Williams's testimony that if he "had a reason to say [no]" with respect to a particular trade, he "would have said it" supports his lack of understanding and experience. It does not establish that Williams was a sophisticated investor able to stand up to Calabro when necessary, as Calabro contends.

39 *Carras*, 516 F.2d at 259.

40 Relying on *Follansbee v. Davis, Skaggs & Co.*, Calabro asserts that the "touchstone" for determining if a representative controls a client account is "whether or not the customer has sufficient intelligence and understanding to evaluate the broker's recommendations and to reject one when he thinks it unsuitable." 681 F.2d at 677. Calabro asserts that, under this test, Williams was sufficiently sophisticated to preclude a finding that Calabro controlled Williams's
(*continued . . .*)

2. Calabro excessively traded Williams's account.

a. Factors applicable to determination of excessive trading

In determining whether a broker has engaged in excessive trading, we have considered, among other factors, the turnover rate and cost-to-equity ratio during the relevant period. "The turnover rate represents the number of times in one year that a portfolio of securities is exchanged for another portfolio of securities" and is calculated "by dividing the total [account] purchase[s] by the average account equity and annualizing the number."[41] The cost-to-equity ratio "measures the amount an account has to appreciate annually just to cover commissions and other expenses" and is obtained "by dividing total expenses by average monthly equity."[42] "While there is no definitive turnover rate or cost-to-equity ratio that establishes excessive trading," we have held that "a turnover rate of 6 or a cost-to-equity ratio in excess[] of 20% generally indicates that excessive trading has occurred."[43] But we also have found "excessive trading where the annual turnover ratio was 4 or less,"[44] and in accounts with cost-to-equity ratios less than 20%.[45]

(. . . *continued*)
account. We disagree. As explained above, the evidence does not demonstrate that Williams was sufficiently sophisticated regarding the investments at issue here to retain control of his account.

41 *Roche*, 1997 WL 328870, at *7 n.6. The turnover rate is sometimes referred to as the "turnover ratio." *See, e.g.*, *Cody*, 2011 WL 2098202, at *6.

42 *Peter C. Bucchieri*, Exchange Act Release No. 37218, 52 SEC 800, 1996 WL 254677, at *1 & n.4 (May 14, 1996). The cost-to-equity ratio is at times referred to as the "break-even cost factor," "cost-to-equity factor," "cost-equity maintenance factor," or other variants. *See, e.g.*, *Roche*, 1997 WL 328870, at *4 n.7.

43 *Daniel Richard Howard*, Exchange Act Release No. 46269, 55 SEC 1096, 2002 WL 1729157, at *3 (July 26, 2002), *aff'd*, 77 F. App'x 2 (1st Cir. 2003); *see also Harry Gliksman*, Exchange Act Release No. 42255, 54 SEC 471, 1999 WL 1211765, at *4 (Dec. 20, 1999) (holding that a turnover "rate in excess of 6 is generally presumed to reflect excessive trading"), *aff'd*, 24 F. App'x 702 (9th Cir. 2001).

44 *Barbato*, 1999 WL 58922, at *12; *Laurie Jones Canady*, Exchange Act Release No. 41250, 54 SEC 65, 1999 WL 183600, at *6 (Apr. 5, 1999) (turnover rates ranging from 3.83 to 7.28), *petition denied*, 230 F.3d 362 (D.C. Cir. 2000); *Roche*, 1997 WL 328870, at *4 (turnover rate of 3.3); *Gerald E. Donnelly*, Exchange Act Release No. 36690, 52 SEC 600, 1996 WL 20834, at *2 n.11 (Jan. 5, 1996) (turnover rates between 3.1 and 3.8).

45 *Simpson*, 2002 WL 987555, at *7, *8, *9, *14 (finding that trading in accounts with break-even rates of return of 11.98%, 12.01%, 13.88%, and 17.88%, among others, was excessive); *see also Gliksman*, 1999 WL 1211765, at *3-4 (finding excessive trading in the account of a conservative corporate investor with an annualized cost-to-equity ratio of 18%).

Other relevant factors in determining the existence of excessive trading include the "number and frequency of trades";[46] the client's "investment objectives and financial condition,"[47] age,[48] and retirement status;[49] and the existence of unauthorized trades.[50]

b. The turnover rate and cost-to-equity ratio, as well as other relevant factors, establish that Calabro excessively traded Williams's account.

Applying the factors outlined above, we conclude that Calabro excessively traded Williams's account over the relevant period.[51] We agree with the law judge that Williams's "investment objectives were capital preservation and capital appreciation" and "his risk tolerance was no greater than moderate." But Calabro's frequent trading, in short positions, exceeded the guideposts we have recognized as indicative of excessive trading because it produced a turnover rate of eight and a cost-to-equity ratio of 22.9%.[52] The sheer volume of Calabro's transactions was also excessive and far exceeded the three-to-six trades a month specified in the AASQ he completed for Williams, as well as the frequency of trading in Williams's Smith Barney account. Moreover, Calabro traded without authorization. Although no one of these factors is dispositive, we find that, under the circumstances, including consideration of Williams's age, trading history, and retirement status, Calabro's trading was excessive.

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46 *See Jack H. Stein*, Exchange Act Release No. 47335, 56 SEC 108, 2003 WL 431870, at *4 (Feb. 11, 2003) (noting that "the number and frequency of trades in an account provide an objective and reasonable basis for a finding of excessive trading").

47 *Cody*, 2011 WL 2098202, at *13 ("Customer investment objectives and financial situation are the benchmarks for evaluating whether the level of trading in any account is appropriate."); *Howard*, 2002 WL 1729157, at *2 (observing that account activity "must be consistent with the customer's investment objectives and needs").

48 *Bruff*, 1998 WL 730586, at *3 (considering, among other factors, client's age).

49 *Cody*, 2011 WL 2098202, at *13 (noting that accounts at issues "were to be used to fund retirement, demonstrating a need to protect principal and limit risk-taking"); *Barbato*, 1999 WL 58922, at *12 (finding that "[f]or an individual who is dependent on the account for retirement," rate of trading was "clearly excessive").

50 *Simpson*, 2002 WL 987555, at *14 (explaining that finding of excessive trading was "bolstered by the unauthorized nature of many of the trades").

51 We separately reject Calabro's assertions that his trading was not excessive because Williams had a high risk tolerance and intended that Calabro speculate in his account, *infra* Section III.B.2.c., and Calabro's attempts to discredit the testimony of Louis Dempsey, the Division's expert on excessive trading. *See infra* Section III.B.2.d.

52 *See supra* note 43.

c. We reject Calabro's argument that his trading in Williams's account was not excessive because Williams was a speculative investor.

Calabro argues that Williams was a speculative investor who wanted to short his account and documented that intention in various account forms and a note to Calabro. For this reason, Calabro contends, the account's high turnover rate and cost-to-equity ratio are consistent with Williams's intentions, rather than indicative of excessive trading. We do not agree.

The weight of the evidence establishes that the preferences stated in Williams's account documents were incorrect, as Williams consistently testified. We first reject Calabro's assertion that Williams's account documents conclusively establish his preference for speculation as a matter of law.[53] Rather, we have found that an account can be churned notwithstanding the customer's signature on an application purporting to state a preference for speculation.[54] We find it significant that Calabro, and not Williams, completed the portions of the account documents upon which Calabro now relies. Calabro concedes this, although he asserts that he completed the documents before Williams signed them, not after. But Williams uniformly testified that, although some portions of his account documents (such as his address) were prefilled, the account preference information in question was not added to the documents until after he signed them.[55] In contrast, Calabro's testimony as to his practices was inconsistent. Calabro initially

53 Calabro relies on inapposite case law to support his argument that Williams "cannot avoid" written "obligations or representations" by "asserting that the documents were not reviewed prior to signing." First, *Coleman v. Prudential Bache Securities, Inc.* holds that a party cannot avoid an arbitration agreement simply by asserting that she did not read it. 802 F.2d 1350, 1352 (11th Cir. 1986). But the issue here turns on Williams's true preferences, not contract enforcement. Second, *First Union Discount Brokerage Services v. Milos* held that the plaintiffs could not justifiably rely on an alleged misrepresentation that was contradicted by subsequent contracts that they signed without reading. 997 F.2d 835, 846 & n.21 (11th Cir. 1993). But justifiable reliance is not at issue here because reliance is not required in a Commission enforcement action. *See SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012).

54 *Michael T. Studer*, Exchange Act Release No. 50543A, 57 SEC 1011, 2004 WL 2735433, at *4 & n.10 (Nov. 30, 2004) (finding that account was churned where "check-mark indications on [client's] account application that [she] was interested in speculation [we]re contradicted by," among other things, her age and investment history); *see also Arceneaux*, 767 F.2d at 1500 (sustaining jury finding of churning although plaintiff "signed an options information sheet, stating his investment objective was trading profits" and "an options agreement which, by plaintiffs' own admission, clearly warned of the risks inherent in trading options").

55 We are not convinced by Calabro's argument that Williams's testimony should be rejected as inconsistent with a handwritten note he sent a Commission staff member in 2010. With the note, Williams forwarded a letter from J.P. Turner compliance that, in turn, attached a final, signed copy of Williams's Options Suitability Questionnaire. Calabro seizes on Williams's statement in the note that the Questionnaire was prefilled and mailed for his signature, as evidence that the Questionnaire was fully completed at the time Williams signed it, rather than

(*continued* . . .)

testified that he "never sent a blank account form to any customer," but later explained that he "[s]ometimes" did so and that customers, at times, would complete those forms incorrectly, which required the forms to be revised. In any event, it is undisputed that the stated account preferences are inconsistent with the conservative trading that Williams favored in the Smith Barney account he held for over fifteen years before retaining Calabro, as well as Williams's retired status and age.

There are additional reasons to believe that the account documents at issue did not represent Williams's true preferences, even assuming they were fully completed when Williams signed them. First, Williams's account application is not convincing evidence that Williams intended to speculate because Calabro initially invested Williams's account in long positions, as Williams's Smith Barney representative had done for over a decade and a half.[56] Calabro did not begin shorting until after Williams had signed the application. Second, we also are not convinced that Williams's execution of J.P. Turner's options documents establishes that Williams had a high risk tolerance. To the contrary, Williams signed the options documents because Calabro represented that he would use options trading as a hedge to *reduce* risk. Third, it also appears that Williams signed the active account documents, not to indicate his assent to aggressive trading, as Calabro asserts, but because Calabro told Williams that if he did not sign the documents J.P. Turner would prohibit Calabro from closing any of the short positions in Williams's account, thereby leaving Williams exposed to additional risk.[57]

Our conclusions are bolstered by the law judge's credibility findings, which supported his conclusion that Williams's "investment objectives did not include speculation and he did not

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(. . . *continued*)
only partially completed as Williams testified. We find Calabro's argument unpersuasive for three reasons. First, Williams's reference to the Questionnaire as prefilled is ambiguous. Williams does not explain if the document was completed in its entirety before he signed it (as Calabro claims) or only in part (as Williams testified at the hearing). Second, it appears that Williams may have misinterpreted the documents he sent the Commission staff member. In his cover note, Williams stated that "*[a]s you can see*," the Questionnaire "was 'pre' filled out and then mailed for my signature." (emphasis added). But these facts are not established by the documents Williams attached because the Questionnaire that he provided was not an unsigned, prefilled form sent for his signature, but rather a fully completed signed copy that J.P. Turner sent Williams. A reader thus cannot "see" if the Questionnaire was complete when Williams signed it. Third, the note addresses only one of the multiple account documents that Williams uniformly testified were not fully completed when he signed them.

[56] And, because the relevant portions of the account application are separated from the signature page by several pages, these portions might easily have been overlooked.

[57] We do not find persuasive Calabro's reliance on a checked box corresponding to speculation in an April 2009 application for an account Williams maintained at Newbridge Securities. Williams testified that the statement regarding speculation was wrong, and he requested Newbridge to correct it on multiple occasions. In any event, the trading in Williams's J.P. Turner account was more frequent than in the Newbridge account.

have an aggressive risk tolerance." "We give considerable weight to the credibility determination of a law judge since it is based on hearing the witnesses' testimony and observing their demeanor."[58] The law judge found that Williams was a "generally credible witness," and that his "demeanor, particularly his tone of voice, bolstered his credibility." The law judge also found that Williams's "testimony regarding his investment experience, his investment objectives, and his dealings with Calabro," were "especially credible." In particular, "Williams consistently and emphatically testified" that his account forms "contained inaccurate information, including his investment objectives and risk tolerance."[59] We see no reason to reject these findings based on the evidence discussed above, as Calabro urges.[60]

We also reject Calabro's argument that Williams necessarily intended to engage in a high volume of trades because he was aware of, and analyzed the performance of, Calabro's shorting in early 2008. That analysis covered only 2007 (approximately a year before the relevant period here), and Calabro had begun shorting only in November 2007. Moreover, when called upon to document his client's objectives in March 2008, Calabro identified a preference for three-to-six trades a month, substantially less than the frequent trading Calabro now seeks to justify.[61]

d. Calabro's challenges to the testimony of the Division's expert regarding excessive trading are meritless.

We find meritless Calabro's argument that the testimony of Louis Dempsey, the Division's expert regarding the excessive nature of Calabro's trading in Williams's account, should be excluded or disregarded. Calabro asserts that Dempsey (i) was not qualified to serve

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58 *Robert M. Fuller*, Exchange Act Release No. 48406, 56 SEC 976, 2003 WL 22016309, at *7 (Aug. 25, 2003) (internal quotation marks and citation omitted), *petition denied*, 95 F. App'x 361 (D.C. Cir. 2004); *see also Martin R. Kaiden*, Exchange Act Release No. 41629, 54 SEC 194, 1999 WL 507860, at *6 (July 20, 1999) (same).

59 "[A]s between Williams and Calabro," the law judge "generally f[ou]nd Williams to be the more credible witness" and concluded that "Calabro was, quite simply, not a believable witness on most crucial points."

60 This case is a far cry from *Kenneth R. Ward*, cited by Calabro, in which we rejected a law judge's credibility findings as "untenable" where testimony credited in the initial decision was "vague and self-serving" and "contradicted by overwhelming testimonial and documentary evidence in the record." *See id.*, Exchange Act Release No. 47535, 56 SEC 236, 2003 WL 1447865, at *10 (Mar. 19, 2003) (noting that overwhelming evidence included "consistent testimony of city officials from the two distinct municipalities involved, misleading facsimile transmissions [respondent] sent to city officials, and contemporaneous notes taken by one of those officials that supported the officials' testimony," as well as "transcripts of taped conversations between [respondent] and one of these officials" and additional testimony of officials from respondent's employer), *aff'd*, 75 F. App'x 320 (5th Cir. 2003).

61 We also reject Calabro's argument that Williams should be deemed a speculative investor because, among other things, he separately invested in oil wells. We find that those non-brokerage investments are beside the point with respect to his J.P. Turner account profile.

as an expert witness and failed to independently analyze Calabro's trading by adopting the Division's trading analysis as his own and (ii) should have adjusted his calculation of the turnover rate and cost-to-equity ratio to account for the sharp decline in Williams's account during the relevant period and Calabro's shorting.

i. Dempsey was well qualified to serve as an expert and independently analyzed Calabro's trading.

Contrary to Calabro's argument, we find that Dempsey was well qualified to serve as an expert. Among other things, Dempsey previously had provided training on churning and conducted many forms of trading analysis, and his expert report and testimony reflected a familiarity and facility with churning literature and concepts. Using established methodology, Dempsey independently verified and corrected the Division's trading analysis in several instances.[62] And, although Dempsey had not testified previously as an expert on churning, this does not bar his testimony (as Calabro suggests) because every expert must testify for the first time at some point.[63] We thus conclude that the law judge properly admitted Dempsey's testimony under our Rule of Practice 320.[64]

ii. Dempsey properly applied the established methodologies in calculating the turnover rate and cost-to-equity ratio.

We also find unpersuasive Calabro's argument that Dempsey's opinion should be excluded or given diminished weight because he did not revise his methodology for calculating the turnover rate and cost-to-equity ratio in light of the steep decline in Williams's account and Calabro's use of shorting. Calabro asserts that Dempsey's opinion thus failed to satisfy the standard for admission of expert evidence established by the Supreme Court in *Daubert v. Merrell Dow Pharmaceuticals, Inc.*[65] But although *Daubert* does not apply because the Federal

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62 *Cf. Donnelly*, 1996 WL 20834, at *2 n.11 (rejecting claim that NASD failed to "perform its own independent analysis," where "NASD calculated the turnover rates, and derived results consistent with," calculations performed by registered representative's employer).

63 *Cf. Paine v. Johnson*, No. 06-cv-3173, 2010 WL 785398, at *3 (N.D. Ill. Feb. 26, 2010) (rejecting argument that expert witness was unqualified to testify under the Federal Rules of Evidence "because he [wa]s not one of the usual suspects, as 'there is a first time in court for every expert' and experts need not be 'professional witnesses' to be qualified in their areas of expertise" (citing *United States v. Parra*, 402 F.3d 752, 758-59 (7th Cir. 2005)).

64 17 C.F.R. § 201.320 (permitting the admission of relevant evidence and excluding "all evidence that is irrelevant, immaterial or unduly repetitious"); *accord* Administrative Procedure Act Section 556(d), 5 U.S.C. § 556(d). Calabro does not challenge the admission of Dempsey's opinion under this standard.

65 509 U.S. 579 (1993) (applying Federal Rule of Evidence 702); *see also Kumho Tire Co. v. Carmichael*, 526 U.S. 137, 141 (1999) (extending *Daubert* approach to non-scientific evidence).

Rules of Evidence are inapplicable in our administrative proceedings,[66] we see nothing in Dempsey's report or testimony that violates its "spirit."[67]

Dempsey calculated the turnover rate and cost-to-equity ratio using established formulas routinely used in cases alleging excessive trading.[68] Indeed, Calabro concedes that "the Commission and the courts have considered two metrics as indicators of excessive trading—the turnover and cost/equity ratios." Although Calabro attacks Dempsey's use of these measures, Calabro offered no expert testimony supporting his critiques of Dempsey's calculations and cites no case, scholarly article, or other apposite authority supporting those critiques. Consistent with this lack of authority, we specifically reject each of Calabro's three articulated attacks on Dempsey's calculations. We also find that calculating the turnover rate and cost-to-equity ratio as Calabro urges would not alter our conclusion that Calabro excessively traded Williams's account.

Use of average account value in turnover rate: Calabro argues that because Williams's account declined rapidly during the relevant period, Dempsey should have calculated the turnover rate by dividing total account purchases by the account's initial value (reduced by the value of commissions), rather than its (lower) average value. Calabro's proposed revision would decrease the turnover rate because, given the decline in Williams's account, its initial value (less

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66 *Del Mar Fin. Servs., Inc.*, Exchange Act Release No. 48691, 56 SEC 1350, 2003 WL 22425516, at *8 (Oct. 24, 2003) ("We have stated on numerous occasions that the Federal Rules of Evidence . . . are not applicable to our administrative proceedings which favor liberality in the admission of evidence.").

Although *Daubert* recognized a "gatekeeping role for the judge" before expert evidence is presented to the trier of fact, *Daubert*, 509 U.S. at 597, "[t]he 'gatekeeper' doctrine was designed to protect juries and is largely irrelevant in the context of a bench trial." *Deal v. Hamilton County Bd. of Ed.*, 392 F.3d 840, 852 (6th Cir. 2004). We see no reason why a law judge, if he deems it appropriate, cannot hear expert testimony (and cross-examination) and then determine what weight to give that testimony. *See City of Anaheim*, Exchange Act Release No. 42140, 54 SEC 452, 1999 WL 1034489, at *2 (Nov. 16, 1999) ("Administrative agencies such as the Commission are more expert fact-finders, less prone to undue prejudice, and better able to weigh complex and potentially misleading evidence than are juries.").

67 *Cf. Niam v. Ashcroft*, 354 F.3d 652, 660 (7th Cir. 2004) (holding that "'[j]unk science' has no more place in administrative proceedings than in judicial ones").

68 *See Stein*, 2003 WL 431870, at *4 n.26 (collecting authority for the proposition that "modified Looper formula" is a "method of calculating the turnover rate [that] has been repeatedly used by the Commission"); *Rafael Pinchas*, Exchange Act Release No. 41816, 54 SEC 331, 1999 WL 680044, at *5 & n.20 (Sept. 1, 1999) (stating that "[a]nother indicator of excessive trading is the cost-to-equity ratio" and citing examples of its use); *see also Kenneth C. Krull*, Exchange Act Release No. 40768, 53 SEC 1101, 1998 WL 849545, at *4 (Dec. 10, 1998) (observing that analysis of "turnover ratios and cost-equity maintenance factors" is "the type of analysis applied when determining whether an account has been churned or excessively traded"), *aff'd*, 248 F.3d 907 (9th Cir. 2001).

commissions) exceeds its average monthly value.[69] But we find that the decline in Williams's account value is not an unusual occurrence requiring a modification to the established turnover rate formula because churning and losses frequently coincide.[70] In addition, average account value yields a more accurate indication of turnover than a modified initial value because average value better reflects the variations in an account over time.[71] This is particularly appropriate because the turnover rate is calculated based on the purchases in the account over the entire relevant period, not just those purchases in its first month.

Calabro attempts to support his argument using a citation to the 1978 Special Study on options trading, but his reliance is misplaced. Calabro cites the Study for the out-of-context proposition that "if the values of portfolio securities change significantly, the [turnover rate] formula will not accurately reflect the ratio of the amount of purchases to the amount of total capital available for investment." But Dempsey did not apply the turnover formula that the passage criticizes. Instead, he applied a revised formula (the modified Looper formula) that addressed the concern identified in the passage.[72]

In any event, calculating the turnover rate in the manner Calabro suggests would make little difference because it still would yield a 5.4 turnover rate. That calculation approaches the rate of six that we have found is generally indicative of excessive trading and exceeds levels at which the Commission previously has found excessive trading in other cases.[73]

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69 Dempsey calculated the turnover rate using the modified Looper formula, which necessitates "dividing total cost of purchases by average monthly equity." *Bucchieri*, 1996 WL 254677, at *6 n.3 (citing *Allen George Dartt*, Exchange Act Release No. 24198, 48 SEC 693, 1987 WL 757985, at *2 n.6 (Mar. 10, 1987)). Dividing by a greater number (initial account value minus commissions) than provided in the formula (average account value) would decrease the turnover rate.

70 We have used the turnover rate to assess the excessiveness of trading in cases in which a client's account value drastically declined. *See, e.g.*, *Roche*, 1997 WL 328870, at *4 (citing ratios relevant to churned accounts where clients lost between 75% and 95% of amounts invested during relevant period).

71 Calabro argues that, if an account's value falls without trading, the turnover rate will be lower than if the value of the account held constant. This criticism is inapposite here because Calabro frequently traded Williams's account. It did not decline under a buy-and-hold strategy.

72 As originally conceived in *Looper & Co.*, Exchange Act Release No. 5676, 38 SEC 294, 1958 WL 55531 (Apr. 15, 1958), the turnover rate formula did not consider the value of securities held in an account. The Special Study thus explained "[i]f substantial securities positions are held in the account . . . , the [original] formula substantially overstates the degree of activity since the value of these positions is excluded from the amount of average monthly investment." As suggested in the Special Study, Dempsey applied a formula (the modified Looper formula) that takes into account the value of held securities.

73 *See supra* note 44.

Effect of shorting on turnover rate: We also are not persuaded by Calabro's argument that, to adjust for Calabro's shorting, Dempsey should have calculated the turnover rate not by using the value of purchases (as is standard), but rather by using the value of sales (for which Calabro cites no precedent).[74] This modification is appropriate, Calabro argues, because when an investor shorts a stock, he first sells borrowed stock and only later repurchases the stock to close the position. This reverses the normal order of transactions from that in a long position, where a purchase precedes a sale. Because the total value of sales in Williams's account over the relevant period is less than the total value of purchases (given Calabro's trading losses), calculating turnover using sales ("opening" transactions) instead of purchases ("closing" transactions), as Calabro proposes, would reduce the turnover rate.

But the reason that Calabro's revision would bring down the turnover rate has nothing to do with the reversal of the usual order of transactions in Williams's account dictated by Calabro's shorting strategy. Rather, it is that, on the whole, Calabro lost money trading Williams's account, making the total value of sales less than the total value of purchases. But selling securities for less than the investor paid for them is not unique to, or necessarily the result of, shorting. If a broker takes long positions and, on the whole, sells those positions for less than their total purchase price (causing a loss in the account), the total value of purchases will exceed the total value of sales. In that instance, calculating turnover using the value of sales, as Calabro urges, would reduce the turnover rate, even though the broker used long positions. On the other hand, if a broker made money using either short or long positions, applying Calabro's revised formula would increase the turnover rate because the total value of sales would exceed the value of purchases. Because Calabro raises nothing unfair or unique to shorting in his argument, we decline to depart from the standard turnover rate formula.[75] We will not apply a different formula simply because Calabro lost money shorting.

In any event, calculating turnover as Calabro advocates still yields a 6.6 turnover rate, which exceeds the rate we have found generally indicative of excessive trading.[76]

Use of average account value in cost-to-equity ratio: Third, we also reject Calabro's argument that Dempsey should have calculated the cost-to-equity ratio based on the initial value of Williams's account (subtracting commissions), rather than the account's average value (as the established formula does). Calabro asserts that this modification to the formula is appropriate because Williams's account declined rapidly during the relevant period. We disagree. Calculating the cost-to-equity ratio based on Williams's account's initial value would assume that

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74 Dempsey testified that it would be unusual and inappropriate to calculate the turnover rate by reference to sales instead of purchases. Calabro also used the value of sales in his calculation of the 5.4 turnover rate discussed in the preceding section.

75 We also reject Calabro's argument that where an account loses money shorting, there is an unfair "double effect" that increases the turnover rate by affecting both the numerator and denominator in the turnover formula. To the extent that such an effect exists, it is a function of the factors addressed above in Calabro's first two arguments and does not present a basis to modify the turnover rate formula.

76 *Howard*, 2002 WL 1729157, at *3.

the account lost no money other than transaction costs. But the cost-to-equity ratio measures the amount that an account must appreciate just to pay the fees charged by the broker over the relevant period.[77] Assuming a constant account value (even adjusted to take out commissions) would ignore the results of Calabro's trading and thus understate the account appreciation necessary to cover the fees he charged Williams. In any event, Calabro's adjustment decreases the cost-to-equity ratio only to 18.7%, which approaches the 20% level that the Commission generally considers excessive,[78] and exceeds levels at which excessive trading has been found or considered to occur.[79]

3. Calabro acted with scienter because his trading in Williams's account was at least reckless.

a. Standard applicable to scienter

Scienter is "a mental state embracing [an] intent to deceive, manipulate, or defraud,"[80] and "is established either by evidence of intent to defraud or by evidence of willful and reckless disregard of the customer's interests."[81] We have stated that scienter "may be inferred from the amount of commissions charged by the registered representative."[82]

b. Calabro exhibited reckless disregard for his customer's interests.

The record establishes that Calabro knew that his client was 70 years old and retired, but he nonetheless coordinated an excessive trading strategy predicated on frequent shorting and options trades, which was contrary to Williams's true account objectives and trading history. Calabro also engaged in unauthorized trading and, at times, exaggerated the results of his trading.[83] And although Williams's account declined from approximately $1.9 million to

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77 *Bucchieri*, 1996 WL 254677, at *1 & n.4.

78 *Howard*, 2002 WL 1729157, at *3.

79 *See supra* note 45.

80 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

81 *Rizek*, 1999 WL 600427, at *5; *Studer*, 2004 WL 2735433, at *4-5; *Roche*, 1997 WL 328870, at *4.

82 *David Wong*, Exchange Act Release No. 45426, 55 SEC 602, 2002 WL 200089, at *4 (Feb. 8, 2002) (citing *Rivera v. Clark Melvin Securities Corp.*, 59 F. Supp. 2d 280, 289 (D.P.R. 1999) and *Sheldon Company Profit Sharing Plan & Trust*, 828 F. Supp. 1262, 1273 (W.D. Mich. 1993)); *cf. Armstrong*, 699 F.2d at 91 (finding that "the scienter required" for a finding of churning is "implicit in the nature of the conduct"); *Dzenits v. Merrill Lynch, Pierce, Fenner, & Smith, Inc.*, 494 F.2d 168, 171 n.2 (10th Cir. 1974) (holding that "proof of churning does not require proof of a specific or invidious intent to defraud").

83 The law judge specifically found Williams's testimony that "Calabro would sometimes exaggerate the results of his trading" to be credible. This exaggeration, Calabro's unauthorized trading, and the much more frequent trading than specified in the AASQ distinguish *Hotmar v.*

(*continued . . .*)

approximately $550,000 over the relevant period (principally attributable to Calabro's trading rather than withdrawals), Calabro received nearly $250,000 in commissions from that trading.[84] In short, the risk that Calabro's excessive trading was in derogation of Williams's investment objectives and contrary to Williams's interests was so obvious that Calabro must have been aware of it. We accordingly find that Calabro willfully and recklessly disregarded Williams's interests and thus acted with scienter.

Calabro denies that he acted with scienter for two principal reasons, each of which we reject. First, Calabro asserts that he "followed a strategy which he explained to each of his customers and which was reviewed and approved by his superiors." The record does not support this contention. Despite his claims of transparency, Calabro executed unauthorized trades and traded much more frequently than the three-to-six trades a month that he himself indicated in the AASQ.[85] We also are not convinced that Calabro's supervisors made a thorough review of his trading in Williams's account after it raised red flags internally. Among other things, there is no indication that Calabro's supervisors were aware of Williams's history of conservative investing or his true account objectives or that they ever spoke with him.[86]

Second, we also reject Calabro's argument that he did not act with scienter because he consistently had Williams's best interests in mind and worked tirelessly on his behalf. Calabro asserts that he extensively researched his trading strategy, was initially very successful using it, and experienced the substantial losses in Williams's account solely as a result of his honest miscalculations about the effect and extent of government intervention in the economy. Calabro's assertion that he initially made money in Williams's account (in part before the

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(. . . *continued*)
Lowell H. Listrom & Co., Inc., 808 F.2d 1384, 1386 (10th Cir. 1987), in which the Court "fail[ed] to perceive any real evidence of deception" by the alleged churner.

84 *Roche*, 1997 WL 328870, at *5 (finding that, where respondent's "clients were sustaining large losses while he was generating substantial commission income for himself," "[a]t the least, Roche acted in reckless disregard of his customers' interests and account objectives, and in favor of his own interests"). Calabro blames market upswings for the poor performance of his shorting strategy. But nothing compelled Calabro to follow a frequent trading strategy that benefitted him at his client's expense.

85 *Cf. Rizek*, 1999 WL 600427, at *6 (finding scienter where "[e]ven assuming that Rizek believed in the efficacy of his strategy, he had no justification for recommending it to unsophisticated customers who were incapable of making an independent judgment, when he knew that the extremely high risk was directly contrary to the customers' conservative investment objectives").

86 Calabro relies solely on alleged review by J.P. Turner's Executive Vice President, Michael Bresner, who the law judge found had failed to reasonably supervise Konner and Koutsoubos, and James McGrath, who did not testify. Although Bresner testified that McGrath told him that he had talked to Calabro's customers (at a time when their accounts purportedly had increased in value), Bresner conceded that he did not know the names of the clients McGrath called. Indeed, there is no evidence that McGrath or Bresner spoke with Williams.

relevant period) does not excuse his excessive trading. That an account makes money does not mean it is free from churning, which will decrease the gains a customer would receive but for the churning.[87]

Calabro also argues that, had he wanted to churn Williams's account, he could have done so much more easily by frequently trading in and out of recommended stocks. We do not find this assertion compelling. That Calabro did not pursue a more transparent form of misconduct does not establish that he did not churn Williams's account. Indeed, after Williams's account suffered losses from shorting attributable to the market recovery in March 2009, Calabro accelerated his trading in Williams's account over the next three months. Although the increased frequency of trading no doubt required more effort from Calabro, we conclude that it was no coincidence that that it benefitted him. Accordingly, we find that Calabro enriched himself by receiving substantial commissions at Williams's expense and acted, at a minimum, recklessly in excessively trading Williams's account.

* * *

For the reasons set forth above, we find that Calabro's excessive trading of Williams's account was fraudulent. We thus conclude that Calabro violated Securities Act 17(a), Exchange Act Section 10(b), and Rule 10b-5.

IV.

A. Facts relating to Jason Konner

Jason Konner began working in the securities industry in 1994. He holds Series 7 and 63 securities licenses and worked as a registered representative at several other brokerage firms before joining J.P. Turner's Brooklyn branch in September 2006. Konner spent much of his time at J.P. Turner "prospecting" new clients—i.e., trying to get additional clients through cold calls—often making more than 200 calls a day. Konner testified that when he searched for new clients he looked for experienced investors and those who could afford to speculate. When he started at J.P. Turner, Konner had approximately 20 clients. By 2010, he had approximately 200. At J.P. Turner, Konner was compensated solely based on commissions and received 65% of the commissions charged to his clients.

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87 *Studer*, 2004 WL 2735433, at *5 ("The existence of churning does not turn on whether the customer lost money. . . . An account may be churned even if the customer shows a profit on the excessive trading."); *accord Davis v. Merrill Lynch, Pierce, Fenner & Smith*, 906 F.2d 1206, 1218 (8th Cir. 1990) (refusing to recognize profit as a defense to churning claim because "securities brokers would be free to churn their customers' accounts with impunity so long as the net value of the account did not fall below the amount originally invested"); *Nesbit v. McNeil*, 896 F.2d 380, 385-86 (9th Cir. 1990) (finding that plaintiff was entitled to recover for churning despite an increase in the value of the portfolio and that portfolio gains will not offset losses due to commissions from churning), *overruled on other grounds by Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 501 U.S. 350 (1991).

1. James Carlson, a self-employed Iowa farmer, opened a J.P. Turner account in July 2007.

After a cold call from Konner and a few follow-up telephone conversations, James Carlson opened an account with J.P. Turner in July 2007. Carlson is a self-employed farmer residing in Winfield, Iowa. He graduated from Iowa State University with a degree in agriculture and has farmed corn and soybeans for over 30 years. At the time he opened his J.P. Turner account, Carlson had a few individual retirement accounts and one non-retirement account. All of these accounts were managed "fairly conservative[ly]," with a buy-and-hold approach and relatively few trades. Carlson does not consider himself a sophisticated investor and does not believe that he has the expertise to trade stocks on his own. He does not regularly read investment-related periodicals and only occasionally watches investment-related television shows "for entertainment."

Carlson testified that Konner was "a good salesman" and that he decided to open a J.P. Turner account because he "assumed [Konner] knew what he was doing" and he "thought [Konner] had ideas." At the time Carlson opened the account, he told Konner that his goal was "to make money," but they never discussed a trading strategy. Carlson initially deposited about $6,500 into his J.P. Turner account.

With this relatively small amount of money, Carlson said he was willing to "take a few chances." This was reflected in the account application that J.P. Turner sent to Carlson with relevant information about the account's objectives and his finances already filled in: the primary investment objectives for the account were marked "Trading Profits" and "Speculation" and Carlson's risk tolerance was marked "Aggressive." Although Carlson agreed that the account application reflected his investment objectives and risk tolerance "[w]ith a small amount of money," he testified that "[w]ith a large amount of money" it did not. He also agreed that the information in the account application about his personal finances—income, net-worth, and investable assets—was accurate at the time. Carlson testified that he "glanced over" the account application briefly before signing it, but because "everything came filled out," he did not read it closely.

2. Konner made the investment decisions in the account and engaged in active trading including unauthorized transactions.

By April 2008, Carlson had deposited significantly more money into his J.P. Turner account—over $200,000—derived from proceeds he had received from a successful farming season. With the additional funds, Konner began to execute more and more trades. According to Carlson, "Konner made the decisions" for the transactions in the account. Konner initiated essentially all of the trades in the account in 2008 and 2009—a fact reflected in the account statements, which show virtually all of the transactions were marked "solicited." Although Carlson remembered mentioning a few stocks picks to Konner, he could specifically recall Konner purchasing only one of his suggestions. Carlson testified that he "went along with" Konner's recommendations "probably 100 percent" of the time. For his part, Konner insisted that he and Carlson were "managing [the account] together" and that Carlson declined trades, but

Konner conceded that "the vast majority of the trades were done at [his] recommendation" and that Carlson went along with "the majority of the recommendations."[88]

When they spoke on the telephone, Konner usually called Carlson and did most of the talking. Carlson did not typically ask Konner many questions. Carlson did not conduct any independent research on stocks, and Konner rarely sent him investment research. Instead, when deciding whether to accept a recommendation, Carlson typically had only the information Konner gave him over the telephone at the time Konner called with the recommendation. Konner himself acknowledged that Carlson was relying on Konner's knowledge of the market, and Carlson testified that he was willing to go along with Konner's recommendations because he trusted Konner.

Carlson's trust in Konner was further demonstrated by his not objecting to unauthorized trading. Carlson testified repeatedly and emphatically that Konner executed transactions in the account without first obtaining Carlson's permission. When asked specifically whether Konner called every time a trade was made, Carlson responded, "No. Oh, no. I would have been on the phone all day." When asked why he never confronted Konner about the unauthorized trading, Carlson explained that he "thought it was okay for [Konner] to do that, as my broker" and that he trusted Konner. Konner denied unauthorized trading in Carlson's account, but the law judge credited Carlson's testimony on this point.

As the trading in the account increased in volume and frequency through 2008 and 2009, Carlson found it difficult to keep up with the activity because "there were so many trades and so many companies involved that [he] didn't know anything about." Carlson acknowledged that he received trade confirmations and account statements, but testified that "for the most part" he did not review account statements when he received them. When he was busy farming, Carlson might not have even opened the account statements, and he often just threw them in a box because he "didn't have time to go through all the mail."

In the second quarter of 2008, because of the high level of activity, J.P. Turner placed a commission restriction on the account of $100 per trade.[89] Konner was "upset" about the restriction. According to Konner's testimony, he notified Carlson of the change in commissions

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88 Konner insisted that Carlson declined his recommendations for some mutual funds and a real estate investment trust, but in his testimony Konner appears to confuse Carlson with another customer, Gordon Miller. For example, Konner testified that both Carlson and Miller had acknowledged during the hearing "that they declined to buy the mutual funds and the REIT that I recommended." In fact, Carlson never testified to this effect.

89 The trigger for the restriction was a high ROI ("return on investment") number in J.P. Turner's Account Activity Review System. What J.P. Turner called ROI in this context is essentially the same as the cost-to-equity ratio. *Compare Bresner*, 2013 WL 5960690, at *4 ("ROI was measured by adding all charges to the account, including fees, commissions, and margin interest, and dividing that total by the average market value over the twelve preceding months.") *with supra* note 42 and accompanying text (explaining that the cost-to-equity ratio is obtained by dividing total expenses by average monthly equity).

but did not tell him it was imposed because of active trading in the account.[90] In any event, Carlson did not "keep up with the commissions" he was being charged in the account.

3. Carlson raised concerns to Konner, but Konner continued to actively trade the account through at least the end of 2009.

At some point in 2008, Carlson became concerned about the "level of activity" in the account and "the fact that [the] account was dropping" in value. Carlson told Konner "several times" that the account needed to perform better and that he "c[ould]n't afford to lose" the money in the account.[91] But the active trading in Carlson's J.P. Turner account continued in 2009. In fact, J.P. Turner's Account Activity Review System put Carlson's account at the highest level for trading (Level 4) each quarter from the second quarter of 2008 to the third quarter of 2009. In 2009, Konner executed 118 sales totaling $4,163,638.86 and 134 purchases totaling $4,419,365.84. This trading generated commissions to J.P. Turner of $87,686, with over $55,000 of that amount going to Konner. According to the analysis of the Division's expert, Dempsey, the turnover rate in 2009 was 17 and the cost-to-equity rate was 34.6%. In April, June, and September 2009, the account experienced particularly active trading, with 30 or more trades in each of those months.

4. The account forms signed by Carlson generally did not reflect his financial goals and situation.

After opening the account, Carlson signed several account documents referencing his investment objectives, risk tolerance, and personal financial condition. In every document but one, someone at J.P. Turner filled in the relevant information in these areas and sent the document to Carlson for his signature. The information on these documents, which span from April 2008 to August 2011, was quite consistent. The prefilled forms indicated that Carlson had an annual income of $200,000, a liquid net worth of $750,000, and a net worth of either $2.5 or $2 million.[92] The prefilled forms also indicated (when they included a section for such information) that speculation and short-term trading were the account's primary investment objectives and that Carlson's risk tolerance was aggressive. Carlson testified that he did not read

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90 Konner testified that he negotiated his commission "on a trade by trade basis" with his customers, but later admitted that he did not discuss the commission on each trade with Carlson after the $100 restriction was in place. Carlson recalled a discussion with Konner about commissions only on the "early trades back in 2007" but testified that Konner never "negotiate[d]" the commission with him.

91 Konner gave inconsistent testimony on this topic at the hearing, first testifying that "I don't recall Mr. Carlson ever being upset with commission *or performance* in his account," but later stating that when the account was losing money Carlson did "complain." He denied that Carlson told him that he could not afford to lose his money.

92 Unlike the other forms, the August 2011 form had printed ranges for these categories. The following ranges were preselected by someone at J.P. Turner before the form was sent to Carlson: Annual Income – "> $100,000 < $250,000"; Liquid Net Worth – "> $100,000 < $500,000"; Net Worth – "> $1,000,000 < $2,500,000."

these documents closely when he received them and that he simply signed and returned them to Konner because he thought they were forms that "just had to be on file in [Konner's] office." Carlson explained his approach to the prefilled forms in this way: "I just got stuff from my broker and they had it marked where I was supposed to sign and that's usually what I did, because I trusted my broker."

During the hearing, Carlson stated, in testimony credited by the law judge, that the information in the prefilled forms was incorrect. Had he filled out the forms himself he would not have marked "speculation" as his primary investment objective or "aggressive" as his risk tolerance.[93] Carlson further insisted that he "wasn't worth near" $2 or $2.5 million and that he told Konner this "several times." At least once when Carlson told Konner the net-worth figure was incorrect, Konner told Carlson to "just initial" the form because "it really doesn't mean anything." Based on this representation and because he trusted Konner, Carlson signed the forms, even though he knew they contained inaccurate information. Konner denied that Carlson told him the net-worth numbers were incorrect and that he told Carlson they did not matter, but the law judge rejected Konner's testimony on this point.[94]

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93 Upon cross-examination, Carlson agreed that he did not have "conservative" investment objectives or risk tolerance for the account, but as the law judge found, the record shows "that Konner failed to explain, and Carlson failed to understand, the various types of investment objectives as they apply in the securities industry." For example, when asked directly what the investment objective was for his non-retirement account held with another broker, Carlson responded, "It's local so it's just a place to put some spare money and money I don't think I'm going to need for a while and then he gives me a recommendation on maybe buying a stock or something. So that's why it's there, I guess." Carlson was then asked, "Do you understand what the term investment objectives means?," to which he responded, "Well, I guess I do. I don't know." And when asked about the investment objectives selected on the prefilled April 2008 account update form, Carlson testified, "I still don't understand the difference between trading profits and speculation but, I mean, to me, trading profits makes it sound like any stock you buy, you'll obviously make money on it. Well, that would obviously become the number one rank if you're going to make money on every stock."

94 Even without the benefit of observing Konner's demeanor, we agree with the law judge that Konner's denials on this issue lack credibility. For example, in answering the Division's questions on this topic, Konner was inconsistent and evasive, often failing to give a direct answer:

> Q: Isn't it true that he told you his net worth was nowhere near two to two-and-a-half million dollars?
>
> A: All I know is what he told me and what he signed with the document. What he told me and what he signed to shows that.
>
> Q: Do you have a recollection of what he told you about his net worth?
>
> A: It's what was put down on the form he signed.
>
> Q: You remember him telling you he was worth two-and-a-half million dollars?

(*continued . . .*)

Tellingly, the only J.P. Turner form with all the information filled in by Carlson himself—a February 2010 AASQ—looks markedly different from the prefilled forms. Neither "speculation" nor "short-term trading" is marked as an investment objective,[95] and Carlson's annual income is shown as $120,000, his liquid net worth as $400,000, and his net worth as $800,000. As the law judge found, "Konner failed to provide a credible explanation for the change in the financial information on the forms or the inaccuracies contained thereon."

5. Even after substantial losses, Carlson hoped that Konner could turn the account around.

The value of Carlson's account declined significantly in 2010, but he kept the account open, thinking "that at some point in time, [Konner] would get things headed in the right direction." Konner remained Carlson's registered representative until Konner left J.P. Turner at the end of 2011, by which point Carlson had lost hundreds of thousands of dollars in his account, a substantial portion of which was attributable to commission charges. As Carlson testified at the hearing, "I kept giving [Konner] too many chances to try and turn it around."

B. Based on our analysis of the facts, we conclude that Konner churned Carlson's account between January and December 2009.

As the analysis below demonstrates, in 2009, Konner (1) had de facto control over Carlson's account, (2) excessively traded the securities in the account, and (3) acted with scienter. We thus find that Konner churned Carlson's account in violation of Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5.

(. . . *continued*)

A: If that is what is put down there, yes.

. . .

Q: Isn't it true when discussing this form with Mr. Carlson, you told him the numbers didn't matter and they were merely a formality?

A: If the numbers didn't matter, we wouldn't be sending this out to him.

. . .

Q: Isn't it true that Mr. Carlson told you he wasn't worth two-and-a-half million dollars?

A: I only know what the client told me and what he signed to on the document.

. . .

Q: Mr. Konner, Mr. Carlson was emphatic, said several times he told you that he wasn't worth anywhere near $2.5 million. Do you have a recollection of him saying that to you?

A: He also initialed next to it acknowledging that that is exactly what he told me at that point in time.

95 Carlson selected "Trading Profits" as his investment objective on the February 2010 AASQ, but as noted previously, *see supra* note 93, he did not understand what this term meant.

1. Konner exercised de facto control over Carlson's account.

Upon our de novo review of the record, we find that Konner exercised de facto control over Carlson's account. The record shows that Konner was in control of the volume and frequency of the trading in the account. As Carlson testified at the hearing, "Konner made the decisions" for the trading in the account. Konner initiated essentially all of the transactions during the churn period. In addition, the record indicates that Carlson lacked the knowledge and experience to independently evaluate Konner's recommendations. Carlson did not do any independent investment research. Instead, Carlson habitually relied on Konner and, because he trusted him, "went along with" Konner's recommendations "probably 100 percent" of the time.

Konner's unauthorized trading is further evidence that he had control of the account.[96] In testimony credited by the law judge, Carlson repeatedly stated that Konner did not get his approval before executing transactions in the account. Carlson testified that Konner's unauthorized trading occurred "a lot," and there were many trades for which Konner never sought his approval, even after the fact. Carlson never confronted Konner about the unauthorized trading because he mistakenly believed that Konner, as his broker, could trade without his prior approval.

Konner concedes that Carlson was not a sophisticated investor, that "the lion's share of the activity was initiated by Konner," and that "Carlson accepted most of Konner's recommendations," but he insists that other evidence in the record shows that Carlson maintained control of his account. We disagree. Konner points to the fact that Carlson was a successful farmer who prepared his own tax returns and had other investment accounts, but this is not persuasive evidence that Carlson maintained control of his J.P. Turner account.[97] The record shows that Carlson's other accounts were mostly retirement accounts and that all of his other accounts were managed conservatively with few trades in them. Konner does not dispute this but argues that the existence of the other accounts means that Carlson had "other brokers to go to if he wanted to pursue a different investment approach or philosophy with any or all of his money, or if he needed information or guidance about how to deal with a broker engaged in conduct he didn't understand or thought was misguided." But whether Carlson knew other brokers that he could turn to for advice is beside the point. The relevant question for purposes of control is whether Carlson himself had the wherewithal to independently evaluate Konner's recommendations.[98] The preponderance of the evidence in the record, including evidence of Carlson's prior investment experience, shows that he did not.

In support of his argument that Carlson maintained control of the account, Konner points to the fact that Carlson deposited money into his J.P. Turner account rather than other more

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96 *Supra* note 20 and accompanying text.

97 *Rizek*, 1999 WL 600427, at *6 (rejecting the argument that because the customers were "successful businessmen" they controlled their accounts and noting that the customers lacked "the degree of investor sophistication necessary ... to make any sort of independent evaluation" of the broker's recommendations).

98 *See supra* notes 19 and 39 and accompanying text.

conservative accounts and told Konner he wanted to "make money" with the account. As the Division points out, a desire to make money "is every investor's intent," and Carlson telling this to Konner is not evidence of control. Moreover, even if Carlson was willing to accept more risk in his J.P. Turner account than in his other accounts, his decision to send Konner money does not mean that Carlson had control of the account. In fact, the evidence in record shows just the opposite. Carlson told Konner he wanted to make money, but they never discussed a trading or investment strategy.[99] Instead, convinced that Konner had "new ideas" because he was a "good salesman," Carlson was "willing to send him some money" and let Konner manage the account with very little input from him. The record shows that, because he trusted Konner and because he lacked the knowledge and experience necessary to gainsay Konner's recommendations, Carlson simply "acquiesced in [Konner's] trades."[100]

Konner also insists that Carlson "rejected a number of conservative investment opportunities," but there is scant evidence in the record to support this claim. Konner faults the law judge for crediting Carlson's testimony that he could not recall having rejected a trade recommendation by Konner over Konner's testimony that Carlson rejected specific recommendations. Konner also argues that his version of events is supported by the testimony of Gordon Miller, another of his clients, who admitted rejecting recommendations by Konner. But the fact that Miller rejected Konner's recommendations is hardly convincing evidence that Carlson did. And Konner's testimony on the matter is problematic because he erroneously testified that Carlson admitted during the hearing to rejecting Konner's recommendations when, in fact, only Miller did.[101] Considering the relevant evidence, we decline to overturn the law judge's credibility determination.[102] In any event, whether Carlson rejected none or only a very

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99 As the Division notes, in the same passage in which Carlson testifies to telling Konner he "wanted to make money," he added that he "realized that certain things were a little more risky . . . . But I also know there is also some good stuff out there that will make you money, you know, if you buy and hold it, too." We agree with the Division that this testimony, which suggests that Carlson thought that Konner's approach to trading was consistent with a buy-and-hold approach, underscores Carlson's "lack of investor sophistication" as well as Konner's failure to communicate clearly with Carlson about his investment approach.

100 *Cody*, 2011 WL 2098202, at *12.

101 *See supra* note 88.

102 Konner argues that the law judge's credibility determination on this issue "makes no sense" because Carlson testified only that he had no recollection of rejecting a recommendation whereas Konner's testimony that Carlson rejected specific recommendations was bolstered by Miller's testimony. But given the low probative value of Miller's testimony on this question and Konner's mistaken testimony about what Carlson said during the hearing—which casts doubt on the veracity of Konner's other testimony on this topic—we will not disturb the law judge's credibility determination.

few of Konner's hundreds of recommendations, our conclusion that Konner had de facto control of the account remains the same.[103]

Likewise, we reject Konner's contention that "the fact that Carlson admitted he initiated at least one investment possibility" is convincing evidence of Carlson's control of the account. The record shows that nearly all of the activity in the account was initiated by Konner, with even Konner conceding that "the vast majority of the trades were done at [his] recommendation." This supports a finding of broker control, even if Carlson put forward a suggestion for at least one trade.[104]

Pointing to trade confirmations, account statements, and tax documents Carlson received, Konner argues that Carlson "was continuously informed about the activity in the account."[105] But, as we have held, merely receiving account documents showing the activity in the account does not mean that the customer controlled the account.[106] Although a customer's knowledge and understanding of the trading in the account may be relevant to the issue of control,[107] the record shows that Carlson typically did not review account statements and, when he was busy farming, might not even open them. In addition, because of the high level of activity, Carlson testified that it was "very difficult" to keep up with the trading in the account. And Konner was executing "a lot" of trades without Carlson's authorization. Thus, the facts here show that Carlson lacked control of the account.[108]

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103 *See Sweeney*, 1991 WL 716756, at *4 (finding control when customer rejected one transaction but otherwise routinely followed the broker's recommendations).

104 *See id.* (finding control when "[w]ith few exceptions, the customers did not initiate the transactions in their accounts").

105 Without any citation to the record, Konner contends that Carlson "admitted being aware of all trades and that he never complained about anything." But although Carlson acknowledged receiving documentation on account activity, the record shows that he was not "aware of all the trades" because he typically did not review and might not even read the statements he received. And Konner engaged in frequent unauthorized trading for which he never sought Carlson's authorization, even after the fact. In addition, Carlson repeatedly testified that he did complain to Konner about his account's performance, telling Konner "I can't keep losing money like this."

106 *See supra* note 29; *Sweeney*, 1991 WL 716756, at *4 (holding that the "fact the customers received confirmations and monthly statements" does not mean they controlled their accounts).

107 *See, e.g.*, *Sweeney*, 1991 WL 716756, at *4.

108 Contrary to Konner's suggestions, the fact that Carlson signed certain account documents is not evidence of control because, as the record shows, he did so without closely reviewing or reading them. Moreover, the record does not support Konner's contention that Carlson "affirmed" to J.P. Turner compliance personnel that his account activity was "consistent with his investment objectives." *See infra* Section IV.B.2.b. (discussion of John Williams's testimony).

Konner also argues, citing *Follansbee v. Davis, Skaggs & Co., Inc.*,[109] that "to the extent the Law Judge found that Konner exercised control because Carlson routinely accepted his broker's stock recommendations, following the advice of a broker is hardly tantamount to broker control." But the finding that Konner exercised de facto control over the account is not grounded only on Carlson accepting all or nearly all of Konner's recommendations, even though this is an important factor in the analysis.[110] Here, as we have already discussed, there are multiple factors supporting a finding of broker control, including Carlson's lack of investing sophistication, Carlson's inability to independently evaluate Konner's recommendations, Carlson's failure to keep up with the activity in the account, the trust Carlson placed in Konner, and Konner's unauthorized trading. Unlike in *Follansbee*, which involved a sophisticated investor who actively participated in the management of his account, the evidence in the record here shows that Carlson's involvement can accurately be characterized as "the passive acquiescences of an uninformed dependent."[111] Considering all of the evidence in the record relevant to the issue of control, we find that Konner exercised de facto control of Carlson's account.

2. Konner excessively traded Carlson's account during 2009.

a. Konner's trading in Carlson's account was excessive as demonstrated by the turnover rate and cost-to-equity ratio, as well as other relevant factors.

Konner engaged in excessive trading in Carlson's account between January and December 2009. The account's annual turnover rate of 17 and cost-to-equity ratio of 34.6% during the churn period far exceed the standard benchmarks for trading that is excessive. In 2009, Konner executed over 250 transactions in the account totaling over $8.5 million, which generated commissions to J.P. Turner of $87,686. Konner's trading also included repeated unauthorized trading. These facts are strong evidence that Konner excessively traded Carlson's account.

Konner argues that because "the Carlson account was designed to be an aggressive, short-term trading account, any reliance upon turnover ratios and other indicia of excessive trading

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109 681 F.2d 673 (9th Cir. 1982).

110 In prior cases, we have found that a customer routinely following a broker's recommendations may be dispositive of control. *See, e.g.*, *Sweeney*, 1991 WL 716756, at *4; *see also supra* note 18.

111 *Follansbee*, 681 F.2d at 677-78 (finding that Follansbee was "far from an untutored novice" and that he actively pushed for investments against his broker's recommendation); *see also supra* note 30 (discussing *Follansbee*). For the same reason, Konner's reliance on *IFG Network Securities, Inc.*, Initial Decision Release No. 273 (Feb. 10, 2005), is also misplaced. Further, *IFG Network Securities* did not concern churning and, in any event, is not binding on us. *See Absolute Potential, Inc.*, Exchange Act Release No. 71866, 2014 WL 1338256, at *8 n.48 (Apr. 4, 2014) (noting that the Commission is "not bound by a law judge's initial decision"); *Rapoport v. SEC*, 682 F.3d 98, 105 (D.C. Cir. 2012) (noting that ALJ order was "not a binding Commission decision").

used to evaluate a conservative investment account must be discarded."[112] We reject this argument on two grounds. First, although Konner is correct that the excessiveness of a broker's trading is "considered in light of the nature and objectives of the account,"[113] we find, as explained more fully below, that Carlson was not a speculative or aggressive investor.

Second, Konner is wrong that turnover rates and cost-to-equity ratios have "no relevance" and "must be discarded" except in the case of conservative investors. Although "there is no definitive turnover rate or cost-to-equity ratio that establishes excessive trading"[114] and "our assessment of whether trading is excessive does not rest on any magical per annum percentage,"[115] the standard guideposts or benchmarks that we, the courts, and other regulators have applied for many years to gauge the excessiveness of trading in an account provide a useful starting point in evaluating all customer accounts, not just conservative ones.[116] A respondent may demonstrate a lack of excessive trading by showing that the client was intentionally pursuing an aggressive, short-term trading strategy, but the standard benchmarks remain relevant for the accounts of more than just the most conservative investors.[117] Notably, we have repeatedly found excessive trading occurred in conservative investors' accounts when the turnover rate and cost-to-equity ratio were *below* the standard benchmarks.[118] In this case, the turnover rate and cost-to-equity ratio significantly exceed the standard benchmarks. Given this fact and our findings concerning the character of Carlson's account, we conclude that Konner's trading in the account was excessive.[119]

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112 In his brief, Konner in part frames this argument as an attack on the testimony of the Division's expert, Dempsey. But, in doing so, Konner actually challenges the use of the turnover rate and cost-to-equity ratio at all in this case, rather than Dempsey's calculation of them or some other facet of his testimony.

113 *Costello v. Oppenheimer & Co., Inc.*, 711 F.2d 1361, 1368 (7th Cir. 1983) ("The starting point for such an inquiry is, of course, delineation of the customer's investment goals, for those objectives significantly illuminate the context in which the trading took place and, indeed, form standards against which the allegations of excessiveness may be measured."); *see also supra* note 47.

114 *Howard*, 2002 WL 1729157, at *3.

115 *Cody*, 2011 WL 2098202, at *14 (quoting *Donnelly*, 1996 WL 20843, at *2) (internal quotation marks omitted); *see also Stein*, 2003 WL 431870, at *4 (noting that "there is no single test for making an excessive trading determination").

116 *See supra* notes 43-45.

117 *See, e.g.*, *Murphy*, 2013 WL 3327752, at *13-15 (finding excessive trading by applying the standard turnover and cost-to-equity benchmarks in accounts where clients did not have conservative risk tolerances).

118 *See supra* notes 44 and 45.

119 We also reject Konner's vague and undeveloped argument that "extreme and unusual market conditions" somehow excuse his excessive trading in Carlson's account. Even accepting

(*continued . . .*)

b. Carlson was not a speculative, aggressive investor.

Konner contends that his trading was not excessive because the substantial weight of the evidence shows that Carlson's investment objectives for his J.P. Turner account were speculation and short-term trading. We disagree. Contrary to Konner's insistence, the account forms signed and initialed by Carlson are not convincing evidence that he was a speculative investor. According to Carlson's testimony, when he opened his account with J.P. Turner, he was willing to "take a few chances" with the relatively small amount of money that he invested. For this reason, Carlson admitted that the primary investment objectives ("Trading Profits" and "Speculation") and risk tolerance ("Aggressive") marked on his 2007 account application were "probably" accurate for his initial $6,500 investment, even though he could not recall selecting them. But Carlson testified that "with a large amount of money" his investment objectives and risk tolerance were more conservative than those represented on the 2007 account application and on subsequent account forms that he signed. Specifically, Carlson testified that his risk tolerance during the relevant period was "moderate." Although Carlson admitted that he would not characterize his investment objectives and risk tolerance as "conservative" for his J.P. Turner account, considering all the evidence in the record, we agree with the law judge that "Carlson's investment objectives and risk tolerance [were] not accurately reflected" in the account documents. We base this finding on a variety of considerations.

It is undisputed that, with the exception of one form, Carlson did not fill in the information on investment objectives and risk tolerance on the account forms that he signed but they were sent to him with that information filled in by someone at J.P. Turner. With regard to the prefilled forms most relevant to the churn period—the April 2008 account update and March 2009 AASQ—Carlson testified that he did not recall telling anyone at J.P. Turner before receiving the forms that his investment objectives were speculation and short-term trading, even though those were the primary objectives indicated on the forms.[120] Carlson further testified that, because the account documents were sent to him already filled in, he glanced over them but did not pay close attention to them, particularly to the investment objectives and risk tolerance sections of the forms.[121] Carlson did pay closer attention to the sections concerning his personal financial situation, but when he told Konner "several times" that the forms overstated his net worth, Konner responded that it "didn't mean anything" and that Carlson should "just initial" the

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(. . . *continued*)
that there was a significant amount of market volatility in 2009, we still conclude that Konner's trading in Carlson's account was excessive.

120 Konner testified that he did not know where the information on the April 2008 form came from, which further supports the finding that the information did not come from any conversation he had with Carlson.

121 Carlson testified that he did not read some of the forms at all. For example, Carlson testified that he did not read the Active Account Suitability Supplement forms that accompanied the March 2009 and February 2009 AASQs before signing them. The AASS forms contained boilerplate disclosures about the risks of active trading and stating that the signatory had read and understood the document. *See supra* note 16.

forms. Based on Konner's representations and Carlson's belief that forms were just something that needed to be on file in Konner's office, Carlson signed and initialed the forms as requested because he trusted Konner. These facts give us little reason to rely on the account forms as accurate reflections of Carlson's investment objectives and risk tolerance during the churn period.[122]

In addition, the one form that Carlson did fill out himself just after the churn period—the February 2010 AASQ—did not indicate speculation or short-term trading as his investment objectives. Carlson's explanation for why he selected "Trading Profits" instead is revealing:

> Q: By marking trading profits, what did you intend to happen in your account?
>
> A: I guess I decided that the word profit was involved and I hadn't seen much of that so I wanted to get back into that, trading profits.
>
> Q: Did you have a firm understanding of what these investment objectives meant?
>
> A: I have never understood with trading profits, how it's different. I thought that was the goal of any trade. So I didn't understand the trading profits. *I assumed it was lower risk than the other two.* (Emphasis added.)

Although he did not really understand what trading profits meant as an investment objective and it was undefined on the form,[123] Carlson selected it because he believed it was more conservative than speculation and short-term trading. Based on this testimony and other testimony by Carlson concerning investment objectives,[124] we agree with the law judge's finding that "Konner failed to

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122 Although it was otherwise prefilled, Carlson testified that he wrote "4 a week" next to "Frequency of Trades" in the March 2009 AASQ. When asked how he selected that number, Carlson testified that he did not recall and that he did not remember if he discussed it with Konner. Given this testimony and Carlson's general lack of investing sophistication and experience, unlike the law judge, we are not inclined to place particular significance on what Carlson wrote here. Nevertheless, as the law judge indicated, on average Konner traded "significantly more" than four trades per week during the churn period. Carlson also testified that he was "not sure" why he wrote two trades per week on the February 2010 AASQ, but that he had decided "we needed to cut down on the trades and try to make some money back."

123 One industry source defines "Trading Profits" in this way: "An investment objective of Trading Profits indicates you seek to take advantage of short-term trading opportunities, which may involve establishing and liquidating positions quickly. Some examples of typical investments might include short-term purchases and sales of volatile or low priced common stocks, put or call options, spreads, straddles and/or combinations on equities or indexes. This is a high-risk strategy." Commerce Brokerage Services, Inc., *Glossary of Investment Terms*, *available at* http://www.commercebank.com/wealth-management/investments-and-insurance/glossary.asp#T (last visited May 28, 2015).

124 *See, e.g. supra* Section IV.A.4.

explain, and Carlson failed to understand, the various types of investment objectives as they apply in the securities industry." This finding further undermines Konner's argument that the account forms are convincing evidence that Carlson was a speculative investor. If Carlson did not understand what the investment objectives meant, whatever was marked on the form has little relevance to Carlson's actual objectives.[125]

Although Carlson did not have a firm grasp of the investment objectives on the forms, he told Konner "several times" that he could not afford to lose the money in his account. Carlson thus alerted Konner that he was, in fact, not willing or able to bear the risks associated with Konner's style of trading. Konner points to his "business model" of seeking "high net worth individuals interested in deploying a small portion of their liquid assets in short-term, speculative trading," and he testified that he was looking for clients who were "willing, able, and financially stable enough" to speculate with "a very small portion of the liquid assets they had." But the problem with Konner's argument is that during the churn period Carlson did not fit the profile of the investors Konner sought. As Carlson testified, the money Carlson put into his J.P. Turner account was not "pure profit" but money that he would need to put back into his business the next season, and it represented a "very high percentage" of his liquid net worth. Thus, Konner should not have pursued the aggressive trading that he did in Carlson's account because, as he acknowledged at the hearing, a "customer who didn't have the financial resources to engage in active trading shouldn't do it."[126]

But Konner did more than engage in trading that was inconsistent with Carlson's financial condition. He also inflated the net worth numbers on Carlson's account forms so his trading would seem more consistent with the account's profile, which, as the law judge found, allowed Konner to "engage in active trading in Carlson's JPT account without drawing the attention of the compliance department." As noted, in testimony credited by the law judge, Carlson told Konner multiple times that he was not worth "near" \$2 or \$2.5 million, but Konner told him that the figure "didn't mean anything." Konner insists that the sharp increase in Carlson's net worth as reflected on the account forms following his initial account application is attributable to a "truism known to brokers" that "clients often do not reveal the full extent of their net worth at the beginning, when they are just getting to know their broker." Even if such a phenomenon exists—and Konner offers no evidence that it does other than his own assertion[127]—we reject

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125 Konner argues that a "broader review" of the record evidence shows that Carlson was "a client willing to invest aggressively in order to generate significant investment profits" and that "Carlson knew what was going on and accepted it." We disagree with Konner's characterization of the evidence. Although Carlson hoped to "make money" in his J.P. Turner account, the record demonstrates that he was uninformed about active trading and the associated risks. The record shows that Carlson placed significant trust in Konner's ability to properly manage his J.P. Turner account, and although generally aware that Konner was trading a lot, he did not actively monitor his account and did not "keep up with the commissions" he was being charged.

126 Konner acknowledged that Carlson's significant investment in his J.P. Turner account in 2008 "just didn't match up" to his financial profile in his account application.

127 As the law judge notes, Konner's hearing testimony on this topic was inconsistent. Konner first testified that he did not recall having a conversation with Carlson about his net

(continued . . .)

this explanation both because it is directly contrary to Carlson's credited testimony and because it is inconsistent with the information on the February 2010 AASQ. That form, which Carlson filled out himself, indicated his net worth was $800,000, which differs significantly from *earlier* prefilled forms indicating $2 or $2.5 million.

In support of his argument that Carlson was interested in aggressive, speculative trading, Konner attacks Carlson's credibility and argues that his testimony is biased and inconsistent. The law judge found Carlson to be "generally credible" with a "demeanor and matter-of-fact tone [that] bolstered his credibility." The law judge also specifically credited Carlson's testimony over Konner's on several key points, including the accuracy of the account forms. Konner acknowledges in his brief that the findings against him "turn largely on credibility assessments," but he insists that the law judge's credibility determinations are erroneous. As noted, we give considerable weight to the credibility determinations of the law judge.[128] Based upon our review of the entire record, we decline Konner's invitation to reject the law judge's credibility determinations concerning Carlson's testimony.[129]

Konner argues that Carlson testified to further his own financial interests because he believes a win for the Division "might translate into a financial win for him." But Carlson's testimony that Konner being found liable "can't hurt" any potential effort to recover the financial losses in his J.P. Turner account is hardly a basis to reject the law judge's credibility determination. This is particularly true given Konner's own strong incentive to testify to avoid liability. With the evidence of potential bias before him, the law judge ultimately determined to credit Carlson's testimony over Konner's, and we find no reason to disturb this finding.

Konner further argues that Carlson is not credible because he testified generally that when he signs a document he intends to represent that what he signed was "a truthful and accurate statement" but also testified that he signed and initialed forms that he knew were inaccurate. Along the same lines, Konner attacks Carlson's testimony that he never read certain

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(. . . *continued*)
worth, then he said that Carlson told him "what was put down on the form" and that Carlson had "a two million dollar net worth as he stated to me." Only later did Konner put forward his theory that Carlson was initially reluctant to reveal his full net worth. At this point in his testimony, Konner suggested that he recalled specific details of a conversation about Carlson's net worth in which he told Carlson "to come clean" and provide accurate financial information. But this is inconsistent with Konner's testimony that he never had "any reason to doubt any information that" his customers provided him on their account forms.

128 *Supra* note 58 and accompanying text.

129 In arguing that the law judge's credibility determination should be rejected, Konner cites *Herbert Moskowitz*, Exchange Act Release No. 45609, 2002 WL 434524 (Mar. 21, 2002) and *Ward*, 2003 WL 1447865. In those cases, we found the testimony credited by the law judge "fl[ew] in the face of the substantial, contradictory documentary evidence," *Moskowitz*, 2002 WL 434524, at *6, and "was contradicted by overwhelming testimonial and documentary evidence in the record," *Ward*, 2003 WL 1447865, at *10; *see also supra* note 60 (detailing overwhelming evidence in *Ward*). That is not the case here.

account forms that he signed, which included language that he had read and understood the documents.[130] These arguments miss the mark. Carlson's hearing testimony explains why Carlson signed and initialed account forms even when he had not read or did not fully understand them and sometimes even when he knew they contained inaccuracies. He did so because he trusted Konner and, on at least one occasion, because Konner told him to "just initial" the form and that the inaccuracies "didn't matter." In this context, we do not find that inconsistencies between the account forms and Carlson's hearing testimony undermine his credibility as a witness. On the contrary, other evidence in the record, such as the February 2010 AASQ, bolsters Carlson's testimony that the prefilled account forms were inaccurate and Carlson signed them because Konner asked him to.

Konner places particular importance on the testimony of John Williams, J.P. Turner's Brooklyn branch compliance officer, regarding his general practice of reviewing account forms and contacting customers when there was a change or inconsistency on the forms. Konner argues that this testimony establishes that, in early 2009, "Carlson had reaffirmed that he had the financial wherewithal, the investment objectives, and the risk tolerance, to invest in an actively traded, speculative brokerage account." But Konner's reliance on Williams's testimony is misplaced. First, the law judge found that Williams was not a credible witness generally, and particularly with regard to testimony concerning Carlson's March 2009 AASQ, the law judge found that Williams's credibility was "very low." Upon our review of the record, we find no compelling basis to disturb those findings.[131]

More importantly, Williams's testimony, even if believed, does not have the meaning or importance that Konner ascribes to it. With regard to the March 2009 AASQ, Williams did not actually recall a conversation with Carlson about the form. Instead, Williams speculated, based on his "general practice," about what the conversation might have included if it had taken place. Such testimony is not convincing evidence of what Carlson "reaffirmed" during a telephone conversation that no one actually recalls happening. Similarly, the fact that Williams reviewed Carlson's account documents is not evidence that the forms accurately portrayed Carlson's investment objectives, risk tolerance, and financial condition—particularly given the credited testimony that Konner told Carlson to initial inaccurate information on the forms. And

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130 *See supra* note 121.

131 Konner insists that the law judge unfairly discounted Williams's testimony because he was soft spoken, exhausted from a long day, and had difficulty responding to an "inartful question" by the law judge. But because the law judge is best positioned to judge the demeanor of a witness in assessing credibility, we are particularly wary about second-guessing the law judge's demeanor-based assessments.

We also disagree with Konner's characterization of Williams as a "completely independent" witness. Williams was a former long-time employee of J.P. Turner who had reason to defend his own practices as a compliance officer and who had a "friendly" relationship with Konner. In any event, as we explain, Williams's testimony is not particularly relevant or probative.

Williams's testimony about Konner's practices as a broker, while having some relevance, is not particularly probative because, as Williams acknowledged, "I am not next to the guy 24/7."

For all of the above reasons, we find, upon our de novo review of the record, that during the churn period Carlson's investment objectives did not include a desire for speculative and aggressive trading.

c. Konner's challenges to the Division's expert are meritless.

We also reject Konner's challenges to the testimony of Dempsey, the Division's expert on excessive trading. Konner argues that the churning analysis for Carlson's account is flawed because Dempsey treated the deposit of Quantum Fuel Systems Technologies Worldwide, Inc. stock into the account in September 2009 as a customer deposit, when it should have been treated as investment profit.[132] At Konner's recommendation, Carlson purchased Quantum Fuel Systems "common stock units" in private investment in public equity ("PIPE") transactions directly from the issuer in June and August 2009 for $150,000.[133] Shares of Quantum Fuel Systems stock appeared in Carlson's J.P. Turner account in September 2009, and at the end of that month they were worth approximately $325,000. Konner argues that, if these shares were treated properly, the churning analysis would reflect a net profit rather than a net loss in Carlson's account during the churn period. Konner does not contend, however, that this adjustment would meaningfully impact the turnover rate or cost-to-equity ratio during the churn period.

We reject Konner's contention that Dempsey's treatment of the Quantum Fuel Systems shares is a fundamental flaw in the churning analysis. During the hearing, Dempsey defended his treatment of the shares, testifying that "[i]nvestments outside the account are not included in the analysis for churning purposes." This is entirely consistent with our precedent, which holds that, when determining excessive trading, "the assets by which the rate of activity is to be measured are those *in the account*."[134] As Carlson's account statements show, the Quantum Fuel Systems shares in question were not deposited "in the account" until September 2009. And the September 2009 account statement characterizes the transaction as a deposit "received from"

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132 Konner questions Dempsey's testimony because "he has never qualified to testify as an expert witness in a litigated proceeding about the qualitative aspects of churning." As we have already explained, this fact does not render Dempsey unqualified as an expert in this proceeding. *See supra* note 63 and accompanying text.

133 PIPEs, as we recently explained, "'are unregistered securities issued by companies whose stock is already publicly traded. Because PIPEs are unregistered, they cannot be offered to the market generally, and once issued, they cannot be resold or traded for a set period of time . . . . Issuers . . . offer[] PIPEs at a significant discount from the common stock's market price as compensation for the temporary illiquidity.'" *Peter Siris*, Exchange Act Release No. 71068, 2013 WL 6528874, at *2 n.12 (Dec. 12, 2013) (quoting *SEC v. Lyon*, 605 F. Supp. 2d 531, 536 (S.D.N.Y. 2009)), *petition denied*, 773 F.3d 89 (D.C. Cir. 2014).

134 *Bucchieri*, 1996 WL 254677, at *5 (emphasis added).

Carlson. Under the circumstances, we find no fundamental flaw in Dempsey's treatment of the shares.

Moreover, even if we accepted Konner's argument that the Quantum Fuel Systems PIPE transactions should be treated as a $150,000 investment at the time Carlson executed the PIPE subscription agreements, it would not alter our conclusion that Konner churned Carlson's account. Konner argues that his suggested treatment of the Quantum Fuel Systems shares would mean that the account actually showed a substantial profit during the churn period and that this undermines a finding of churning. We find this argument unconvincing because, as we have held, "the existence of churning does not turn on whether the customer lost money."[135] In addition, although Konner's treatment of the PIPE transactions would show an unrealized profit at the end of December 2009, as the Division points out, Carlson experienced significant realized losses for tax purposes in his J.P. Turner account in 2009.[136] And as Carlson's J.P. Turner account statements show, any profit on paper at the end of 2009 was completely wiped out within the first few months of 2010.[137]

Furthermore, Konner's suggested treatment of the shares would still result in a turnover rate and a cost-to-equity ratio far in excess of the standard benchmarks that show excessive trading has occurred. For example, assuming a hypothetical scenario favorable to Konner—that the initial PIPE investments of $50,000 in June 2009 and $100,000 in August 2009 were treated as stock purchases and that, by the end of the month in which the shares were purchased, they had appreciated to the shares' value at the end of September 2009[138]—the turnover rate would still be 14.78 and the cost-to-equity ratio would be 29.5%. Thus, even under the treatment urged by Konner, the quantitative analysis supports a churning finding.

3. Konner acted with scienter in trading Carlson's account.

We find that Konner acted with scienter when he excessively traded Carlson's account. Although Carlson told Konner "several times" that he could not afford to lose the money in his

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135 *Studer*, 2004 WL 2735433, at *5; *see also supra* note 87.

136 Carlson's 2009 J.P. Turner Form 1099 shows a short-term realized loss of approximately $130,000, which did not include a short-term realized disallowed loss of $90,000.

137 Carlson's account value went from $528,595.42 at the end of December 2009 to $264,359.80 at the end of March 2010. The March 2010 value reflects a $60,000 withdrawal by Carlson, but the account still lost over $200,000 in three months as Konner continued to actively trade the account.

138 There is no evidence in the record concerning the value of the Quantum Fuel Systems investment before the end of September, so we assign a hypothetical value in order to perform this analysis. According to Carlson's J.P. Turner statement, the value of the shares purchased through the June 2009 PIPE transaction was $108,645.04 at the end of September, an increase of over 100% of the $50,000 investment. The value of the shares purchased through the August 2009 PIPE transaction was $217,288.75 at the end of September, an increase of over 100% of the $100,000 investment.

account and that the account forms contained inaccurate information about his net worth, Konner engaged in aggressive and speculative trading that lost Carlson hundreds of thousands of dollars during Konner's management of the account. During the churn period alone, Konner's trading cost Carlson approximately $87,686 in commissions, with over $55,000 going to Konner. The evidence shows that Konner took advantage of Carlson's lack of sophistication and trust to excessively trade his account in a manner that was inconsistent with Carlson's investment objectives. Konner's unauthorized trading also supports a finding of scienter.

We agree with the law judge that Konner's conduct relating to the net worth figures on Carlson's account forms is compelling evidence of scienter. Konner falsely told Carlson that the net worth amount on the forms "didn't matter" and that Carlson should "just initial" the prefilled forms that substantially overstated his net worth. Konner did so because he recognized that Carlson's actual net worth was inconsistent with the type of speculative and aggressive trading that he was engaged in with a "very high percentage" of Carlson's liquid net worth. Instead of managing Carlson's account in a manner consistent with his financial profile and true risk tolerance, Konner pursued excessive trading that primarily benefitted himself. Konner knew that his trading did not make sense for Carlson and he lied to Carlson about the importance of the account forms to evade compliance concerns to generate commissions through excessive trading. In addition, Konner's inconsistent, and ultimately false, testimony on the topic at the hearing is further evidence of his fraudulent intent.[139]

Konner points to a statement by the law judge in dismissing the churning charge with respect to Konner's client, Gordon Miller: "That Konner pursued a speculative and short-term trading strategy is also not evidence of scienter, unless it is knowingly inconsistent with the customer's objectives." As the law judge noted, however, Miller's case is "[i]n sharp contrast to Carlson's" where there was "evidence of false statements both in the account documentation and on the witness stand." Upon our review of all the relevant evidence—including evidence of deception—we find that Konner possessed the intent to defraud Carlson and thus acted with scienter.[140]

* * *

Accordingly, for the reasons set forth above, we find that Konner's excessive trading of Carlson's account was fraudulent. We thus conclude that Konner violated Securities Act 17(a), Exchange Act Section 10(b), and Rule 10b-5.

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139 Relying on *Hotmar v. Lowell H. Listrom & Co.*, Konner argues that scienter is lacking because Carlson received trade confirmations and account statements, Konner did not withhold information, and "there is no evidence to suggest any actual deception." But, similar to our conclusion with regard to Calabro, *see supra* note 83, *Hotmar* is distinguishable because there is considerable evidence of deception in the record, such as Konner's unauthorized trading, his failure to explain the investment objectives and other information on the forms to Carlson, his telling Carlson that the net worth amount did not matter and that he should just sign the prefilled forms, as well as his lack of candor during the hearing.

140 *See supra* note 81.

V.

A. Facts relating to Dimitrios Koutsoubos

Dimitrios Koutsoubos entered the securities industry in 1999 and holds Series 7 and 63 licenses. From November 1999 to August 2009, Koutsoubos worked as a registered representative at J.P. Turner and split his time between the firm's Brooklyn and Fort Lauderdale branch offices.

1. Teddy Dale Bryant, a small business owner, opened a J.P. Turner account in February 2005, and a few months later Koutsoubos was assigned to the account.

Following a cold call from a J.P. Turner representative, Teddy Dale Bryant opened a J.P. Turner brokerage account in February 2005. Bryant is a resident of Holly Springs, Mississippi, where for over twenty years he has owned and operated Teddy's Discount Building Supply. He also owns and operates Grisham Lumber & Supply in Blue Mountain, Mississippi. Bryant attended one semester of college at the University of Tennessee, but he did not earn a degree. At the time he opened his J.P. Turner account, Bryant had limited investment experience. He had two other brokerage accounts but remembered making only one suggestion to buy a particular stock in those accounts. These other accounts did not have many transactions because Bryant took a buy-and-hold approach in them. Bryant does not consider himself a sophisticated investor, and he does not watch any investment-related television shows or subscribe to any investment-related periodicals.

When he opened his J.P. Turner account, Bryant deposited about $4,200. The account application indicates an investment objective of growth and a risk tolerance of medium.[141] Bryant's J.P. Turner account was initially managed by another registered representative, but around May 2005, Koutsoubos was assigned to the account. When he took over the account, Koutsoubos told Bryant that he "was going to make [him] a lot of money." Bryant testified that Koutsoubos never asked him if he was an experienced investor, what his investment objectives were, or anything about his risk tolerance.[142] Bryant told Koutsoubos "[o]n a number of

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141 At the time he opened his J.P. Turner account, Bryant also signed a margin account agreement and suitability supplement, which contained standard disclosures about the risks involved in margin trading. Bryant testified that he likely did not read these documents but signed them because a J.P. Turner representative asked him to do so. Koutsoubos sent Bryant a supplemental application for margin account privileges in July 2006, but again Bryant testified that he just signed the document where Koutsoubos had put an "X" and likely did not read it. Bryant said he signed the document because Koutsoubos said he had to have it "to continue making [Bryant] money." Bryant testified that neither Koutsoubos nor anyone else at J.P. Turner talked to him about the risks of margin trading and that he does not understand margin accounts.

142 In his hearing testimony, Koutsoubos was uncertain about whether he typically discussed with new customers what their investment objectives and risk tolerance were: "Q: Did you typically ask them what their investment objectives were? A: I guess I did. Q: Did you

(continued . . .)

occasions," however, that he wanted the account to be managed conservatively. Bryant testified that "I just told [Koutsoubos] I didn't want to lose money. I wanted to earn money and be conservative."

2. Bryant signed an account update form in March 2007 as requested but did not pay attention to its contents.

In March 2007, about two years after he opened his account, Bryant received an account update form from J.P. Turner. Bryant remembered Koutsoubos telling him: "I've got to have this [form;] get it back[;] just sign where I put the stars, and I'll take care of the rest."[143] Bryant signed the form, but he did not recall if the information on the form was filled in before he signed it. In handwriting that is not Bryant's, the form contains information on Bryant's financial condition, risk tolerance, investment objectives, and investment knowledge. Specifically, the form indicates that Bryant's risk tolerance was "Aggressive," that his investment objectives were "Capital Appreciation," "Trading Profits," and "Speculation," and that his investment knowledge was "Good." But Bryant testified that the information on the form was incorrect and that he had never told Koutsoubos that his risk tolerance was aggressive, that his investment objective was speculation, or that his investment knowledge was good.[144] The law judge explicitly credited Bryant's testimony on this point.[145]

3. Koutsoubos recommended nearly all the trades in the account, and Bryant relied on Koutsoubos's purported expertise.

Throughout the time he managed Bryant's account, Koutsoubos was responsible for recommending almost all of the trading activity. Bryant's account statements show that virtually all of the transactions in his account during the relevant period were marked "solicited." Bryant recalled suggesting to Koutsoubos the purchase of Apple stock and possibly "a couple" of others for his account, but he testified that "98, 99 percent" of the trades in the account were made on

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typically ask them what their risk tolerance was? A: I would guess I would go over their risk tolerance."

143 For his part, Koutsoubos, who was Bryant's registered representative at the time, does not recall sending the form to Bryant or why he received the form: "I don't know where this—who sent it or where it came from. I don't know. I didn't even sign this. That's not my signature, as a registered rep. So I don't know—I've seen this form, but I don't know where this form—who was sent it or what you're—you know, anything."

144 Even Koutsoubos testified that he never had a conversation with Bryant about this form. Bryant has some recollection of speaking with Koutsoubos at some point about "trading profits," which he understood to mean "we would take profits from some trades and trade again."

145 *Bresner*, 2013 WL 5960690, at *103 ("I credit Bryant's testimony that the updated account form contains incorrect information, including incorrect investment objectives and risk tolerance, that Koutsoubos usually sent him forms with stars where Bryant should sign, and that Koutsoubos took care of the rest.").

Koutsoubos's recommendation. At the hearing, Koutsoubos conceded that "the vast majority of the trading activity in Mr. Bryant's account was the result of [Koutsoubos's] recommendations," and when asked, Koutsoubos could not recall any particular trade that Bryant had directed.

Bryant testified that he trusted Koutsoubos and "thought he would deliver on what he said he could do." And Koutsoubos consistently encouraged Bryant to rely on his expertise, telling Bryant on more than one occasion, "you sell lumber, and I'll take care of the stocks." Typically, Bryant and Koutsoubos's conversations about potential investments were one-sided and did not involve a discussion of the investments' pros and cons. According to Bryant, Koutsoubos would call him with a recommendation for a stock "and make some explanation on it." Bryant would not have much to say in response because, as he testified, "I didn't keep up with the stock market. I didn't follow Wall Street. I didn't know if it was a good stock or a bad stock." When asked if he posed questions to Koutsoubos about his stock recommendations, Bryant responded, "I didn't know enough to ask many questions." Koutsoubos testified that he typically asked his clients to make a decision about the trades he was recommending before they hung up the phone with him. Bryant described his conversations with Koutsoubos in this way: "He would call frequently and say, hey, I need to do this, I need to do this, need to do that and boom, he was gone."

Bryant received correspondence from J.P. Turner, including trade confirmations, at his office at the lumberyard. Bryant testified that he "may [have] glance[d] at" trade confirmations after receiving them, but then he immediately put them in a three-ring binder for storage. Because he was busy working, Bryant typically did not focus on account documents when he received them and "may not even [have] read them." When asked why, Bryant responded, "I trusted [Koutsoubos]."

4. Koutsoubos traded frequently in Bryant's account, incurring significant losses, and also engaged in unauthorized trading.

Bryant testified that altogether he invested approximately $250,000 in his J.P. Turner account. Using this considerable investment, Koutsoubos engaged in frequent trading in the account. J.P. Turner's Account Activity Review System put Bryant's account at the highest level for trading (Level 4) each quarter between the third quarter of 2007 and fourth quarter of 2008. During 2008, Koutsoubos executed 99 sales totaling $4,202,728.03 and 92 purchases totaling $4,032,172.11. Koutsoubos's trading in 2008 resulted in losses in the account of approximately $190,000 and generated approximately $47,000 in commissions. In the months of May, August, and October 2008, trading in Bryant's account was particularly active, and Koutsoubos effected 25, 39, and 49 transactions respectively in those months. In 2008, according to the analysis of the Division's expert witness, the turnover rate in Bryant's account was 56 and the cost-to-equity ratio was 73.3%.

In the second half of 2008, as the losses in his account continued to mount, Bryant suggested to Koutsoubos that he convert his account to cash and "sit on the sideline until it settled down some." Koutsoubos was opposed to this idea and convinced Bryant not only to continue trading but to day trade in his account. Bryant was not really comfortable with day trading but agreed because Koutsoubos said he "needed" to do it and Bryant "just was so disgusted" with the account's losses.

Bryant also testified that during this time Koutsoubos made trades without getting Bryant's prior approval before each trade. When asked why he did not complain to Koutsoubos's supervisors about the unauthorized trading, Bryant responded that Koutsoubos convinced him that he could recover the account's losses, noting that Koutsoubos "was a great cheerleader." The law judge explicitly credited Bryant's testimony concerning Koutsoubos's unauthorized trading, noting that "[i]nasmuch as Bryant and Koutsoubos differ as to whether Bryant gave such approval, I find Bryant to be more credible on this point."

Bryant understood that he was incurring a commission charge for each transaction in the account, but he testified that Koutsoubos did not discuss with him what the commission would be for each purchase or sale. Although the commission charge was included on the trade confirmations, J.P. Turner's account statements did not provide commission information, and Bryant never added up the amounts from the trade confirmations to see how much he was paying in commissions. Bryant testified that, if he had, he would have told Koutsoubos to stop trading. Bryant further testified that around the time Koutsoubos began day trading he told Bryant he would waive his commissions.[146] In fact, Koutsoubos did not waive commissions at any point, something that Bryant realized only when he filed his taxes the following year.

5. Bryant signed documentation for active accounts in May 2009, and Koutsoubos left J.P. Turner soon thereafter.

In May 2009, J.P. Turner sent Bryant an Active Account Suitability Supplement and an Active Account Suitability Questionnaire.[147] Koutsoubos testified that he filled out the AASQ before sending it to Bryant. The investment objectives circled on the form are "Trading Profits," "Speculation," and "Short-Term Trading." Next to "Frequency of Trades," Koutsoubos wrote "6 / monthly." Before returning them by fax to J.P. Turner, Bryant signed both documents and initialed the AASQ in two places. He testified, however, that he likely did not read the documents and could not say whether the AASQ was filled in when he signed it.

Koutsoubos left J.P. Turner in August 2009. At the time of Koutsoubos's departure, Bryant's account was worth only a few thousand dollars. Bryant decided to leave the account open, but there were not many trades in the account after Koutsoubos left. After leaving J.P. Turner, Koutsoubos worked for a couple of years at two Internet startups and then began working again as a registered representative at a securities firm in June 2011.

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[146] Koutsoubos denied that he agreed to waive the commissions in Bryant's account, but the law judge credited Bryant's testimony on this point.

[147] It is unclear from the record why these forms were first sent to Bryant in mid-2009 when his account had been identified by J.P. Turner as actively traded for at least six consecutive quarters before the forms were sent.

B. Based on our analysis of the facts, we conclude that Koutsoubos churned Bryant's account between January 2008 and December 2008.

As detailed below, we find that, in 2008, Koutsoubos (1) exercised de facto control over Bryant's account, (2) excessively traded the account, and (3) acted with scienter. Accordingly, we find that Koutsoubos churned Bryant's account in violation of Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5.

1. Koutsoubos exercised de facto control over Bryant's account.

A preponderance of the evidence shows that Koutsoubos had de facto control over Bryant's account. Koutsoubos conceded that he was the source of virtually all of the trading recommendations in the account, and the record shows that Koutsoubos, not Bryant, was responsible for the volume and frequency of the trading. Because of his lack of investment knowledge and expertise, Bryant neither questioned nor independently evaluated Koutsoubos's recommendations.[148] And as in other cases in which we have found de facto control, Bryant "placed [his] reliance on [Koutsoubos's] supposed expertise, and almost always invariably followed his recommendations."[149]

In addition, Koutsoubos's trading without prior approval from Bryant is strong evidence of control. In testimony explicitly credited by the law judge, Bryant said that Koutsoubos sometimes traded without first "get[ting] a hold" of him and that Koutsoubos traded "on his own" without Bryant's prior approval.

Koutsoubos makes several arguments for why he did not control Bryant's account. We find none of them convincing. Koutsoubos argues that Bryant maintained control of his account because he was a relatively young, successful businessman with prior investment experience who closely monitored his account and did not place undue trust and confidence in Koutsoubos. It is true that, at the time of the alleged violations, Bryant was in his late forties, the owner of two lumberyards, and had a net worth of around $3 million, but these facts are not determinative of control. We have rejected similar arguments, noting that although the "customers may have been successful businessmen" they lacked "the degree of investor sophistication necessary ... to make any sort of independent evaluation" of the broker's recommendations.[150] Such is the case here. Bryant described himself as "absolutely not" a sophisticated investor. He "didn't keep up with the stock market" and had no basis to determine if a recommendation "was a good stock or a bad stock." Because of his lack of investing knowledge, Bryant simply deferred to Koutsoubos without questioning his recommendations. And Koutsoubos encouraged Bryant to rely upon him, telling him, "you sell lumber, and I'll take care of the stocks."[151]

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148 *See Cody*, 2011 WL 2098202, at *12 (finding de facto control where the customers "did not independently evaluate [the broker's] recommendations but rather acquiesced in his trades").

149 *Rizek*, 1999 WL 600427, at *6.

150 *Id.*

151 Despite the evidence in the record that Bryant was not a sophisticated investor, Koutsoubos insists that Bryant held himself out as one by signing account documents that

(*continued . . .*)

Moreover, even if Bryant were capable of independently evaluating Koutsoubos's recommendations, the manner in which Koutsoubos consulted with Bryant prevented him from having any meaningful opportunity to do so. Koutsoubos testified that he typically insisted that his customers make a decision about a recommendation immediately while on the telephone with him. Without the knowledge necessary to question Koutsoubos's recommendations and without any real opportunity to investigate them further, Bryant simply acquiesced to Koutsoubos's recommendations, with the telephone consultations being "merely a formality."[152]

Koutsoubos points to account documents indicating that Bryant was an experienced investor. For example, the account update form completed in March 2007 indicates that Bryant had "Good" general investment knowledge and "Extensive" knowledge of stocks. But in testimony explicitly credited by the law judge, Bryant said that the information on the forms was incorrect and that, in fact, his investment knowledge was limited.[153] We find based on all the evidence in the record, including Bryant's credible testimony, that the forms did not accurately reflect Bryant's investment knowledge and experience.

The fact that Bryant had other brokerage accounts and some prior investment experience does not alter our conclusion. Bryant testified that he could remember making only one suggestion for trading in his other accounts and that he took a buy-and-hold approach to the stocks in them.

Likewise, Koutsoubos's claim that Bryant "closely monitored the activity in his account" is not supported by the record.[154] Bryant testified that he "may [have] glance[d]" at trade

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"repeatedly represented in writing that he understood the risks associated with the securities traded in his J.P. Turner account" and that Koutsoubos was entitled to rely upon these representations. For the purpose of determining whether Koutsoubos had de facto control of the account, the question of Koutsoubos's alleged reliance on the account documents is irrelevant. For this reason and for those we have already articulated above, *see supra* note 53, Koutsoubos's reliance on cases such as *First Union Discount Brokerage Services v. Milos* and *Coleman v. Prudential Bache Securities* is misplaced. The question regarding Bryant's sophistication as it relates to the issue of control is whether, in fact, "the customer, based on the information available to him and his ability to interpret it, can independently evaluate his broker's suggestions." *Carras*, 516 F.2d at 259. The evidence in the record supports the finding that Bryant lacked the ability independently to evaluate Koutsoubos's suggestions.

152 *Sweeney*, 1991 WL 716756, at *4.

153 Bryant suggested that the form's indication that he had "Good" knowledge of bonds was clearly incorrect because he had, in fact, never invested in bonds.

154 Because the record shows that Bryant was not closely monitoring his account, the cases relied upon by Koutsoubos in which courts have found the element of control lacking are easily distinguished. In *Xaphes v. Merrill Lynch, Pierce, Fenner & Smith*, the plaintiff was a "well-educated, sophisticated investor" who "monitored his account constantly and in great detail" and "took an active role in the management of his account." 632 F. Supp. at 483. In *Leib v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 461 F. Supp. 951, 956 (E.D. Mich. 1978), the plaintiff was
(*continued . . .*)

confirmations before he put them in a three ring binder, but that given his busy work schedule, he typically did not focus on, or even read, account documents sent to him from J.P. Turner. As we have held, merely receiving trade confirmations and account statements does not amount to customer control over the account.[155] Bryant acknowledged receiving some investment research from Koutsoubos, but testified that he does not remember using it. Koutsoubos points to a single instance when Bryant tried to reach Koutsoubos when he was out of the office as evidence that Bryant was closely monitoring his account, but Bryant testified that he "very seldom" called Koutsoubos. Instead, the trading in the account was almost always initiated by a call from Koutsoubos telling Bryant what he "needed" to do.[156] And when Koutsoubos began day trading in the account without receiving Bryant's prior approval for each trade, Bryant testified, "I didn't know what was going on."

Furthermore, the record shows that Bryant placed considerable trust in Koutsoubos. Bryant repeatedly testified that he trusted Koutsoubos and that he followed Koutsoubos's recommendations because of that trust. Bryant's trust in Koutsoubos is shown by his willingness, despite reservations, to allow Koutsoubos to day trade in his account. Koutsoubos argues that Bryant acted independently without undue trust in Koutsoubos because he declined Koutsoubos's investment recommendations and "sometimes came up with his own investment ideas." But the record suggests that such occurrences were rare and thus not indicative of control by Bryant.[157] For example, Bryant testified he can remember suggesting only a couple of trades, and Koutsoubos could not remember any particular trade that Bryant had directed. Similarly,

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"a man with professional experience in managing the financial affairs of others," who "understood the dynamics of the stock market" and kept "tabs on the account on a daily basis—often on an hourly basis." And in *Norniella v. Kidder Peabody & Co., Inc.*, 752 F. Supp. 624, 629 (S.D.N.Y. 1990), the court dismissed plaintiffs' churning claim for a failure to plead fraud with particularity based in part on the complaint's admission that the plaintiffs "monitored their accounts and raised questions about the accounts with" their broker. The active monitoring in these cases is in stark contrast to the current case, in which Bryant glanced occasionally at trade confirmations but typically did not even read account documents sent to him by J.P. Turner and rarely, if ever, questioned Koutsoubos's recommendations.

155 *See supra* notes 28 and 29. Koutsoubos also argues that he "[p]rovided [o]nly [a]ccurate [i]nformation to Bryant," but given the evidence that Bryant typically did not scrutinize or even read the account information he received, the accuracy of the information is largely irrelevant to the issue of control.

156 We are not convinced that Bryant writing the number of shares and the stock ticker symbol in the memo line of some checks he sent to J.P. Turner is persuasive evidence that he was actively monitoring his account. As Bryant testified during the hearing, he wrote the number of shares and the stock symbol simply "so [he] would know what [the check] was for."

157 *See supra* notes 103 and 104.

there is no evidence in the record of Bryant declining any particular recommendation by Koutsoubos.[158]

Koutsoubos argues that the law judge erred by finding he had de facto control over Bryant's account "solely on the grounds that Koutsoubos made most of the recommendations and that Bryant typically followed his securities recommendations." But this argument erects a straw man; our finding of control is not based *solely* on our finding that Koutsoubos made nearly all of the recommendations in the account and Bryant invariably followed them.[159] As the above analysis shows, consideration of several other factors—Bryant's lack of investing sophistication, Bryant's inability to independently evaluate Koutsoubos's recommendations, Bryant's lack of active account monitoring, the interactions between Koutsoubos and Bryant, and Koutsoubos's trading without prior approval—all strongly support the conclusion that Koutsoubos controlled the account.[160] Upon our de novo review of the record, we find that Koutsoubos exercised de facto control over Bryant's account based on this multitude of factors.

2. Koutsoubos excessively traded Bryant's account in 2008.

a. The activity in Bryant's account, as reflected in the high turnover rate and cost-to-equity ratio, evidences excessive trading.

Koutsoubos engaged in excessive trading in Bryant's account between January and December 2008. Koutsoubos's trading in 2008 far exceeded the established benchmarks for excessive trading. The turnover rate was a staggering 56 and the cost-to-equity ratio was 73.3%. This means that on average all of the securities in Bryant's account were being bought and sold every week and that Bryant's account would have had to appreciate by over 73% during the period just to cover the commissions and other expenses. Koutsoubos's trading also included

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158 Although Koutsoubos testified that he remembered Bryant declining recommendations, he could not say whether it happened frequently or infrequently, and the law judge appears to have discredited his testimony on this point. *See Bresner*, 2013 WL 5960690, at *102 ("Koutsoubos asserts that … Bryant rejected recommendations as well as made his own investment recommendations. I reject Koutsoubos' arguments as unpersuasive." (internal citations omitted)).

159 *See supra* notes 18 and 110. Indeed, even the authority relied upon by Koutsoubos recognizes that "[e]vidence that an investor routinely followed his broker's recommendation is certainly an important consideration in deciding who controlled an investment account." *Tiernan v. Blyth, Eastman, Dillon & Co.*, 719 F.2d 1, 3 (1st Cir. 1983).

160 Koutsoubos is correct that the Division's expert, Dempsey, did not offer a legal opinion about whether Koutsoubos controlled Bryant's account for the purpose of a churning violation, but neither the Division nor the law judge has suggested otherwise. Based on his analysis of the account documents, Dempsey testified that Koutsoubos recommended "virtually all" of the trades made in Bryant's account, and in that sense, he controlled "the selection of transactions and the frequency of the transactions in the account." Like the law judge, we have considered this evidence—corroborated by other evidence in the record—together with other relevant evidence of control to conclude that Koutsoubos had de facto control of Bryant's account.

transactions for which he did not receive prior authorization. This fact and the high volume and frequency of transactions in 2008—almost 200 transactions totaling over $8 million—further demonstrate that there was excessive trading in the account.

Koutsoubos argues that reliance upon the standard benchmarks for excessive trading is "entirely misplaced" in this case because Bryant had a high risk tolerance and intended to use his J.P. Turner account for speculative and aggressive trading. Although trading in an account must be considered in light of the account's nature and objectives to determine whether the trading has been excessive,[161] as we explain below, we find that Bryant did not have a high risk tolerance and was not interested in speculative and aggressive trading. Moreover, even if (contrary to our finding) Bryant had a desire to speculate, this does not permit Koutsoubos to "deplete [his] account through commissions."[162]

In addition, as explained previously, Koutsoubos is wrong that the standard benchmarks are relevant only when evaluating the trading in accounts of conservative investors.[163] In any event, the turnover rate and cost-to-equity ratio are so high here—respectively more than nine and three-and-a-half times the standard benchmarks—we conclude that Koutsoubos's trading in Bryant's account was excessive.

b. Bryant was not a speculative, aggressive investor.

We reject Koutsoubos's insistence that Bryant had a "high risk tolerance and desire to aggressively trade his account." Koutsoubos points to a handful of account documents as "clear and unequivocal" proof of Bryant's risk tolerance and investment objectives. But Koutsoubos's reliance on these documents is misplaced for several reasons. Based on our review of the entire record—including Bryant's testimony that the law judge credited—we find that the account documents relied upon by Koutsoubos do not reflect Bryant's true risk tolerance and investment objectives. A preponderance of the evidence shows that Bryant's risk tolerance was at most medium and that his investment objectives did not include speculation.

Koutsoubos first points to two sets of margin-related documents,[164] but none of these documents demonstrates that Bryant had a high risk tolerance or desired speculative or active trading. Although the documents contain boilerplate disclosures about the risks of trading on

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161 *See supra* note 113.

162 *Shearson Lehman Hutton, Inc.*, Exchange Act Release No. 26766, 49 SEC 1119, 1989 WL 257097, at *2 (Apr. 28, 1989) (noting that "[t]here is a difference between aggressive investing and excessive trading" and that a 50% cost-to-equity ratio shows a "depletion of principal clearly indicat[ing] excessive trading").

163 *See supra* note 117 and accompanying text.

164 Specifically, Koutsoubos relies on (1) a Customer's Margin Agreement and accompanying Suitability Supplement Margin Account Agreement that Bryant signed at the time he opened his account in February 2005 and (2) a Supplemental Application for Margin Account Privileges he signed about a year later when J.P. Turner changed clearing firms.

margin, there is no evidence in the record that Bryant desired to trade on margin or even understood margin trading. Bryant testified that he signed the documents—likely without reading them—because Koutsoubos told him that they were just paperwork that he needed to sign for trading to occur in the account. He further testified that no one at J.P. Turner explained anything about the risks of margin trading to him. In addition, Bryant's account application, signed at the same time as the first set of margin-related documents, indicated that his risk tolerance was "Medium" and investment objective was "Growth." There is nothing in any of the margin-related documents—which contain no specific customer information about risk tolerance or investment objectives—that would show the information in the account application was incorrect.

The next document identified by Koutsoubos presents a closer call, but ultimately we conclude that it did not accurately reflect Bryant's risk tolerance and investment objectives. In March 2007, Bryant signed and initialed an Account Update Form, which indicated a risk tolerance of "Aggressive" and investment objectives of "Capital Appreciation," "Trading Profits," and "Speculation." Bryant testified that even though he signed and initialed the Account Update Form, he did not fill in any of the information other than his name and address. He testified that he was unsure whether the information about risk tolerance and investment objectives was filled in at the time he signed the form. In any event, he testified that the information about his risk tolerance and investment objectives was incorrect—in reality he had a more conservative risk tolerance and was not interested in speculation. When asked why he would sign and initial a form that was blank or did not contain accurate information, Bryant testified that Koutsoubos told him that he needed the form back and that Bryant should "just sign where [Koutsoubos] put the stars, and [he would] take care of the rest." Bryant simply signed and initialed the form as requested without paying attention to its contents. The law judge expressly credited Bryant's testimony in this regard and found "that the updated account form contains incorrect information, including incorrect investment objectives and risk tolerance." We find no basis to disturb the law judge's finding.[165]

The final set of documents relied upon by Koutsoubos are the Active Account Suitability Supplement and the Active Account Suitability Questionnaire, which Bryant signed and initialed in May 2009.[166] The AASQ indicates that Bryant's investment objectives were "Trading Profits," "Speculation," and "Short-Term Trading." Like the 2007 Account Update Form, Bryant

165 As the law judge noted, the record is devoid of any evidence explaining why Bryant would have changed his risk tolerance and investment objectives at this time. Koutsoubos's testimony does not help his case. Koutsoubos, who was Bryant's registered representative at the time, testified that he did not send the form to Bryant or have any conversations with him about the form. If true, this testimony means that Koutsoubos did not discuss with Bryant his risk tolerance and investment objectives in order to accurately reflect them on the form, and there is no evidence in the record that anyone else at J.P. Turner did so either, which casts further doubt on the form's accuracy.

166 The AASS reads directly above Bryant's signature, "I have read and understand the Active Account Suitability Agreement as required. I am aware of the liabilities which may be incurred through active trading."

testified that he did not fill in any of the substantive information on the AASQ and that it was "highly unlikely" that he read the documents before signing and initialing them. We find that, like the 2007 Account Update Form, the AASS and AASQ are not convincing evidence that Bryant was an aggressive, speculative investor. Bryant simply signed the forms at Koutsoubos's request without paying attention to them. The forms are therefore of little value in determining Bryant's relevant risk tolerance and investment objectives.[167]

Moreover, the AASS and AASQ postdate the churning period by almost a half year, and therefore, even if the AASQ were accurate at the time Bryant signed it, it would not prove what Bryant's investment objectives were in 2008. Koutsoubos insists that the AASQ is probative of Bryant's investment objectives during the churn period because it is consistent with the 2007 Account Update Form. But given Bryant's testimony—which the law judge credited—that he did not pay attention to the information on either form, we conclude that the consistency of the two forms carries little probative value as to Bryant's actual investment objectives.

Koutsoubos appears to argue that he was entitled to rely on the account forms indicating a high risk tolerance and speculative investment objective when he actively traded Bryant's account. This argument misses the mark. Any reliance on the forms was misplaced because the record evidence—including Koutsoubos's own testimony—shows that Koutsoubos did not conduct a meaningful inquiry into Bryant's risk tolerance and investment objectives. Moreover, to the extent they discussed the issue, Bryant testified that he repeatedly told Koutsoubos that he wanted his account managed conservatively, which would not permit Koutsoubos to rely on the contrary representations in the documents.

In conjunction with his arguments based on the account documents, Koutsoubos attacks the credibility of Bryant's hearing testimony, arguing that it is contradictory, unsupported by other evidence in the record, and biased. We disagree. The law judge found that "Bryant had a

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167 In fact, neither the AASS nor the AASQ has specific information about the customer's risk tolerance. Koutsoubos also points to Bryant's testimony that he was "on board" with Koutsoubos trading actively in his account in order to try to regain the account's considerable losses, but it is unclear from the record the point in time at which Bryant agreed to more active trading. It appears likely that it was toward the end of the churn period because it was the account losses in the second half of 2008 that caused Bryant to agree to Koutsoubos's day trading. Moreover, Bryant explained that, because the account had lost so much money, he felt that he had few options but to let Koutsoubos try to regain some of the losses. That Bryant reluctantly agreed to Koutsoubos's day trading to try to recoup significant losses in the account does not suggest that he had a high risk tolerance and was interested in speculation—particularly for the time before he gave his assent.

Bryant testified that he remembered having a conversation about active trading with someone from J.P. Turner in addition to Koutsoubos. But Bryant testified that this conversation did not include a discussion of his risk tolerance or investment objectives. In addition, it is unclear when this conversation took place. If it took place in conjunction with J.P. Turner sending the AASS and AASQ to Bryant, as John Williams's testimony would suggest, it happened several months after the churn period.

straightforward and matter-of-fact demeanor while testifying, and his credibility was bolstered by evidence that corroborated his hearing testimony." And the law judge specifically credited Bryant's testimony that the account documents did not reflect his true risk tolerance and investment objectives. As we have indicated, we give considerable weight to the credibility determinations of the law judge.[168] Koutsoubos's challenges to Bryant's testimony do not provide a sufficient basis for us to reject the law judge's credibility determination. In fact, we agree with the law judge that the credibility of Bryant's testimony is bolstered by other evidence in the record.

In addition to testifying at the hearing about what his risk tolerance and investment objectives were, Bryant gave an explanation for why the account forms did not accurately reflect those facts—namely, that he did not pay attention to the account forms and simply signed and initialed them because Koutsoubos asked him to. This explanation is corroborated by other evidence in the record, which shows that Bryant lacked investing sophistication, that Bryant placed significant trust in Koutsoubos, that Bryant was not actively monitoring his account, that Bryant did not fill in the relevant information on the forms, and that (consistent with Koutsoubos's own testimony) Koutsoubos did not ask Bryant about his risk tolerance and investment objectives. In addition, Koutsoubos points to nothing in the record that would explain the change in risk tolerance and investment objectives between those reflected in the 2005 Account Application and the 2007 Account Update Form. Far from undermining Bryant's credibility, we find that the weight of the record evidence supports the law judge's credibility determination.

Bryant's testimony is not undermined by the testimony of John Williams regarding his work as the compliance officer in J.P. Turner's Brooklyn office. Williams was found by the law judge to be "generally not credible except on technical issues." Moreover, even if believed, his testimony does not impeach Bryant's testimony. Although he testified about his general practices as the compliance officer, Williams disclaimed any independent recollection of speaking to Bryant or reviewing his account forms.[169] If credited, Williams's testimony about the procedures at J.P. Turner's Brooklyn branch office would, at most, serve as evidence that Bryant's account forms were not blank when he signed them—assuming that Williams consistently followed the procedures he described.[170] But contrary to Koutsoubos's suggestion,

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168 *See supra* note 58 and accompanying text.

169 When asked if he recalled ever speaking to Bryant, Williams testified, "I don't recall a specific conversation with him," and he later confirmed that "I don't recall if I ever spoke to [Bryant] or not." Williams also confirmed that apart from a document from another client's account he did not "have any independent recollection regarding any of the other documents that [he had] been shown in this case."

170 Williams testified that his signature and initials on the 2007 Account Update Form and the 2009 AASS and AASQ indicated that he reviewed the forms either before or after they were sent to Bryant. Upon receiving account forms from clients, Williams testified that he generally would review the information on the forms to ensure they were completely filled out and consistent with other account documentation in the client's file, and that if there was a discrepancy he typically would call the client to resolve the issue. Similarly, he testified that any

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Bryant's testimony does not actually contradict Williams's testimony on this topic. Bryant repeatedly testified only that he could not say for sure whether the forms were blank or filled in at the time he signed them.[171] Similarly, Williams's testimony that he never heard Koutsoubos tell his clients to "just sign" forms is not persuasive evidence that it did not happen. Koutsoubos split his time with another J.P. Turner branch office, and there was no testimony that when Koutsoubos was in the Brooklyn office, Williams listened to every conversation that Koutsoubos had with clients. Furthermore, Koutsoubos's characterization of Williams as an "independent" and "unbiased" witness is questionable given that Williams was a long-time employee of J.P. Turner who had reason to defend his own practices and who admitted he was friendly with Koutsoubos outside of work.

In addition, we reject Koutsoubos's argument that Bryant's testimony must be disregarded because he is biased. Bryant acknowledged that he hopes to recover some of the hundreds of thousands of dollars that were lost in his J.P. Turner account, but this does not establish that his testimony was not credible. Koutsoubos himself had a strong incentive to testify in a way that would help him avoid liability. And ultimately, the law judge credited Bryant's testimony over Koutsoubos's, even with the evidence of Bryant's alleged bias squarely before him.

Contrary to Koutsoubos's contentions, we find, based upon our de novo review of the record, that during the churn period Bryant had at most a medium risk tolerance and that his investment objectives did not include aggressive and speculative trading.

c. Koutsoubos's challenges to the Division's expert are meritless.

We find no merit to Koutsoubos's challenges to the evidence put forward by the Division's expert Dempsey. Koutsoubos argues that (1) Dempsey was not qualified as an expert, (2) his calculations failed to take into account a unique period of market decline, (3) his calculations overstated the number of transactions in Bryant's account, (4) he made mistakes in his analysis of other customers' accounts, and (5) he was biased. We reject each of these challenges in turn.

(. . . *continued*)
fax or mail correspondence to or from customers would be seen by the branch supervisors. This testimony suggests that if Bryant signed and returned forms to the Brooklyn branch office with information about his risk tolerance and investment objectives not filled in, Williams would have noticed it and followed up with Bryant over the telephone.

171 For example, with regard to the 2007 Account Update Form, Bryant testified, "I don't know if it was filled out when I received it because [Koutsoubos] just said, sign where I put the stars and send back, [and] I'll take care of the rest." And upon cross-examination, Bryant made clear that he was "not testifying that it was filled out or not filled out when I signed it." When asked to speculate about whether the 2007 Account Update Form was blank when he signed it, Bryant said "it's a real good possibility," but he never testified to have actual knowledge that it was blank. This makes sense given Bryant's testimony that he did not read the form before signing it.

First, as we have previously explained, the fact that Dempsey had never testified previously as a churning expert does not disqualify him.[172] For the reasons we have already stated, we find that Dempsey was well qualified as an expert on churning.[173]

Second, Koutsoubos contends that Dempsey's calculations were "skewed" because he failed to take into account "the 'anomaly' of the downward market forces during 2008, which dramatically inflated turnover and cost/equity since account values declined rapidly." We find no flaw in Dempsey's calculation of the turnover rate and cost-to-equity ratios in the account. It is true that (holding other factors constant) a decrease in the account's value increases the turnover rate and the cost-to-equity ratio and that Bryant, like many other investors, saw the value of his account decrease in 2008. But this is not a legitimate reason to reject Dempsey's use of the recognized methods for calculating the turnover rate and cost-to-equity ratio.[174] Koutsoubos introduced no expert testimony in support of his contention that the standard methods should be altered and he offers no alternative methods. Although we may consider other factors—such as market conditions—in evaluating whether excessive trading has occurred, this does not provide a basis for changing the standard methods for calculating a turnover rate and cost-to-equity ratio.[175] In this case, we find that the incredibly high turnover rate and cost-to-equity ratios are strong evidence of excessive trading, even considering the general downturn in the U.S. equities market in 2008.[176]

Third, Koutsoubos challenges Dempsey's treatment of stop-loss orders, arguing that an initial purchase and a subsequent sale based on a stop-loss order should be treated as a single transaction. We find no fault in Dempsey's treatment of stop-loss orders because the initial purchase and the subsequent sale based on a stop-loss order are separate transactions and are treated as such in Bryant's account documents. Moreover, Koutsoubos argues only that Dempsey's treatment of stop-loss orders "affects the calculation of the *number* of transactions effected in the Bryant account." Even if we accepted this argument, it would not reduce the turnover rate or cost-to-equity ratio Dempsey calculated because these calculations do not depend on the number of trades at issue.[177] In any event, we have considered the fact that, in

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172 *See supra* note 63 and accompanying text.

173 *Supra* Section III.B.2.d.i.

174 *See supra* note 68 and accompanying text.

175 *Cf. Fronta v. Prudential-Bache Sec., Inc.*, 639 F. Supp. 1186, 1191 (S.D.N.Y. 1986) (noting that the calculation of the turnover rate is separate from a consideration of "market conditions, size of commissions, and sophistication of the customer").

176 As the Division points out, Bryant expressed a desire to pull out of the market altogether during the market decline in the latter half of 2008, but Koutsoubos insisted that he stay in.

177 We also reject Koutsoubos's argument that Dempsey improperly counted some transactions in Bryant's account involving multiple executions for the same stock on the same day. Dempsey properly calculated the number of transactions based on what was reported in

(*continued*...)

some instances, sales in Bryant's account were the result of stop-loss orders but nonetheless find that the activity in Bryant's account was excessive.

Fourth, Koutsoubos points to alleged flaws in Dempsey's analysis of other accounts besides Bryant's to show that his testimony is unreliable, but we find this argument unpersuasive. Not only do the alleged miscalculations have nothing to do with Bryant's account, but, as we explained above in the context of Dempsey's treatment of the PIPE transactions in Carlson's account, Dempsey's calculations were entirely proper under the circumstances.[178]

Finally, Koutsoubos argues that Dempsey's testimony should be rejected because his wife works for the Division. Whenever an expert is hired by a party in litigation there is a potential for bias because the expert is being remunerated by the party for whom he or she is testifying. This fact may be considered in assessing the expert's testimony.[179] So too with regard to the employment of Dempsey's wife.[180] Dempsey disclosed that his wife worked for the Commission in a capacity unrelated to this case, Koutsoubos's counsel examined Dempsey on the topic, and we have this evidence before us in assessing Dempsey's testimony. Koutsoubos points to no specific evidence in the record that Dempsey's spouse's employment had any influence on his testimony, and we find none. For all of these reasons, we decline Koutsoubos's invitation to reject Dempsey's testimony on this basis.

(. . . *continued*)
Bryant's account statements. And this contention, even if accepted, would have no effect on the turnover rate or cost-to-equity ratio.

178 *See supra* Section IV.B.2.c. We also see no error on Dempsey's part in treating a dividend distribution in the Mills account as a customer contribution. Koutsoubos offers no expert opinion of his own supporting his view that Dempsey's treatment was improper, and Dempsey admitted only that another treatment of the dividend distribution was possible, not that his treatment was incorrect. And even if we agreed with Koutsoubos that the treatment of the dividend distribution was incorrect, this would not show that Dempsey's calculations for *Bryant's* account were flawed.

179 *See Cruz-Vazquez v. Mennonite Gen. Hospital*, 613 F.3d 54, 59 (1st Cir. 2010) (holding that "[a]ssessing the potential bias of an expert witness" is a matter for the trier of fact and "considerations such as an expert witness's pecuniary interest in the outcome of a case . . . go to the probative weight of testimony, not admissibility"); *Apple Inc. v. Motorola, Inc.*, 757 F.3d 1286, 1321 (7th Cir. 2014) (noting that opposing counsel may probe potential bias through cross-examination of the expert and the trier of fact may then take that into account in assessing the expert's testimony).

180 *Cf. Braun v. Lorillard Inc.*, 84 F.3d 230, 237-38 (7th Cir. 1996) ("A litigant, or a litigant's CEO, or sole stockholder, or mother, or daughter is not, by reason of his or her or its relation to the litigant, disqualified as an expert witness."); *Cole v. Reader's Digest Sales and Servs., Inc.*, 139 F. App'x. 707, 708 (6th Cir. 2005) (holding that the district court erred in striking the expert affidavit of the plaintiff's husband because"[n]othing . . . in Fed. R. Evid. 702 disqualifies an individual from serving as an expert by virtue of his or her relationship to the plaintiff").

3. Koutsoubos acted with scienter in trading Bryant's account.

We find that Koutsoubos acted with scienter with respect to his trading in Bryant's account. The record shows that, at a minimum, Koutsoubos acted with recklessness in his handling of Bryant's account.[181] Bryant told Koutsoubos on a "number of occasions" that he wanted his account managed conservatively, but Koutsoubos engaged in aggressive and speculative trading that resulted in Bryant losing approximately $190,000 during the churn period. At the same time, Koutsoubos's trading cost Bryant approximately $47,000 in commissions, of which Koutsoubos kept a significant amount.[182] As discussed above, Koutsoubos took advantage of Bryant's lack of sophistication and the considerable trust he placed in Koutsoubos to excessively trade his account in a manner that was inconsistent with his true risk tolerance and investment objectives. Koutsoubos sent account forms to Bryant without discussing them with him and told Bryant to "just sign" where indicated and that Koutsoubos would take care of the rest.[183] When Bryant wanted to minimize his losses and pull out of the market, Koutsoubos insisted that he be allowed to continue trading. But what Koutsoubos failed to tell Bryant was that, given the costs associated with his trading, it was "extremely unlikely that [Bryant] would be able to break even, much less earn any profit."[184] Koutsoubos also engaged in unauthorized trading and, around the same time, falsely told Bryant that he would waive his commissions. These facts establish that Koutsoubos must have known that his actions were inconsistent with Bryant's interests. By, at a minimum, recklessly disregarding those interests, Koutsoubos acted with scienter.

Koutsoubos argues that he did not act with scienter because he had no economic incentive to excessively trade Bryant's account. Koutsoubos contends that, because Bryant's was an inherited account, he received only 35% of the commissions charged to the account, not the typical 60% or 65%. Because his payout for each trade in Bryant's account was less than a typical client and he had other expenses that he had to cover, Koutsoubos argues that "[t]here was simply no pecuniary reason for Koutsoubos to defraud Bryant or even to recklessly disregard his interests."

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181 *See supra* note 81.

182 *See Roche*, 1997 WL 328870, at *4 (finding that, where respondent's "clients were sustaining large losses while he was generating substantial commission income for himself," "[a]t the least, Roche acted in reckless disregard of his customers' interests and account objectives, and in favor of his own interests").

183 We agree with the law judge that the fact that there is no AASS or AASQ for Bryant's account prior to March 2009 suggests that "Koutsoubos did not even bother to ensure that Bryant had adequate documentation on file."

184 *Roche*, 1997 WL 328870, at *5. As previously noted, during the churn period, Bryant's account would have had to increase in value more than 73% just to cover the commissions and other expenses.

We agree with Koutsoubos that a preponderance of the evidence establishes that his payout percentage for Bryant's account was 35%.[185] We disagree with Koutsoubos, however, that this fact negates a finding of scienter because we find that the record does not support Koutsoubos's contention that he would have no reason to engage in excessive trading at a 35% commission level.

Koutsoubos points to the testimony of J.P. Turner's Executive Vice President, Michael Bresner, who opined that, because registered representatives must pay insurance, secretarial, telephone, delivery service, and other fees out of their own pocket, if the broker's gross commission is 50% to 60% of the commission paid by the client, on trades with a $100 maximum commission the broker was "at best breakeven," and on trades with a $60 maximum commission the broker was "getting crushed." Other than Bresner's unsupported assertion, there is no evidence in the record to support his conclusion about the commission level at which a registered representative would have an economic disincentive to trade. And because Bresner's testimony was an attempt to justify J.P. Turner's commission restriction policies for actively traded accounts, we are wary of relying on his unsupported economic analysis. We note, for example, that many of the additional costs to registered representatives that Bresner identified are fixed and therefore would not lower a registered representative's payout for each trade.[186] Indeed, as Bresner acknowledged during the hearing, there may be an incentive to trade a restricted account *more* actively in order to make up for the lost revenue imposed by the commission restriction.[187] As long as a registered representative is not actually losing money on a trade, there is some economic incentive to make the trade.[188] Indeed, because Koutsoubos engaged in frequent trading, his claims that he had no economic interest in doing so are simply not compelling. We conclude that the evidence in the record supports a finding of scienter even when considering that Koutsoubos received a 35% payout of gross commissions for Bryant's account.

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185 This finding is supported by Bryant's account documentation. Dempsey testified that he based his calculation of the payout Koutsoubos personally received only on Koutsoubos's prior investigative testimony about the percentage he typically received.

186 Relatedly, Konner acknowledged that the money he "would pay for [his] sales assistant and for all this overhead cost would be spread out among all of [his] clients and customers." The same is true for Koutsoubos.

187 This may be particularly true when a client readily acquiesces to trading recommendations or where unauthorized trading is involved because more trading does not involve a significant additional expenditure of the broker's time convincing the client of the appropriateness of the trades.

188 The law judge found that the "only plausible explanation for the sharp drop in trading activity" in Bryant's account after October 2008 was the change in the commission restriction from $100 to $60 per trade. Although we do not find that this is the *only* plausible explanation, the dramatic decrease in trading activity supports the conclusion that the commission restriction at this point created an economic disincentive for Koutsoubos's trading that resulted in less churning.

Koutsoubos also argues that the record does not support a finding of scienter because of his "hard work and good faith in recommending transactions consistent with Bryant's stated investment objectives." But as we have explained, Koutsoubos's trading was not consistent with Bryant's true investment objectives. Moreover, as the Division points out, Koutsoubos never articulated an actual investment strategy and offers no plausible explanation for the high level of trading in Bryant's account. At the hearing, for example, Koutsoubos was at a loss to explain his in-and-out trading in Informatica stock in the account. For all of the above reasons, we conclude that the evidence in the record demonstrates, at the very least, a reckless disregard by Koutsoubos of Bryant's interests in favor of his own.

* * *

Accordingly, we find that Koutsoubos's excessive trading of Bryant's account was fraudulent. We thus conclude that Koutsoubos violated Securities Act 17(a), Exchange Act Section 10(b), and Rule 10b-5.

VI.

The law judge barred Respondents from association with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and he ordered them to cease and desist from committing or causing violations or future violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5 thereunder, to disgorge certain amounts attributable to commissions received from the customers whose accounts they churned and to pay prejudgment interest, and to pay certain civil money penalties. Based on our consideration of the relevant factors, we impose these same sanctions with some modifications to the disgorgement amounts as discussed below.

A. Bar Orders

Exchange Act Section 15(b)(6)(A) authorizes us to bar any person who, at the time of the misconduct, was associated with a broker or dealer, from "being associated with a broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization"—a bar referred to as an industry bar—if we find "on the record after notice and opportunity for a hearing" that the person willfully violated the securities laws and the sanction is in the public interest.[189] We find that an industry bar is appropriate for all Respondents under this standard.[190]

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[189] 15 U.S.C. § 78o(b)(6)(A) (referencing, among other provisions, Exchange Act Section 15(b)(4)(D), 15 U.S.C. § 78o(b)(4)(D) (referencing willful violations of the securities laws, among other things)).

[190] Although the conduct at issue here occurred before Exchange Act Section 15(b) authorized complete industry bars, none of the respondents challenges the extent of their bars on that basis, and any such argument is accordingly waived. In any event, we have found that the Dodd-Frank Act's expansion of Section 15(b)'s bar provisions is not impermissibly retroactive.

(*continued . . .*)

1. Respondents willfully violated the securities laws.

We find that Respondents each willfully violated Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5. To support a finding of willfulness, it is sufficient that the respondent "intentionally commit[ed] the act which constitutes the violation."[191] The respondent need not "also be aware" that he "violat[ed] one of the Rules or Acts."[192] We find that the willfulness standard is satisfied by ample record evidence showing that Respondents intentionally engaged in the excessive trading in their clients' accounts that constituted churning.

2. The public interest favors an industry bar as to each Respondent.

Our analysis of the relevant public interest factors also supports the imposition of industry bars against Respondents. In analyzing whether an industry bar would serve 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 nature of his conduct, and the likelihood that the respondent's occupation will present opportunities for future violations."[193] Our inquiry into the public interest "is a flexible one, and no one factor is dispositive."[194] We address each Respondent in turn.

a. Barring Calabro is in the public interest.

We find that barring Calabro is in the public interest. Calabro's actions were egregious. By churning Williams's account, Calabro put his own financial interests above those of his elderly retired client and caused Williams devastating financial harm through excessive commissions and drastic account depreciation. Calabro also made unauthorized trades and exaggerated his trading results to Williams. These actions were not isolated but rather part of a pattern and practice that continued over a year, albeit with respect to one client. Calabro churned Williams's account, acting with, at a minimum, recklessness. Calabro offers no assurance against future violations other than to assert that he has left the industry voluntarily, which

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(*. . . continued*)
See Johnny Clifton, Exchange Act Release No. 69982, 2013 WL 3487076, at *13 (July 12, 2013) (considering respondent's pre-Dodd-Frank Act conduct in assessing his future risk to the investing public and stating that "prospective remedies whose purpose is to protect the investing public from future harm" do not implicate retroactivity concerns).

191 *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal citation omitted).

192 *Id.* (internal citation omitted).

193 *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at *6 (Feb. 13, 2009) (citing *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981)), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010).

194 *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *15 (Dec. 21, 2007) (internal citation omitted), *petition denied*, 334 F. App'x 334 (D.C. Cir. 2009).

provides no guarantee that he will not seek to return at some point in the future.[195] Absent a bar, nothing would prevent Calabro from reentering the industry.[196] Moreover, he does not recognize the wrongful nature of his conduct. Given his personal profit at a customer's expense, unauthorized and excessive trading, and exaggeration of trading results, among other things, Calabro's continued participation in the industry would present a risk of future violations.

We also find that Calabro's serious misconduct justifies an industry bar. "The securities industry presents continual opportunities for dishonesty and abuse, and depends heavily on the integrity of its participants and on investors' confidence."[197] The risks to customers from self-dealing of the sort in which Calabro engaged exist not only in the broker-dealer context but also throughout the industry, which presents multiple opportunities for personal enrichment at a client's expense. An industry bar will protect investors from future violations by Calabro.

b. Barring Konner is in the public interest.

We also find that barring Konner is in the public interest. Konner acted egregiously and with scienter in churning Carlson's account. Taking advantage of Carlson's lack of investing sophistication, Konner engaged in risky and excessive trading that he knew was inappropriate for an investor in Carlson's financial situation. Carlson told Konner repeatedly that he could not afford to lose the money in his account, but Konner treated the account as if Carlson could afford to lose all of his investment. When Carlson told Konner that his net worth on account documents was significantly inflated, Konner lied to Carlson, telling him that the figures on the forms did not matter, and urged Carlson to "just initial" forms that he knew to be inaccurate.

Konner placed his own interest in commissions over the interests of Carlson. Konner's trading during the churn period resulted in commissions to Konner of over $55,000.[198] Konner

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195 The Division reads Calabro's brief as asserting that he should not be barred because he "relinquished" his career as a registered representative.

196 *Cf. James E. Franklin*, Exchange Act Release No. 56649, 2007 WL 2974200, at *8 (Oct. 12, 2007) (rejecting respondent's argument that penny stock bar was unnecessary given his claim that he could no longer work in the industry because "absent a bar, there would be no obstacle to [his] participation in a penny stock offering in the future"); *Conrad P. Seghers*, Advisers Act Release No. 2656, 2007 WL 2790633, at *8 & n.48 (Sept. 26, 2007) ("A bar is necessary to protect the public interest because, absent a bar, there would be nothing to prevent Seghers from becoming an investment adviser to the Funds' investors or others in the future."), *petition denied*, 548 F.3d 129 (D.C. Cir. 2008).

197 *Seghers*, 2007 WL 2790633, at *7; *see also Charles Phillip Elliot*, Exchange Act Release No. 31202, 50 SEC 1273, 1992 WL 258850, at *3 (Sept. 17, 1992) (noting that the industry "presents many opportunities for abuse and overreaching"), *aff'd*, 36 F.3d 86 (11th Cir. 1994).

198 Even if we accept Konner's contention that his conduct resulted in the value of Carlson's account being net positive during the churn period, we do not find this sufficiently mitigating to avoid a bar. The record shows that Konner's trading overall resulted in significant losses to Carlson. And even during the churn period, any net gains were unrealized and fleeting, as

(*continued . . .*)

also engaged in unauthorized trading. Although we find Konner liable for violations with regard to a single client, his conduct continued over the course of at least one year. In addition, Konner has offered no assurances against future violations and has not recognized the wrongful nature of his conduct. Konner represents in his reply brief that he "is no longer working in the securities industry," but absent a bar nothing will prevent him from seeking employment in the "only field in which he has worked during his adult life."[199] Accordingly, based on our consideration of the relevant factors, we conclude that barring Konner is in the public interest. Given the nature of Konner's misconduct, which involved fraudulent self-dealing at the expense of his client, an industry bar is appropriate.[200]

Konner points to other disciplinary cases in which brokers received sanctions less than a bar to argue that a bar is unnecessary here. But as we consistently have held, the appropriateness of a sanction "depends on the facts and circumstances of each particular case" and "cannot be precisely determined by comparison with action taken in other proceedings."[201] And in any event, the cases cited by Konner are readily distinguishable. In *Shearson Lehman Hutton, Inc.* and *Michael David Sweeney*, there was no finding of scienter or fraud.[202] Moreover, we reviewed NASD's imposition of sanctions in those cases only for whether they were excessive or oppressive; we could not have increased the penalties in those cases even if we had concluded that they should have been more severe in light of the facts and circumstances.[203] In addition, in

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(. . . *continued*)
contrasted with the significant *realized* losses that Carlson suffered during the churn period. *See supra* note 136.

199 *See supra* note 196 and accompanying text.

200 *See supra* note 197 and accompanying text.

201 *Leslie A. Arouh*, Exchange Act Release No. 50889, 57 SEC 1099, 2004 WL 2964652, at *11 (Dec. 20, 2004); *see also Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) ("'The employment of a sanction within the authority of an administrative agency is thus not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases."); *Hiller v. SEC*, 429 F.2d 856, 858 (2d Cir. 1970) ("[W]e cannot disturb the sanctions ordered in one case because they were different from those imposed in an entirely different proceeding."); *Wong*, 2002 WL 200089, at *5 ("We consistently have held that the appropriate sanctions in a case depend on its particular facts and circumstances and cannot be determined by comparison with action taken in other cases.").

202 In responding to the argument that the sanctions were unwarranted in *Shearson Lehman Hutton*, we noted that, if anything, the sanctions imposed by the NASD, which included censure and a $3,000 fine, were "mild." 1989 WL 257097, at *5. And in *Sweeney*, we rejected the type of argument made by Konner here by noting that "'[a] sanction is not invalid simply because it is more severe than a sanction imposed in a similar case.'" 1991 WL 716756, at *5 (quoting *Carter v. SEC*, 726 F.2d 427, 474 (9th Cir. 1983)).

203 Pursuant to Exchange Act Section 19(e)(2), we will sustain a self-regulatory organization's sanction unless we find, having due regard for the public interest and protection of investors, that the sanction is "excessive or oppressive" or imposes an unnecessary or

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Brian J. Kelly, FINRA, in imposing a two year suspension, relied on mitigating factors not present in Konner's case, namely, that Kelly "accepted responsibility for his misconduct and consistently expressed remorse" including expressing "deep regret" for trading that he conceded was inappropriate.[204] By contrast, Konner continues to insist that his trading was fully appropriate for Carlson.[205] Although we agree with Konner that the Division has not proved actual misconduct in his disciplinary history,[206] we find that the other factors supporting a bar outweigh the lack of prior misconduct in this case. Upon consideration of all the relevant factors, we conclude that an industry bar is fully appropriate under the circumstances.

c. Barring Koutsoubos is in the public interest.

Consideration of the public interest factors also supports barring Koutsoubos. As detailed above, Koutsoubos's conduct was egregious and involved scienter. Directly contrary to Bryant's wishes to have his account managed conservatively and inconsistent with Bryant's true risk tolerance and investment objectives, Koutsoubos engaged in aggressive and speculative trading that resulted in investment losses in Bryant's account of approximately $190,000 during the churn period. The level of trading in the account during the period was staggering, with a turnover rate of 56 and a cost-to-equity ratio of 73.3%. Koutsoubos abused the trust Bryant placed in him by, among other things, insisting that Bryant continue excessive trading when Bryant wanted to get out of the market and by executing unauthorized transactions. Koutsoubos

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(*. . . continued*)
inappropriate burden on competition. 15 U.S.C. § 78s(e)(2). The same section permits us to "cancel, reduce, or require the remission of" an SRO sanction but does not authorize us to increase the sanction. *Id.*; *see also Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 WL 6044123, at *17 n.128 (Nov. 15, 2013) (noting that the Exchange Act does not authorize the Commission to increase an SRO disciplinary sanction).

204 Complaint No. E9A2004048801, 2008 WL 5273298, at *9 (NAC Dec. 16, 2008).

205 We also are unpersuaded by Konner's citation to a NASD hearing panel case, *Frank Rocky Mazzei*, Discip. Proc. No. C10970120, 1998 WL 1768418 (OHO June 24, 1998). Not only is the case in no way binding on us, it was decided under an earlier version of the NASD sanctions guidelines, in which a bar was not recommended for churning violations. *Id.* (noting that for churning "[t]he *Guidelines* recommend suspension for ten to thirty days, and for up to two years in egregious cases."). The current version of FINRA's Sanction Guidelines provides that a bar may be appropriate in egregious cases of churning or excessive trading. *FINRA Sanction Guidelines* (July 2013 version) at 77, *available at* http://www.finra.org/sites/default/files/Industry/p011038.pdf.

206 The Division insists that "Konner's career in the securities industry has not been without blemish," and it points to a 2006 settled case involving unauthorized trading and a 2012 FINRA arbitration alleging churning among other violations. But Konner's unrebutted testimony during the hearing was that these cases in which he was named did not, in fact, involve any misconduct on his part but that of other brokers.

also misled Bryant by falsely stating he would waive his commissions.[207] Koutsoubos's actions were not isolated but involved misconduct spanning at least one year. In addition, Koutsoubos has failed to recognize the wrongful nature of his misconduct and has offered no assurances against future violations. Indeed, he continues to insist that his actions were wholly appropriate. For these reasons and given the fraudulent nature of the misconduct, we conclude that an industry bar is in the public interest.[208]

Koutsoubos argues that certain mitigating factors counsel against an industry bar, such as his "pristine disciplinary record," that his conduct involved a single customer account, and that the trading occurred "during a unique period of market decline." We have considered these factors, and have determined that they are not mitigating or are outweighed by the relevant public interest factors supporting a bar.[209] As indicated, Koutsoubos's scienter-based fraud raises significant doubts about his fitness to remain in the securities industry in any capacity. Accordingly, we will impose an industry bar.

B. Cease-and-desist Orders

Exchange Act Section 21C(a) authorizes the Commission to issue an order against "any person [who] is violating, has violated, or is about to violate any provision" of the Exchange Act or "any rule or regulation thereunder" that requires the person "to cease and desist from committing or causing such violation and any future violation of the same provision, rule, or regulation."[210] Securities Act Section 8A(a) contains similar provisions with respect to violations of the Securities Act and related regulations.[211]

In determining whether a cease-and-desist order is appropriate under either of these provisions, we consider the same factors used in determining whether a bar is in the public interest. We also take into account "whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought in the same

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207 In challenging the imposition of a bar, Koutsoubos contends that the finding that he misled Bryant about waiving commissions is "unsupported by the totality of evidence in the record." As discussed above (*supra* note 146), we find no reason to reject the law judge's findings on this point, which were based on credibility determinations.

208 *See supra* note 197 and accompanying text.

209 As noted in our discussion of Konner, Koutsoubos's reliance on *Kelly* for this argument is misplaced because, among other reasons, Koutsoubos has failed to recognize the wrongful nature of his misconduct. *See supra* notes 204 and 205 and accompanying text.

210 15 U.S.C. § 78u-3(a).

211 15 U.S.C. § 77h-1(a).

proceedings."[212] In addition, we consider the risk of future violations.[213] Although "'some' risk is necessary, it need not be very great to warrant issuing a cease-and-desist order."[214] "Absent evidence to the contrary, a finding of violation raises a sufficient risk of future violation."[215]

We find it is appropriate to order Respondents to cease and desist from committing or causing violations or future violations of Securities Act Section 17(a), Exchange Act Section 10(b), and Rule 10b-5.[216] As explained above, our findings with respect to the imposition of industry bars strongly support the need for serious sanctions against Respondents. Respondents' violative conduct occurred within the last six years, caused their clients significant financial harm, and demonstrates a sufficient risk of future violations to enter cease-and-desist orders. In addition to the risk raised by their fraudulent conduct, Respondents' continued insistence that their trading was appropriate reflects their refusal to recognize any wrongdoing, which in turn supports a finding that these Respondents pose a significant risk of committing future violations. The cease-and-desist orders are a crucial complement to the industry bars: because "the antifraud provisions apply to securities transactions by any person," cease-and-desist orders are "therefore necessary to protect the public against future violations that [Respondents] could commit without being . . . associated person[s] of a broker-dealer,"[217] or other entity covered by an industry bar.

C. Disgorgement

In any cease-and-desist proceeding under Exchange Act Section 21C(a) or Securities Act Section 8A(a), or proceeding seeking a penalty under Investment Company Act Section 9(d), such as this one, we "may enter an order requiring accounting and disgorgement, including reasonable interest."[218] Disgorgement "is intended primarily to prevent unjust enrichment."[219]

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212 *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 54 SEC 1135, 2001 WL 47245, at *26 (Jan. 19, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002); *see also Moskowitz*, 2002 WL 434524, at *8.

213 *KPMG Peat Marwick*, 2001 WL 47245, at *26.

214 *Id.* at *24.

215 *Id.*

216 Although they challenge the law judge's findings of liability, Respondents do not directly contest the imposition of a cease-and-desist order.

217 *See Thomas C. Bridge*, Exchange Act Release No. 60736, 2009 WL 3100582, at *21 (Sept. 29, 2009) (imposing cease-and-desist order and broker-dealer bar) (internal citation omitted).

218 Exchange Act Section 21C(e), 15 U.S.C. § 78u-3(e); Securities Act Section 8A(e), 15 U.S.C. § 77h-1(e); Investment Company Act Section 9(e), 15 U.S.C. § 80a-9(e).

219 *Zacharias v. SEC*, 569 F.3d 458, 471 (D.C. Cir. 2009) (*quoting SEC v. Banner Fund Int'l*, 211 F.3d 602, 617 (D.C. Cir. 2000)); *see also Sweeney*, 1991 WL 716756, at *5 ("[D]isgorgement is intended to force wrongdoers to give up the amount by which they were unjustly enriched.").

Although "the amount of disgorgement should include all gains flowing from the illegal activities," calculating that amount "requires only a reasonable approximation of profits causally connected to the violation."[220] "Once the Division shows that its disgorgement figure" reasonably approximates the ill-gotten gains, "the burden shifts to the respondent to demonstrate that the Division's estimate is not a reasonable approximation."[221] Thus, "[e]xactitude is not a requirement; '[s]o long as the measure of disgorgement is reasonable, any risk of uncertainty should fall on the wrongdoer whose illegal conduct created that uncertainty.'"[222]

1. We order Calabro to disgorge his ill-gotten gains.

During the churning period, Calabro received approximately $247,945 from commissions and fees charged to Williams. Calabro does not dispute that this number is a reasonable approximation of his ill-gotten gains.[223] We therefore find it appropriate to order Calabro to disgorge $247,945 plus prejudgment interest.[224]

We reject Calabro's contrary arguments that disgorgement is "unnecessary" because (1) "a $2,500,000 settlement [was] entered with Williams and another customer in settlement of a related arbitration," and (2) Calabro has now left the securities industry. Because the recent BrokerCheck report that Calabro submitted to us states that he made no monetary contribution to

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220 *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1113-14 (9th Cir. 2006) (quotation omitted); *Canady*, 1999 WL 183600, at *14 n.35 (noting that "courts have held that '[t]he amount of disgorgement ordered need only be a reasonable approximation of profits causally connected to the violation [and that] any risk of uncertainty [in calculating disgorgement] should fall on the wrongdoer whose illegal conduct created that uncertainty'" (*quoting SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1475 (2d Cir. 1996))) (alterations in original and internal quotation marks omitted); *see also SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1231 (D.C. Cir. 1989) (noting that, when calculating disgorgement, "separating legal from illegal profits exactly may at times be a near-impossible task").

221 *Eric J. Brown*, Exchange Act Release No. 66469, 2012 WL 625874, at *15 (Feb. 27, 2012) (citing *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 2006)), *petition denied sub nom.*, *Collins v. SEC*, 736 F.3d 521 (D.C. Cir. 2013).

222 *SEC v. Calvo*, 378 F.3d 1211, 1217 (11th Cir. 2004) (*quoting SEC v. Warde*, 151 F.3d 42, 50 (2d Cir. 1998)); *see also Zacharias*, 569 F.3d at 473 (noting that, where disgorgement cannot be exact, the "well-established principle is that the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoers who create that uncertainty").

223 Although the law judge reached a slightly higher number taken from Dempsey's pre-hearing expert report, Calabro verified during the hearing at the Division's request that the disgorgement number we order represented his share of commissions from Williams's account.

224 *See Terence Michael Coxon*, Exchange Act Release No. 48385, 56 SEC 934, 2003 WL 21991359, at *14 (Aug. 21, 2003) ("[E]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the equivalent of an interest free loan from the wrongdoer's victims."), *aff'd*, 137 F. App'x 975 (9th Cir. 2005).

the settlements he identifies,[225] it provides no basis to "vacate any monetary obligation," as Calabro urges.[226] Calabro also fails to establish that any particular component of the settlement payment (to two customers) is attributable to disgorgement of his ill-gotten gains with respect to Williams.[227] Nor is disgorgement "unnecessarily punitive" because Calabro purportedly has left the industry. Rather, an order for disgorgement "is not a punitive measure; it is intended primarily to prevent unjust enrichment."[228] That Calabro may have left the securities industry does not diminish the amount of his ill-gotten gains.[229] And because disgorgement will "deter others from similar misconduct,"[230] we reject Calabro's assertion that "there is no further need for deterrence" because he "is no longer a broker."[231]

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225 We take official notice of the report. *See* Rule of Practice 323, 17 C.F.R. § 201.323; *Robert D. Tucker*, Exchange Act Release No. 68210, 2012 WL 5462896, at *1 n.1 (Nov. 9, 2012) (taking notice of BrokerCheck report), *appeal dismissed*, No. 13-31 (2d Cir. Sept. 24, 2013).

226 *See Murphy*, 2013 WL 3327752, at *25 (finding, in a FINRA review proceeding, that applicant failed to "provide a basis to decrease the disgorgement amount" where he introduced no evidence "show[ing] his contribution to the settlements"); *cf. Disraeli*, 2007 WL 4481515, at *17 n.106 ("Repayments that Disraeli *proves he made* could offset his disgorgement.") (emphasis added).

227 *See Montford & Co.*, Investment Advisers Act Release No. 3829, 2014 WL 1744130, at *23 (May 2, 2014) (finding insufficient evidence in the record to support respondent's request for offset based on alleged payment to victim, where, although the respondent identified the amount of the settlement, the record contained no evidence on the basis of the settlement amount), *petition for review docketed*, No. 14-1126 (D.C. Cir. June 27, 2014).

228 *Zacharias*, 569 F.3d at 471 (internal quotation omitted).

229 Indeed, we repeatedly have ordered that barred respondents disgorge their ill-gotten gains. *See, e.g.*, *Brown*, 2012 WL 625874, at *1 (barring three respondents and imposing, among other things, disgorgement and civil money penalties); *Gregory O. Trautman*, Exchange Act Release No. 61167A, 2009 WL 6761741, at *1 (Dec. 15, 2009) (barring respondent and ordering, among other things, respondent to pay in excess of $600,000 in disgorgement, as well as a third-tier civil money penalty); *see also John W. Lawton*, Advisers Act Release No. 3513, 2012 WL 6208750, at *7 (Dec. 13, 2012) (explaining that "[t]he Commission is authorized to impose a bar not to punish the respondent for past misconduct or to remedy past harms suffered by victims of that misconduct, for example, in the form of disgorgement or damages," but rather "to protect the investing public from the respondent's possible future actions").

230 *Joseph John VanCook*, Exchange Act Release No. 61039, 2009 WL 4005083, at *16 (Nov. 20, 2009) (citing *First City*, 890 F.2d at 1230), *petition denied*, 653 F.3d 130 (2d Cir. 2011).

231 We reject Calabro's argument that he is "financially unable to pay any level of disgorgement or penalty" because he failed to offer the record evidence required to support such a modification of sanctions. *See* Rule of Practice 410(c), 17 C.F.R. § 201.410(c) ("Any person who files a petition for review of an initial decision that asserts that person's inability to pay

(*continued . . .*)

2. Konner must also disgorge his commissions.

Konner does not dispute that during the churn period he received approximately $55,000 in commissions and fees from his trading activity in Carlson's account. We conclude that this amount is a reasonable approximation of Konner's ill-gotten gains and order disgorgement in this amount, plus prejudgment interest.

Konner insists that disgorgement is unwarranted because Carlson's account was profitable during the churn period. As explained more fully below, we dispute Konner's characterization that his churning was profitable for Carlson. More fundamentally, however, whether Carlson's account value was net positive or negative during the churn period does not affect the disgorgement analysis because disgorgement corresponds to ill-gotten gains—in this instance, commissions—and not losses suffered by a customer. In churning cases, we have typically ordered the disgorgement of the commissions received by the broker during the churn period, because this is the closest approximation of the broker's ill-gotten gains from the violative conduct.[232] Konner offers no reason to depart from that approach in this case.[233]

3. Koutsoubos must disgorge those commissions he actually received.

Koutsoubos argues that any finding of disgorgement should reflect that his payout ratio for commissions from Bryant's account was 35%, not 65%. As noted above, we agree with

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(. . . *continued*)
either disgorgement, interest or a penalty shall file with the opening brief a sworn financial disclosure statement containing the information specified in Rule 630(b).").

232 *See Murphy*, 2013 WL 3327752, at *24 (finding that disgorgement based on total commissions retained by the broker in a churning case was appropriate even when this amount exceeded the client's net loss in the account); *Roche*, 1997 WL 328870, at *6 (finding that total commissions represented a reasonable approximation of ill-gotten gains retained from churning); *Sweeney*, 1991 WL 716756, at *5 (sustaining the disgorgement of all commissions in a case of excessive trading and noting that "courts have approved action like that taken by the NASD here in civil actions involving excessive trading, basing their determinations on the difficulty of specifying a 'correct' level of trading and the conclusion that the burden of this problem should be borne by the broker who caused it" (citing *Costello*, 711 F.2d at 1374 and *Carras*, 516 F.2d at 259)).

233 We also reject Konner's contention that the disgorgement amount is too high because his "actual earnings" were "far less than his share of the commissions paid by the customer." That Konner paid for business expenses out of his share of his customers' commissions does not make the disgorgement calculation incorrect. *See SEC v. Brown*, 658 F.3d 858, 861 (8th Cir. 2011) (noting that "'the overwhelming weight of authority hold[s] that securities law violators may not offset their disgorgement liability with business expenses.'" (quoting *SEC v. United Energy Partners, Inc.*, 88 F. App'x 744, 746 (5th Cir. 2004))). Moreover, even were we to accept Konner's contention that he is entitled to an offset, his unsupported insistence that the disgorgement amount is too high fails to meet his burden to show that the Division's calculation of disgorgement was not a reasonable approximation of his ill-gotten gains.

Koutsoubos that a preponderance of the evidence supports his claim that he was paid 35% of the commissions charged to Bryant.[234] We therefore order the disgorgement of $16,461 (which represents 35% of the approximately $47,034 in commissions that Bryant paid during the churn period), plus prejudgment interest.

D. Civil Money Penalties

As relevant here, Exchange Act Section 21B(a) and Investment Company Act Section 9(d) each authorize the Commission to assess civil money penalties, among other things, where a respondent has willfully violated any provision of the federal securities laws or the rules or regulations thereunder.[235] In considering whether a penalty is in the public interest, we may consider (1) whether the act or omission for which such penalty is assessed involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement; (2) the harm to other persons resulting either directly or indirectly from such act or omission; (3) the extent to which any person was unjustly enriched, taking into account any restitution made to injured persons; (4) any previous Commission, other regulatory agency, or SRO findings that the person violated federal or state securities laws or SRO rules, court orders enjoining the person from violations of such laws or rules, or specified felony or misdemeanor convictions; (5) the need to deter such person and other persons from committing such acts or omissions; and (6) such other matters as justice may require.[236]

The relevant statutes create a three-tier system of civil penalties, with each tier corresponding to increasingly serious misconduct.[237] First-tier penalties require no additional statutory showing.[238] Second-tier penalties require a showing that the act or omission giving rise to the penalty "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement."[239] Third-tier penalties can be imposed on an additional showing that the violation "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain" to the violator.[240]

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234 *See supra* text accompanying note 185.

235 15 U.S.C. § 78u-2(a); 15 U.S.C. § 80a-9(d).

236 Exchange Act Section 21B(c), 15 U.S.C. § 78u-2(c); Investment Company Act Section 9(d)(3), 15 U.S.C. § 80a-9(d)(3).

237 Exchange Act Section 21B(b), 15 U.S.C. § 78u-2(b); Investment Company Act Section 9(d)(2), 15 U.S.C. § 80a-9(d)(2).

238 Exchange Act Section 21B(b)(1), 15 U.S.C. § 78u-2(b)(1); Investment Company Act Section 9(d)(2)(A), 15 U.S.C. § 80a-9(d)(2)(A).

239 Exchange Act Section 21B(b)(2), 15 U.S.C. § 78u-2(b)(2); Investment Company Act Section 9(d)(2)(B), 15 U.S.C. § 80a-9(d)(2)(B).

240 Exchange Act Section 21B(b)(3), 15 U.S.C. § 78u-2(b)(3); Investment Company Act Section 9(d)(2)(C), 15 U.S.C. § 80a-9(d)(2)(C).

Each tier of penalties is subject to specified maximum penalties per violation, which are periodically adjusted.[241]

We find that it is appropriate to impose a $150,000 third-tier penalty against Calabro, which is the maximum third-tier penalty for violations occurring between March 2009 and March 2013.[242] Calabro willfully violated Exchange Act Section 10(b) and Rule 10b-5 by engaging in fraud and deceit. He acted with scienter, and, at a minimum, his conduct was extremely reckless. By churning Williams's account, Calabro directly caused Williams to suffer substantial losses, while at the same time Calabro was unjustly enriched through his nearly $250,000 share in commissions.[243] In addition, imposing a civil money penalty will provide general and specific deterrence of future violations and is particularly appropriate given the many factors discussed above that establish the egregiousness of Calabro's conduct.[244]

We reject Calabro's contention that we should not impose a civil money penalty because "there is no need for deterrence given his departure from the industry." As we have recognized, civil money penalties provide specific deterrence even where respondents may no longer work in the industry.[245] And the relevant statutes provide that we may also consider "the need to deter . . . *other persons* from committing" the misconduct at issue.[246] In any event, we find that the

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241 Exchange Act Section 21B(b), 15 U.S.C. § 78u-2(b); Investment Company Act Section 9(d)(2), 15 U.S.C. § 80a-9(d)(2); 17 C.F.R. §§ 201.1003, 1004, and 1005 (effecting adjustment of civil money penalties for violations after, respectively, February 14, 2005, March 3, 2009, and March 5, 2013), Tables III, IV, and V to Subpart E of Part 201 (specifying such adjusted penalty amounts); *see also* Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, ch. 10, sec. 31001 (providing for, among other things, periodic adjustment of penalty amounts).

242 This maximum penalty is available because, although Calabro began to churn Williams's account in November 2008, the churn period did not end until December 2009.

243 Although Calabro settled a FINRA arbitration with Williams, there is no evidence that Calabro financially contributed to that settlement. *See supra* notes 225 and 226 and accompanying text.

244 *See supra* Section VI.A.2.a.

245 *See, e.g.*, *Clifton*, 2013 WL 3487076, at *16 (finding, in case in which an industry bar was imposed, that "[a] single penalty at the maximum end of the third tier is necessary to deter Clifton from future misconduct and will have an additional remedial effect of deterring others from engaging in similar misconduct").

246 15 U.S.C. § 78u–2(c)(5) (emphasis added); *see also Bridge*, 2009 WL 3100582, at *24 ("The Exchange Act also requires that, in determining whether civil penalties are in the public interest, we examine . . . *the need to deter others*, and other matters as justice may require." (emphasis added)).

statutory factors as a whole support the imposition of a single maximum penalty. We thus reject Calabro's argument that the "loss of [his] career is penalty enough."[247]

We find that imposing a maximum third-tier penalty of $150,000 on Konner is also appropriate. As discussed above, Konner acted with scienter and thus his conduct meets the requirement that it involve "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." In addition, we conclude that Konner's violative conduct "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to" Carlson and that Konner received a "substantial pecuniary gain" of $55,000 in commissions. Given the serious nature of the misconduct and the need for appropriate deterrence, we find that the statutory factors as a whole support the imposition of a $150,000 civil penalty.

Konner insists that the financial penalty is not justified because Carlson's account was profitable during the churn period due to the PIPE transactions. This argument is disingenuous. As the Division points out, Carlson's realized losses during the churn period were well over $100,000, and given the high turnover in the account, these losses are the direct result (and certainly the indirect result) of Konner's violations. Even accepting Konner's argument that his conduct caused Carlson's account to be net profitable on paper in 2009, we still conclude that his churning, which involved aggressive and speculative short-term trading, created a significant risk of substantial losses to Carlson. Indeed, the precipitous drop in the value of Carlson's account in the first few months of 2010 showed that the risk became reality.[248] In any event, we conclude that Konner's retention of approximately $55,000 in commissions satisfies the alternative requirement for the imposition of a third-tier penalty—the violation "resulted in substantial pecuniary gain" to the violator.

Finally, we find that a third-tier penalty of $130,000—the maximum penalty for conduct occurring between February 2005 and March 2009—is appropriately imposed on Koutsoubos.[249] Like the other Respondents, Koutsoubos's scienter-based conduct involved "fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement." Koutsoubos's conduct also resulted in significant harm to Bryant, who lost nearly $200,000 during the churn period. In addition, Koutsoubos retained over $16,000 in ill-gotten gains from his churning. Koutsoubos insists the penalty is too severe and that he "actually received a pittance" from the commissions Bryant paid. But Koutsoubos's ill-gotten gains of over $16,000 are hardly a "pittance," and the harm to Koutsoubos's client from his violative conduct is far greater. Upon our consideration of all the relevant statutory factors, we conclude that the imposition of a $130,000 civil penalty on Koutsoubos is appropriate.

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[247] Calabro also asserts that the civil money penalty ordered by the law judge should be eliminated or reduced because the law judge determined that Calabro acted with the "lowest level of scienter" of the three appealing Respondents. We make no such finding and, in any event, find it appropriate to determine the sanction applicable to Calabro based on the factors relevant to his misconduct, rather than by comparison to the other Respondents.

[248] *See supra* note 137 and accompanying text.

[249] Koutsoubos's misconduct occurred before March 2009, so the maximum penalty is $130,000 rather than $150,000. *See supra* note 241 and accompanying text.

An appropriate order will issue.[250]

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

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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250 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9798 / May 29, 2015

SECURITIES EXCHANGE ACT OF 1934
Release No. 75076 / May 29, 2015

INVESTMENT COMPANY ACT OF 1940
Release No. 31657 / May 29, 2015

Admin. Proc. File No. 3-15015

In the Matter of

RALPH CALABRO,
JASON KONNER, and
DIMITRIOS KOUTSOUBOS

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Ralph Calabro, Jason Konner, and Dimitrios Koutsoubos be barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and it is further

ORDERED that Calabro, Konner, and Koutsoubos cease and desist from committing or causing any violations or future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Rule 10b-5 thereunder; and it is further

ORDERED that Calabro disgorge $247,945, plus prejudgment interest of $45,997.68 such prejudgment interest calculated beginning from December 1, 2009, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Konner disgorge $55,000, plus prejudgment interest of $9,982.61, such prejudgment interest calculated beginning from January 1, 2010, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Koutsoubos disgorge $16,461, plus prejudgment interest of $3,826.79, such prejudgment interest calculated beginning from January 1, 2009, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that Calabro pay a civil money penalty of $150,000; and it is further

ORDERED that Konner pay a civil money penalty of $150,000; and it is further

ORDERED that Koutsoubos pay a civil money penalty of $130,000.

Payment of the amounts to be disgorged and the civil money penalties shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary