THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

UNOFFICIAL TRANSCRIPT OF THE OPEN MEETING

WEDNESDAY, MAY 23, 2007

BEFORE: CHAIRMAN CHRISTOPHER COX
COMMISSIONER PAUL S. ATKINS
COMMISSIONER ROEL C. CAMPOS
COMMISSIONER ANNETTE L. NAZARETH
COMMISSIONER KATHLEEN L. CASEY

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COMMISSION GUIDANCE REGARDING MANAGEMENT'S REPORT
ON INTERNAL CONTROL OVER FINANCIAL REPORTING UNDER
SECTION 13(a) OR SECTION 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934 AND AMENDMENTS TO RULES
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CHAIRMAN COX: Good morning. Thank you for bearing with us. This is a meeting of the Securities and Exchange Commission under the Government Sunshine Act being conducted at our Headquarters in Washington, D.C., and also electronically connected to Zurich. Commissioner Atkins will be joining us shortly.

The first item on our agenda today is the Commission's interpretative guidance for management in evaluating and assessing internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act, and related rule changes.

It was over a year ago that the Commission and the Public Company Accounting Oversight Board announced a road map to improve the reliability of financial statements, while making compliance with Section 404 of the Sarbanes-Oxley Act more efficient and cost effective for public companies of all sizes.

Last December, the Commission proposed for public comment interpretative guidance for management to follow in conducting Section 404 evaluations.

The guidance was designed to focus management's attention on those internal controls that pose the greatest risk for a material financial misstatement.

At the same time, as a companion to our proposal,
the Public Company Accounting Oversight Board proposed an
extension revision of its existing standard for Section 404
audits.

After the comment periods for these proposals
ended, the Commission held an open meeting on April 4th. At
that meeting, we received a report on SEC staff's progress in
working with the Public Company Accounting Oversight Board's
staff to address the issues in the comment letters, and to
coordinate and align the standard with our interpretative
guidance.

At the end of that meeting, the Commission voted to
support the staff's approach in all respects.

Our meeting this morning is to consider the
recommendations by the Office of the Chief Accountant and the
Division of Corporation Finance to approve the interpretative
guidance for management, as well as tomorrow's PCAOB meeting
in which the Board will consider the adoption of its new 404
auditing standard. This is a significant achievement.

Our efforts to reach this point have been
considerably aided by the public comment process and by our
staff's interaction with the PCAOB staff, and by the feedback
and report that we received from the Congress.

If we continue to proceed as we have, our time
table established for the Commission and the PCAOB last May
will be able to positively and significantly affect the 2007
Despite the high costs over the last four years of implementing Section 404 of the Sarbanes-Oxley Act, I believe that Sarbanes-Oxley overall, including Section 404, may fairly be credited with correcting the serious problems that beset our securities markets just a few years ago. SOX fairly can be credited with restoring investor confidence in our markets.

The challenge has been to find the right balance between financial reporting and efficiency in achieving it. Congress never intended that the 404 process should become inflexible, burdensome and wasteful. The objective of Section 404 is to provide meaningful disclosure to investors about the effectiveness of the company's internal control systems, without creating unnecessary compliance burdens or wasting shareholder resources.

The Commission's interpretative guidance for management on the evaluation and assessment of its internal controls over financial reporting is intended to right size the evaluation and assessment efforts of management, and it is intended to do that for companies of all sizes.

With this guidance, management will be able to scale and tailor their evaluation procedures to fit the facts and circumstances, and investors will benefit from reduced compliance costs.
While the guidance is intended to help public companies of all sizes, smaller companies should particularly benefit from its scaleability and its flexibility.

When we announced our Section 404 extension for non-accelerated filers last December, we stated that we would consider further postponing the compliance date for management's report on internal controls if the Commission did not issue its guidance in time to be of sufficient assistance in connection with annual reports filed for fiscal years ending on or after December 15, 2007.

In light of the excellent progress that's been made and the flexibility and scaleability that the new provisions add, it would not appear that additional postponement is necessary.

Section 404 and compliance with it by smaller companies will further the primary goal of Sarbanes-Oxley, which is to enhance the quality of financial reporting and increase the confidence of investors in both small and large companies alike.

Before we hear from the staff, I want to particularly call out for recognition of the extraordinary efforts by the Office of the Chief Accountant and the Division of Corporation Finance. Your work and your leadership in developing the interpretative guidance for management and your work with the Public Company Accounting
Oversight Board staff to align the PCAOB's proposed auditing standard with our management guidance has been exemplary. Particular in the Office of Chief Accountant, I want to thank Conrad Hewitt, currently in Zurich, Zoe-Vonna Palmrose, Nancy Salisbury, Mike Gaynor, Brian Krodo, and Josh Jones.

In the Division of Corporation Finance, I want to thank John White, Carol Stacey, Elizabeth Murphy, Sean Harrison, Kimberly Drexler. Obviously, there is an Army here, men and women who deserve thanks standing right behind those that I've already mentioned.

Now I would like to turn the meeting over to John, Director of the Division of Corporation Finance, and to Conrad Hewitt, electronically connected, as I mentioned, for a presentation of the staff's recommendations.

ITEM 1

COMMISSION GUIDANCE REGARDING MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING UNDER SECTION 13(a) OR SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 AND AMENDMENTS TO RULES REGARDING MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

MR. WHITE: Thank you, Chairman Cox. Chairman Cox, members of the Commission, we are here today to recommend to you that you approve and publish in final form interpretative guidance regarding the planning and conduct of management's
evaluation of internal controls.

I must say that it has been an exciting and important journey to arrive at today's recommendations to the Commission, a journey that started soon after I arrived and began with the SOX 404 Roundtable and the Next Steps press release last May.

I was told when I arrived that addressing the implementation of SOX 404 was perhaps the most pressing issue facing the Commission at the time, and it should be given our highest priority.

The decision announced in your press release last May to have the Commission provide so-called management guidance is something the Commission had actually chosen not to do when SOX 404 was being implemented three years earlier, and was a critical element in this plan to improve the implementation of SOX 404.

In a very intense effort on this front, I believe that the Commission, all of you, have moved forward in its best traditions, working extraordinarily hard, collecting extensive public comments, first on a concept release and then on a proposing release, and then holding an open meeting to discuss alignment of your proposed management guidance with the current efforts of the PCAOB to provide a new auditing standard, AS-5.

In the process, the Commission and the staff has
created something that simply did not exist before in one place, guidance for management in implementing SOX 404.

Today is the culmination of that effort. I must say for all of us on the staff, at the table here and behind us, we are very pleased and really very proud to make these recommendations to you.

In a moment, Conrad Hewitt and Zoe-Vonna Palmrose are going to set out the core principles that have guided us in the last year and lay out the details of our recommendations to you.

First, I will take a few minutes to lay out the structure of our recommendations and how we got there.

An important initial decision for us was whether management guidance should be issued as an interpretation or instead codified as a Commission rule.

Over two-thirds of the commentors preferred that the guidance be issued as an interpretation. We agree with that, and we are following that advice and recommending that you issue the final version of the guidance in the form of an interpretative release.

This will permit the guidance to be more easily updated and modified than if it were incorporated right into the Section 404 rules themselves.

In addition to this interpretative guidance, we are recommending that you approve in a separate release today
amendments to the Section 404 rules.

At the proposing stage back in December, the interpretative guidance and the proposed rule amendments were actually combined in a single release. We believe at this stage, it is more practical and really user friendly if you adopt two separate releases.

One setting forth the guidance and the other the final rule amendments. That way, when codified, the rule amendments will appear in their appropriate places interspersed with our other 404 related rules, and for ease of use by all issuers, including particularly small issuers who will be complying with 404 for the first time this year. The interpretative guidance will be a free standing release on its own. The two releases will appear together in the Federal Register.

Zoe-Vonna will be describing the guidance in detail in a moment. Let me outline for you the rule amendments.

First, one of the amendments states that while there are many ways to conduct an evaluation of effectiveness in internal control, an evaluation conducted in accordance with the interpretative guidance will satisfy our rules.

There is an important aside to this because we understand obviously that many of the larger public companies have already been complying with Section 404 for the past three years, and they have established evaluation processes
that may differ from the approach described in the interpretative guidance.

Please understand, that's okay. There is no requirement for these companies to alter their procedures from the last three years to align them with our new interpretative guidance unless they choose to do so.

Second, we are also recommending that you revise two regulation S-X provisions pertaining to the auditor's attestation report on internal control to clarify going forward that the auditor will be required to express only one opinion in the audit report, directly on the effectiveness of internal control.

Under the existing requirement, as you know, the auditor must express two opinions, two separate opinions. One on effectiveness and another on management assessment.

Finally, we are recommending that you codify the definition of the term "material weakness" substantially as it was proposed last December in the interpretative guidance.

The final rules would define a "material weakness" as a deficiency or a combination of deficiencies in internal control or financial reporting, such that there is a reasonable possibility that a material weakness in the company's annual or interim financial statements will now be prevented or detected on a timely basis.

We anticipate that the PCAOB's revised auditing
standard will include the same definition.

    One further recommendation on the rule. We think
it makes sense to also include a definition of the term
"significant deficiency" in the Commission's rules. We,
therefore, are recommending that you issue a third release
today to seek additional public comment on the proposed
definition of this term.

    Although the Commission's July 2006 concept release
sought comment on definitions of both "material weakness" and
"significant deficiency," the proposed interpretative
guidance last December defined only the term "material
weakness."

    Several commentators on the guidance indicated that
the Commission should also define the term "significant
deficiency" and we agree with those comments.

    We actually have three releases, separate releases
we are recommending to you.

    That is kind of the outline. Let me get to the
thank you part. Chairman Cox has already thanked the many
members of the staff who have worked on these releases as
well as the staff and Board of the PCAOB who worked with us,
and I certainly very much echo those thanks.

    I will not read off the names again. I really want
to say to everyone here that I sincerely appreciate the help
we had by every one of you.
Before I turn things over to Conrad, I do want to extend special thanks to a key member of the Section 404 team, to my right, Carol Stacey, Corporation Finance's Chief Accountant for the past five years. She will be leaving the Commission this week to return to the private sector.

Carol has been a major force in shaping the Section 404 policies ever since 2002 when Sarbanes-Oxley first became law. It is actually very fitting that she is here at the table today as we reach this important milestone and work to improve the implementation of 404.

Carol, I said those other words at your private good-bye, but I now want to publicly express the deep appreciation for your 11 years of service to the Commission and extend our best wishes to you in the future.

You will be greatly missed by all of us in Corp Fin and by all of the Commission. Thank you very much.

Now I'd like to turn the meeting over to Conrad Hewitt, the Commission's Chief Accountant, for what I guess is a first, participation from Zurich. Now we are going to find out whether our electronics work.

Conrad, are you there?

MR. HEWITT: Yes, I am, John. Thank you.

Chairman Cox and members of the Commission, I am pleased to be able to participate in this important open meeting of the Commission on the proposed interpretative
guidance to management via video conference.

Last October I was asked and I accepted to be the keynote speaker at the Annual International Accounting Standards Conference here in Zurich. I will present my speech in about an hour and a half from now.

Obviously, I had a tremendous conflict to be at the Commission hearing and also be in Zurich at the same time. However, through technology, I am able to be in both places at the same time.

As Chairman Cox mentioned, the Commission proposed the interpretative guidance for management on the evaluation and assessment of internal control over financial reporting and the related rule changes last December.

The comment period for these proposals ended February 26th. My staff and I have been working very diligently to address the comments received and finalize the proposals to you. Today, we are here to present for your consideration our finalized interpretative guidance for management and the related rule changes mentioned by John.

An overall objective of Section 404 and the Commission rules are to foster the preparation of reliable financial statements. Another objective is that the Commission rules implementing Section 404 are intended to bring information concerning material weakness into public view.
We believe the interpretative guidance we are presenting here today maintains both of these objectives. At the same time, the guidance provides a principle based framework to management of how they may complete their assessment in a more efficient and effective manner.

We believe the guidance will be beneficial to companies of all sizes, but especially smaller companies, including those who have not yet completed their first evaluation.

The majority of the comment letters we received on our proposing release expressed overall support for the principle based nature of the Commission's interpretative guidance. Many commentors believed that this guidance will encourage a healthy use of judgment and common business sense in formulating the procedures companies use to evaluate whether material weaknesses exist in their internal control systems.

Further, over 70 percent of the commentors that were smaller companies or representatives of smaller companies expressed support for the guidance. Many commentors indicated the guidance would allow management to focus on areas most important to reliable financial reporting. Also, the commentors said the guidance would allow management to tailor their evaluations to each company's facts and circumstances.
Interpretative guidance reiterates the Commission's position that management must bring its own experience and informed judgment to bear in order to design an evaluation process. The evaluation process needs to provide a reasonable basis for its annual assessment of whether ICF is effective. The guidance is intended to allow management sufficient and appropriate flexibility to design such an evaluation process.

Smaller public companies which generally have less complex internal control systems than larger public companies should use this guidance to scale and tailor their evaluation methods and procedures to fit their own facts and circumstances.

We encourage smaller public companies to take advantage of the flexibility and scaleability afforded in the guidance to conduct an evaluation of ICFR that is both efficient and effective at identifying material weaknesses.

The core principles of the interpretative guidance have not changed from our proposing release. However, we have made certain clarifications and modifications to the proposed guidance as a result of the comments received.

In a moment, Zoe-Vonna Palmrose will overview the more significant changes made.

At this point, I would like to reiterate the Chairman's thanks to the staff who worked tirelessly on this
important effort. During this process, we have worked closely with the PCAOB. I would like to add my thanks to the Board and staff of the PCAOB.

We would also like to thank the Commissioners and their staff for their countless hours that they have worked with us on this topic over the past several months providing their insight and guidance.

Finally, we believe that the interpretative guidance for management when adopted by the Commission will provide for many years in the future a more effective and efficient ICFR evaluation process for existing and future public companies.

The guidance will allow companies of all sizes to comply with our rules while reassuring investors that material weaknesses in internal controls will be brought to light, disclosed and corrected.

Stated simply, we believe that the interpretative guidance will play an important role in achieving the cost/benefit balance that must be brought to the Section 404 compliance for all companies.

Because this guidance to management did not exist before the approval of the Commission of this interpretative guidance to management, it will provide additional protection and transparency to investors for many years in the future.

I would like to turn it over to Zoe-Vonna Palmrose,
and thank you very much.

MS. PALMROSE: Thank you, Conrad. The Commission received over 200 comment letters on its proposed interpretative guidance and related rule changes.

As Conrad noted, the majority of the comment letters expressed overall support for the principles based nature of the Commission's interpretative guidance.

Based on the support expressed, the staff determined that wholesale changes to the proposed guidance were not warranted. However, commentors did provide invaluable feedback on areas in which the interpretative guidance could be clarified or improved, and I would like to touch on some of this feedback.

The Commission's proposed interpretative guidance was centered around two broad principles. These principles have not changed in the guidance we are presenting today.

The first principle is that management should evaluate whether it has implemented controls that adequately address the risk that a material misstatement in the financial statements would not be prevented or detected in a timely manner.

The second principle is that management's evaluation of evidence about the operation of its controls should be based on its assessment of risk.

Under the guidance, management can align the nature
and extent of its evaluation procedures with those areas that pose the highest risks to reliable financial reporting. That is whether the financial statements are materially accurate.

As a result, management may be able to use more efficient approaches to gathering evidence such as self assessments in low risk areas and perform more extensive testing in higher risk areas.

By following these two principles, we believe companies of all sizes and complexities will be able to implement our rules effectively and efficiently.

While commentors expressed support for this principles based approach, some requested that the proposal be revised to include additional guidance and illustrative examples in areas such as the identification of controls that address financial reporting risks, including IT general controls, the assessment of risk, and how risk impacts the nature, extent and timing of evidence needed to support the assessment.

However, we believe additional specificity and examples in the areas requested would likely have a negative unintended consequences of establishing bright lines or one size fits all evaluation approaches.

We have seen that an overly prescriptive set of rules can lead to inefficiencies, and we want to avoid ending up with evaluations more concerned with forms than substance
and which are inefficient to implement, ineffective at
detecting material weaknesses or both.

The guidance that you are considering here today
maintains the view that effective and efficient evaluation
require company management to make reasonable judgments that
reflect each company's individual facts and circumstances.

Nonetheless, based on comments received, we did
make modifications to the proposed interpretative guidance in
a number of areas. For example, we made revisions to better
align it with the PCAOB's proposed auditing standard, to
provide clarification on the role of entity level controls,
as well as on the nature of ongoing monitoring activities in
relation to management's evaluation, and to enhance the
guidance on fraud risk consideration.

I would like to briefly highlight the changes that
we made in each of these areas as a result of the comment
process.

Regarding alignment, as discussed at the open
Commission meeting on April 4th, commentors expressed concern
that confusion and inefficiencies may arise from differences
between the Commission's proposed guidance for management's
evaluation of ICFR and the PCAOB's proposed auditing
standard.

Commentors cited a lack of alignment in the
terminology and definitions used, as well as differences in
overall approaches. For example, some commentors while
supportive of our principles based approach to the
interpretative guidance expressed concern that improvements
in the efficiency of management's evaluation of ICFR would be
limited by what they viewed as comparatively more
prescriptive guidance for external auditors in the PCAOB's
proposed auditing standards.

In response to the comment letters and the guidance
provided by the Commission of the open meeting on April 4th,
we worked with the PCAOB staff to more closely align our
respective documents.

These revisions include aligning the definition of
"material weakness" and the related guidance for evaluating
deficiencies, including the indicators of material weakness.

We also considered differences and improved the
alignment around guidance for evaluating whether controls
adequately addressed financial reporting risks, the factors
to consider when identifying financial reporting risks, and
the factors for assessing the risk associated with individual
financial reporting elements and controls.

These represent key areas of judgment for both
management and auditors in determining whether ICFR is
effective and in determining the nature, timing and extent of
evaluation and audit procedures.

Even so, some differences are expected to remain
between our final interpretative guidance for management and the PCAOB's audit standard. These differences are not necessarily contradictions or misalignments, rather, they reflect the fact that management and auditors have different roles and responsibilities with respect to evaluating and auditing ICFR respectively.

Management's daily involvement with its internal controls system provides it with knowledge and information that may influence its judgments about how best to conduct the evaluation, and the sufficiency of evidence it needs to assess ICFR's effectiveness.

Differences in the respective approaches are likely to exist because the auditor does not have the same information and understanding as management, and because the auditor will integrate its test of ICFR with the financial statement audit.

Next, commentors requested further clarification of how entity level controls can address financial reporting risks in a top down risk based approach. Commentors also suggested that the guidance place more emphasis on entity level controls, given their pervasive impact on all other aspects of ICFR.

We revised the proposal to expand the discussion of entity level controls and how they relate to financial reporting elements.
This discussion further clarifies that some entity level controls, such as controls within the control environment, have an important but indirect effect on the likelihood that a misstatement will be prevented or detected on a timely basis.

Further, the revised guidance clarifies that some entity level controls may be designed to identify possible breakdowns in lower level controls, but not in a manner that would by themselves adequately address financial reporting risks.

In these cases, management would identify the additional controls needed to adequately address financial reporting risks such as those that operate at the transaction or account balance level. However, management would consider both the entity level and transaction level in designing the nature and extent of the evaluation procedures, including those procedures for transaction level controls.

We have also revised the guidance to further clarify that the controls management identifies should include entity level and pervasive elements of ICFR that are necessary for reliable financial reporting.

This revision is intended to emphasize that management's evaluation of ICFR should consider the control environment and other entity level activities that are necessary to have an internal control that is effective at
providing reasonable assurance regarding the reliability of financial reporting.

Another area where we made modifications to the proposed guidance to reflect the comments received relates to how self assessment, including ongoing monitoring activities, were addressed in the proposal.

Commentors expressed concern that as defined in the proposal, some ongoing monitoring activities would not be deemed to provide sufficient evidence. Other commentors suggested that self assessment can provide a significant source of evidence when their effective operation is verified by direct testing over varying periods of time based on the manner in which the self assessments were conducted and based on the level of risk associated with the controls.

Commentors also requested the guidance be revised to clarify how based on the definitions provided in the proposed guidance self assessments differed from direct testing.

We agreed with a number of comments received, so we revised the guidance regarding ongoing monitoring activities, including self assessment and direct testing to clarify how the evidence obtained from each of these activities can vary.

These revisions are important as they demonstrate that management's assessments can be supported by information management obtains from its normal monitoring activities that
will often times be built into the daily responsibilities of
the employees involved in the processes, rather than from
consultants hired for testing purposes.

The revisions included discussion of how management
should consider the objectivity of the individuals performing
the activities when determining the evidence obtained from
each of these activities.

As part of this discussion, we clarified that when
evaluating the objectivity of personnel, management is not
required to make an absolute conclusion regarding the
objectivity but rather should recognize that personnel will
have varying degrees of objectivity based on among other
things their job function, their relationship to the subject
matter, and their status within the organization.

Management should consider the risks to reliable
financial reporting when determining whether the objectivity
of the personnel involved in the monitoring activities
results in sufficient evidence.

Finally, commentors suggested that further guidance
in the area of fraudulent financial reporting would improve
the proposal. We agreed and revised the proposal
accordingly.

For example, while the proposal provided general
directions to assess the risk of fraud and to focus
evaluation procedures on controls that address such risks, we
have enhanced the final guidance by explaining that the risk of fraudulent financial reporting will exist in virtually all companies. Rigorous evaluations require management to recognize that the existence of a fraud risk does not mean fraud has occurred. Likewise and importantly, it should not take an incident of fraudulent financial reporting to recognize the existence of fraud risk.

Further, the guidance clarifies that the risk of management overrides, particularly in the period end financial reporting process, is something that virtually every company needs to consider. Effective control systems ought to take steps to manage this risk, and we believe that companies of all sizes, including smaller companies, can do so.

Clearly, fraudulent financial reporting was a primary motivation for the Sarbanes-Oxley Act, including Section 404. From an investor protection standpoint, we agree with commentors on the importance of emphasizing management's responsibility to identify and evaluate fraud risks and the related controls to address such risks.

Overall, these modifications to the proposed guidance are consistent with our objective of rationalizing the planning and conduct of the ICFR evaluation process for all companies regardless of size, by allowing companies to focus their efforts on those areas that management has
identified as posing the greatest risks of material
misstatement in the financial statements not being prevented
or detected on a timely basis.

This is what investors care about and what is
important for achieving reliable financial reporting.

The key objectives of Section 404 and the
Commission's implementation rules are to foster more accurate
financial reporting as well as provide investors with useful
and important information about the adequacy of a company's
internal controls.

The interpretative guidance we are recommending the
Commission adopt today we believe will assist management in
meeting these objectives in a cost efficient manner while
providing the intended investor protection benefits for many
years to come.

In closing, I would like to reinforce the
appreciation expressed by others to the Commission, including
their guidance to the staff at the April 4th open Commission
meeting, the PCAOB Board and staff, and the Office and
Division staff that have worked so long and hard on this
project, including my staff, in particular, Nancy Salisbury,
Brian Krodo, Josh Jones, Mike Gaynor, Kevin Stout, and Katy
Scarborough.

Mike Gaynor, who along with others has played a key
role in developing and drafting the guidance, is with us at
the table today to help answer your questions.

That includes our opening remarks. Chairman Cox and the Commissioners, the staffs of OCA and the Division of Corp Fin are ready and happy to address any comments you would have.

CHAIRMAN COX: Thank all of you, including those of you electronically from Zurich, thank you for a very elaborate and complete presentation. This is another opportunity for me to observe a great deal of effort, a lot of intellectual fire power was brought to bear on this, and the whole purpose, of course, was to make sure that as regulators we are implementing the Sarbanes-Oxley Act as Congress intended it.

We have had a lot of participation from the Congress in our efforts. We have had formal hearings devoted to this and a lot of informal give and take and collaboration.

I think we have been extraordinarily successful in getting it right as Congress intended.

As Congress has been very attentive to our efforts to align Sarbanes-Oxley implementation to the intent of the law in the first place, one particular remaining focus has been the impact on smaller companies.

Since SOX was enacted, they have not had to comply with 404. This will be the first time they do. You have
recommended that the Commission not provide any further delays for non-accelerated filers.

Can you elaborate on how the guidance within this release will assist smaller companies as they in many cases for the first time complete the evaluation of internal control of financial reporting and putting this in language that small companies will understand, why should they not be concerned that there will not be enough time to comply with 404?

MS. PALMROSE:  I'd be delighted to do that.  We do believe that the interpretative guidance will allow companies of all sizes to appropriately tailor their evaluation efforts in response to their own facts and circumstances.

We made a specific effort to highlight important areas where the evaluation at a smaller company might be different than that for a larger company, including the nature of the efforts management undertakes to evaluate, whether it is controls designed in a way to provide reasonable assurance about the reliability of its financial reports, how management can obtain information about whether those controls as designed are operating and the documentation needed to provide reasonable support for both.

At the core, our guidance for conducting the evaluation suggests that certifying officers ask themselves two questions. Do my employees understand what they need to
do to prepare reliable financial statements and what
information do I need to be sure they have done those things.

For many small companies, the answer to these two
questions need not be complicated or costly, and we believe
complying with our guidance will not make them so.

Yes, we do believe not only that it is doable for
smaller companies, but doable in 2007.

MR. WHITE: I might add just in terms of the phase
in here, in 2007 or year end 2007, only the management
assessment is required for the smaller companies. They will
not have to do the audit requirement until the end of 2008.

CHAIRMAN COX: What that means, since you are
talking about 2008 financials, is for calendar year filers,
March or thereabouts in 2009; is that correct?

MR. WHITE: Correct, March 2009 would be the first
time they would provide an audit report under 404.

CHAIRMAN COX: There were some commentors that
suggested that further revisions be made to the definition
that we proposed for "material weakness." The final release
adopts a definition substantially as proposed.

Can you explain in a more elaborative fashion why
that is so?

MS. PALMROSE: Yes, once again, we would be
delighted to do that. We actually received comments on this
issue from about 24 commentors as to the definition in
About half supported the proposed definition and indicated that it was actually a revision from the previous one, the proposed definition was a revision from the previous one, and they supported that revision and its clarified meaning.

However, some commentors did acknowledge that the wording of the likelihood standard within the prior definition as "more than remote" was misunderstood to mean something less than reasonably possible. The proposed definition represents a meaningful clarification.

Other commentors noted that while the change in the proposed wording of the likelihood standard within the definition for "more than remote" to "reasonable possibility" might represent what was meant all along, not actually using the term "remote" in this new definition may still have an important psychological benefit of getting auditors and managements' mindset out of the weave.

CHAIRMAN COX: Apart from the specifics of the definition, part of the substance of what this is all about, where are we seeing these material weaknesses coming from and how does this guidance interact with that?

MS. PALMROSE: Actually, most of the material weaknesses that we are seeing do involve areas that -- let me step back and say we do rely on audit analytics for their
analysis of the disclosures of material weaknesses.

The categories there, to say that the majority of them involve accounting related issues would be sort of obvious because this is about financial reporting.

The real question is to drill down into what is the nature of those weaknesses within the accounting areas, and we do see some within the areas of more complex accounting standards.

For example, we do see taxes and the tax area as being a major area of material weaknesses. We also see some but a much lower percentage in the area of derivatives.

What we have tried to do is provide some additional guidance that focuses on the higher risk areas and that could include accounting complexity and the more complicated accounting areas.

CHAIRMAN COX: The weaknesses we are seeing are tied to the misapplication of generally accepted accounting principles which in turn might be tied to the complexity of those?

MS. PALMROSE: Yes, that is one dimension of it. There is another dimension, too, which involves the expertise and competence and training of accounting personnel, which is another category that gives rise to about half of the material weaknesses that were seen. Again, that probably interacts with more complicated accounting standards, but
also gets into areas that we touched on in the guidance in terms of the control environment and those aspects.

I do not know if Mike would like to elaborate on that a little, or if that is sufficient.

MR. GAYNOR: I think she has covered the waterfront. I will just add that one of the things that we are trying to achieve in the guidance and in particular with our discussion around the importance of being risk based is particularly now that we have several years of reporting of material weaknesses behind us, we see where the problems are, and that should allow people to sharpen their risk focus.

If it is the complicated areas of GAAP, revenue recognition perhaps, income taxes, derivative, what not, those are known facts. They are things that accountants can react to, go in and put some controls in those areas and hopefully tighten up the reliability of the financial recording.

Hopefully, we can use what we are learning from the disclosures to enhance the risk based approach that we are prescribing in the guidance.

CHAIRMAN COX: Just a couple of quick final things I want to ask about. Our December proposing release had as one of its main goals making it clear, as the Sarbanes-Oxley statute makes clear, that the management assessment needs to be driven by the auditing standard. One of the most frequent
complaints that we were hearing from accelerated filers was that the auditors were driving the process.

What I would like to ask publicly is based on the comments that you received and the revisions that we have made, do you believe that this issue has been addressed?

MS. PALMROSE: Yes. That was something that was very important as we were developing the initial guidance. It was actually something obviously that both the staffs of the PCAOB and our staff were cognizant of.

What we have done is we have further refined that in this guidance that is with you today. One of the important elements of that is around the alignment. We think in our initial proposed guidance, we got it right in terms of what we needed to focus on and the PCAOB's proposed standard took the management's assessment -- the auditor's role in evaluating management's process out of their standard.

That was the first phase we discovered, so the comment process has been enormously useful to us in helping us understand how these two documents need to work together, and that is part of the alignment that we are talking about.

That has really been a major focus for our efforts here in the last few months in working with the PCAOB staff, too, to make sure that these documents work together, and that management looks to the interpretative guidance and is able to rely on it for their evaluation process and that
auditors can then look to the auditing standard.

CHAIRMAN COX: Last week, the FEI released a study and their new study on the costs of implementing Section 404 of Sarbanes-Oxley indicated that the average cost of year three compliance had dropped 23 percent from the two year cost, but that the auditor attestation fees hadn't dropped on average.

How do you believe this guidance and the related rule changes that we are considering here today will impact the cost of year four efforts?

MS. PALMROSE: Let me start out and maybe others would like to add in. Certainly our focus today is on management guidance. We do expect, as did the FEI expressed in their press release, that further efficiencies should be achieved as we go forward under our new guidance, so they not only documented that costs have declined but they expect them to continue to do so because there would be opportunities provided to the accelerated filers under our guidance for further cost efficiencies, and some of the fine tuning that we have done on the guidance during this process.

In terms of the audit side, the PCAOB will be proposing their standard tomorrow -- the Board will be meeting tomorrow on this.

CHAIRMAN COX: Assuming that what happens tomorrow is they adopt what we think they are going to adopt, the very
document we have been closely coordinating with in our management guidance, what is the answer to that?

MS. PALMROSE: I was just going to say having said that they are meeting tomorrow, we would like to re-affirm that we have been working very hard during this process just to achieve exactly what you are asking about, to make sure that auditors are able to achieve efficiencies through a more judgment based standard, and not have to do work for work's sake or ask management to do work for work's sake.

That is actually what we have been spending a great deal of time on to make sure that each individual document works on its own as well as works together, so we get effective results here, but in the evaluation phase as well as the audit phase, but that it is not work for work's sake. It is really substance and not form.

CHAIRMAN COX: That really is the bottom line of what we are trying to do here. John?

MR. WHITE: Probably also worth commenting, we are certainly hopeful that the auditors will be able to begin the preliminary processes after tomorrow of incorporating the changes that the PCAOB has put in place into their procedures.

As you know, it does get sent over here. There is a process over here before their new standard will actually become final. We are certainly hoping that the auditing
firms will be able to start the initial process.

CHAIRMAN COX: The entire Commission has had this in mind all along, the reason for our trying to work hand and glove with the PCAOB is so we do not have a serial process in which everyone has to wait until first the PCAOB and then the SEC conducts all of this. I think we all have a pretty high degree of confidence about what we are seeing in the PCAOB standard.

I would say that the most striking them to me in that FEI study was that 78 percent of the respondents said the cost of compliance with Section 404 under the old system exceeded the benefits. We really do need to focus on that performance metric for our own efforts.

MS. PALMROSE: We agree that is a really important data point and it certainly is something that has been upper most in our minds as we have worked on this guidance from the beginning.

I thought it might be also beneficial to add some other statistics from their survey, that in spite of that particular frequency, it is also worth noting that 60 percent of the accelerated filers that responded to their surveys did agree that compliance with 404 has resulted in more investor confidence in their financial reports and nearly half of the respondents agreed their financial reports are more accurate and reliable given this effort.
CHAIRMAN COX: That, of course, is the part we want to keep and indeed enhance.

MS. PALMROSE: Yes, exactly. That is exactly what we are striving for here to accomplish.

MR. WHITE: I just want to reiterate a point that we made earlier, that for the smaller public companies that will be involved for the first time with 404, they will have yet a whole another year in the audit cycle because their first reports, as you described a moment ago, will be coming in in March of 2009.

CHAIRMAN COX: Just as they got to watch and learn from the experience of all those filers over the last few years, but not filing themselves, they will under this new guidance that we are proposing and new auditing standard from the PCAOB get to watch, as there is a full year of experience that others have with their auditor involvement, and they will wait until their 2009 filings to come into compliance.

MR. WHITE: That's correct. That is exactly the point.

CHAIRMAN COX: Speaking to that audience in truly plain English, because we have talked a lot about definitions and how our guidance interacts with PCAOB standards and so on, and we have been beating a lot of auditores, in plain English, what are the inefficiencies that are being washed out? What was happening under the old system that the SEC
did not want to see happening that diverted resources from
genuine investor protections that won't be happening any
more?

MS. PALMROSE: I can start and then maybe others
would like to join in. I think clearly one of the areas that
has received a lot of attention in terms of that is the
extent of testing of controls.

The fact that controls irrespective of their risk
of failure or the financial reporting risk they were related
to, you tested them all the same. Once you identified the
control was in, it beat them all essentially.

What we have really tried to do here is recognize
that the risks associated with those will vary and the level
of testing then will vary, including some of these new tests
automatically in your daily activities, and there is no
needed incremental effort.

It is a combination of moving up what needs to get
tested, refining how you think about testing, and the
sufficiency of the evidence that you need to satisfy yourself
they are operating effectively, and recognize that in lower
risk areas, what you are already doing can provide you with
that evidence.

The second thing is extensive documentation for
documentation sake. We have tried to refine that so that
documentation is what is necessary, not what is not
necessary.

The third thing is to recognize in smaller companies there is an element of daily interaction that occurs, so that you do not have to go out and ask somebody to tell you what you already know and duplicate that effort in some other way.

It is those three things I think I would start with as being areas that we focused on in terms of trying to obtain efficiencies.

My comments really focused on the management guidance, what we did in management guidance.

CHAIRMAN COX: As I pass it to Commissioner Atkins for his opening remarks and questions, how would investors be better off?

MS. PALMROSE: Their resources will be spent in a cost effective way and they will have the disclosures that the Act identified were important for them, and they will have transparency around disclosure.

CHAIRMAN COX: Excellent. I really do appreciate the extraordinary amount of work that has gone into this and completing this work. Perhaps this is my last opportunity to say thanks again.

I pass to Commissioner Atkins. Thanks again.

COMMISSIONER ATKINS: Thank you, Mr. Chairman. I also appreciate really the remarkable efforts of the folks in
the Office of Chief Accountant and Division of Corporation 
Finance, and our economic analysis group and general 
counsel's group over the last several months.

    You have worked hard to address the many helpful 
recommendations that commentors made in response to our 
proposal and to align the SEC's guidance with that of PCAOB.

    The guidance that we are reviewing today should 
allow management to apply a risk based approach to evaluating 
and testing internal controls over financial reporting and to 
tailor that approach to the specific characteristics of their 
companies.

    The matters before us today are of course only one 
part of the solution to the Section 404 implementation 
problems that have arisen over the last few years. The 
actions that PCAOB is planning to take as we have discussed 
tomorrow to replace the failed Audit Standard No. 2 are also 
critical.

    After soliciting comment on the new standard, we 
will determine whether the auditing standard will solve the 
problems caused by its predecessor. If we do approve the new 
standard, auditors' implementation of the standard and 
PCAOB's oversight of auditors' implementation also will be of 
great importance.

    Likewise, the SEC will have to continually monitor 
the manner in which PCAOB carries out its oversight.
Auditors will need to be cognizant of the fact that management is not required to perform its assessment in accordance with the audit standard.

In short, the puzzle of how to meaningfully overhaul the implementation of Section 404 has many moving pieces. Solving the puzzle will not be easy, but I believe that the recommendations before us is a step in the right direction. As far as Audit Standard No. 5 is concerned, I am anticipating that what PCAOB will adopt tomorrow will be consonant with the word and the spirit of what we do today, so that we can finally close the loop expeditiously and without re-writing the standards over time.

Therefore, I support the recommendations we have before us today, but I do have several questions, and before I get to that, I wanted to also like John extend a thanks and gratitude to Carol Stacey who has done so much over the past several years with a steady hand and a level head with so much change swirling all around her, at times, some very difficult calls to make. Thank you very much and good luck in your future endeavors.

First, one of the problems that cropped up during the inaugural years of Section 404 is that companies have been driven by their auditors to identify and test sometimes hundreds of thousands of key internal controls. This has made the whole process extremely costly with little
corresponding benefits to customers.

How will this new management guidance make this problem better?

MR. GAYNOR: There are several moving parts, if you will, one of which is important that is actually outside of the guidance that we proposed and that is the PCAOB in its December proposals removed some paragraphs in AS-2 that required the auditors to evaluate aspects of management's process.

It appears from feedback through the comment process and the roundtables that had a lot of unintended consequences as to auditors' roles in how management arrived at its own conclusions.

The December proposal from the PCAOB removed those paragraphs. We think that is immensely helpful relative to this problem.

The second piece that I think is important is what we have tried to recognize in management guidance, and that is that in certain instances, particularly in companies of any size, there may be a lot of controls that are required in order to get the financial statements right, but the likelihood that those controls fail or the likelihood that those controls represent a material weakness isn't equal amongst all of them.

What is really important at the end of the day is
whether or not management has the information that it thinks it needs to support a disclosure to investors about whether a material weakness exists.

We have provided some principles-based guidance that allow management to put itself in that position in a way that it believes best suits its needs.

In order to maintain discipline in the evaluation process, we describe certain areas that we would expect to ordinarily be high risk. I do not think there is any sort of question or concern about whether in fact those areas do represent high risk areas, but outside of those areas, management can implement whatever methods and procedures for gathering that evidence that they think are appropriate in the circumstances, and sort of traditional audit-like testing that often times requires audit departments or consultants to be brought in from outside to perform testing in areas where people believe there is actually low risk to the reliability of financial reporting, we have really sort of freed management up to make decisions not to do that, and we hope that is allowing them to comply most cost effectively.

COMMISSIONER ATKINS: Another problem has been failure of people to focus on the entity level and on the consolidated financial statements as far as the work that is being done.

How would the interpretative guidance affect the
approach that management takes in evaluating the operation of
controls say across multiple locations or across business
units?

MR. GAYNOR: One of the ways that we talk about it
internally and like to think about it is that heretofore, the
implementation, you probably have not seen one of these, but
a lot of times, consolidating schedules, it will have ten
divisions going across, ten individual columns, and you get
to a consolidating total on the right.

Horetore, the implementation has been very
columnar focused. If a division was deemed to be material
and all controls of that division got tested in a manner that
was sort of indiscriminate relative to the risk, what we have
tried to do in the management guidance and the PCAOB has made
similar revisions to AS-5, is to get people to think about
the risk sort of more in a vertical -- in a horizontal level
as opposed to a vertical level where they are looking at the
element of financial reporting and thinking about the risks
of that and less about sort of the consolidation process and
coverage in percentage terms.

We think that will allow people to spend less time
in areas where the time is not warranted.

COMMISSIONER ATKINS: Thank you for that. You had
made that point the other day in my office. I wanted to make
sure we got you on record. I think that is the clearest
explanation of how people should be approaching this, so it
does not get into granularity like we were seeing before.

Conrad is off, and I'm sure he's getting questions
posed by foreign issuers. I was wondering what some of the
issues were that foreign commentors raised and how you
addressed them. The draft guidance notes that a Frequently
Asked Questions document might be necessary to address some
of the issues that are of unique concern to foreign private
issuers.

I was wondering what sort of issues you anticipate
might be addressed for that document.

MS. PALMROSE: Yes, let me start. First of all,
I'd like to say we did receive comment letters from a number
of foreign private issuers and we very much appreciate their
participation in the comment process. They were all
informative to us. Some really broadened and deepened our
thinking. Again, thank you very much to the foreign private
issuers for participating.

In all honesty, many of the comments were very
similar to what we heard from others. There was a high
degree of overlap here on comments from them.

However, let me just talk about two areas. In the
proposing guidance, we had two footnotes that were directed
at issues unique to foreign private issuers. We received
some comments on those footnotes requesting a little bit
It was really hard to expand within the guidance on those, so the staff is currently drafting a series of Frequently Asked Questions. Basically, we are going to update the Frequently Asked Questions and include in them some that are specific to foreign private issuers. Those will be coming out shortly.

COMMISSIONER ATKINS: We look forward to reading that. A number of commentors asked for more specific examples. We have discussed this back and forth over the last few months, and in the last public meeting we had.

When you compare it to PCAOB's -- it is a very prescriptive standard with lots of must's and should's and things like that in it. How do we say that the PCAOB's more specific prescriptive standard is not going to serve as a de facto standard for management?

MS. PALMROSE: Again, we have spent a lot of time on this issue. What we have tried to do is obviously eliminate any confusion over terminology and definitions. We have also thought about how the two approaches for management's evaluation and the auditors work together.

We have thought a lot about that. Again, the comments informed our thinking. There were some easy fixes that were suggested and there were some more substantive or difficult fixes, but we did challenge what we were doing in
order to make sure we synced up.

I will say that we did obviously stay principles based. We did get requests, as I said, for additional examples. Paradoxically, what makes this work and what makes it scaleable is the principles based nature of this guidance.

The key here is to provide enough context to understand and apply it, but not let that become sort of a checklist or that kind of approach. We stayed with the principles based guidance that really recognizes the importance of judgment and the facts and circumstances of each individual company, and then put structure around that in terms of those processes.

COMMISSIONER ATKINS: I applaud that. Hopefully, that will work out.

Another one of the concerns that I have with the manner in which Section 404 is currently being implemented is that management produces reams and reams of documentation, which I've seen for a number of companies, which seems to be of little value and auditors do not take it into account, and in fact, often, it is almost out of date shortly after it is produced.

How is today's rule going to address that problem?

MS. PALMROSE: Let me start again and maybe Mike would like to weigh in here. We actually in terms of documentation have empowered essentially through our guidance
that it is not necessarily necessary to create additional documentation just for the evaluation process. We have talked about where existing documentation can work.

We have also talked about this notion for smaller companies where daily interaction -- you don't need somebody else to tell you what you already know, although on the other hand, you have to be able to communicate that to others. There may be some documentation in the form of a memo rather than binders and binders and binders.

We have talked about how you can document that you have sufficient evidence based on your facts and circumstances and recognize that sort of some of these traditional things aren't mandatory at all.

I think Mike will add in a little about the process and a little bit more on the technicalities here.

MR. GAYNOR: One of the things the Advisory Committee for Smaller Public Companies noted in their report was the process maps in small companies are often times a waste of time because of the dynamic nature of those environments, they are often outdated as of the time they are completed.

In thinking about the requirements around documentation and management guidance, I guess sort of our overall principle was the idea that when management says to an investor my internal controls over financial reporting are
effective, included in the books and records ought to be some reasonable amount of documentation of what the controls were that were the basis for that disclosure.

This is not unlike a disclosure in the financial statements for accounts receivable. Investors expect and understand that there is details supporting the amount of accounts receivable included in the company's financial statements.

The notion of controls is really not that much different. It is not an exacting standard, if management has written down 200 controls and they figure out after the fact that it is actually 210, it is not an automatic fail. You don't immediately have ineffective internal controls.

It is just this general idea that when you make disclosures that your internal controls on reporting were effective, included in the company's books and records ought to be some reasonable amount of evidence as to what in fact those controls were that were the basis for that disclosure.

COMMISSIONER ATKINS: Commissioner Campos and I have been around the block before. Back in 2003, in connection with the initial adoption of the requirements that companies include in their audit reports a report on internal controls.

The SEC estimated compliance costs of about $91,000 per company. This number didn't include auditor expenses or
indirect costs such as the cost of public capital markets. Even so, it represented a significant under statement of the costs that companies actually incur. The cost/benefit analysis in today's package simply asserts that the costs are uncertain. I would like to ask our economists to elaborate on this.

MS. MURPHY: We have looked at the costs and the benefits relating to the proposing release. I think your citing that earlier number is certainly a striking fact and has been the source of some chagrin to the entire staff as we have seen something that everyone thought would be less consequential turn out to be a big difficulty.

What we have done in looking at the consequences of the proposing release is do what we are supposed to be doing in the benefit/cost analysis which is looking at the incremental effects of the proposed rule relative to what it would be otherwise.

The incremental benefits and costs of this particular rule are relative to what would happen without the guidance that is being provided to management and the change in the requirements of the auditor to do interpretation that they are now not going to have to do, and so from that perspective, there is uncertainty.

Compliance is voluntary or the adoption of the management guidance by management is voluntary. It is a
principles based approach.

The idea is to inform managers, as you have heard people say that managers are being given a tool that they can use. The question about the benefit is really what is the information value to the managers in complying with the rule relative to what they already have.

There, I think we do have some uncertainty. We have appropriately framed up what we have said in the release to reflect that, and also to emphasize -- I guess this is in the spirit of the principles based nature of the guidance.

I think we really laid out what we think are the principles that are going to guide in the marketplace the magnitude of the costs and benefits. Those really go to how different parties in the process will respond, managers, auditors, and others.

COMMISSIONER ATKINS: I agree. I think the up shot of it with differences between hopefully what AS-5 is going to look like and AS-2 and then management guidance that the costs should come down. If they don't, I think all things being equal, an issuer needs to really think about whether or not he should put out the work for another competing bid. That is a problem where we probably have to look at the accounting profession if there is something more that needs to be done on the competitive side to increase competition.

Many commentors called for the elimination of
references to "interim" in "material weakness." I was wondering why you have determined not to alter the definition.

MS. PALMROSE: I would be glad to answer that. Our guidance for management's evaluation of ICFR makes clear that scoping is based on annual materiality. That is what is appropriate when making judgments about the nature and extent of the evaluation procedures.

Pulling "interim" out of the definition will not necessarily reduce in a meaningful way the number of controls being tested by management or auditors or their level of effort. Rather, it would just impact the size of errors we would expect those controls to prevent or detect and the real problem in this area is just that, what is considered material to a quarter.

Essentially, "interim," as it relates to materiality, it is largely driven by financial statement materiality considerations, not ICFR. In other words, issues around interim materiality for financial reporting bleed into the ICFR assessments and attestations.

In this regard, it might be helpful to note that the staffs of OCA and the Division of Corporation Finance are currently considering questions around materiality in the context of financial reporting, including interim materiality, but back to ICFR, if control deficiencies are
identified, management guidance does require they be evaluated as to their effect on annual and interim financial reporting.

In addition, controls over quarterly reporting are within scope. Yet, another point for considering the inclusion of "interim" within the "material weakness" definition is that under our rules implementing SOX, companies reporting under 404 must include in their quarterly certifications that they have designed their ICFR to provide reasonable assurance that their financial statements filed through their Form 10-Qs are prepared under GAAP.

Finally, "interim" we maintained in the definition of "material weakness" because the staff thinks it is important from an investor protection standpoint. The staff does not believe that it is appropriate to have management assessments of ICFR under 404 that essentially would be telling investors you can't necessarily count on our quarterly's but our annual financial statements will be okay.

COMMISSIONER ATKINS: I guess ultimately on the other side of this is ICFR is a critical part of financial auditing, auditing of financial statements. They can't necessarily be separated.

MS. PALMROSE: Yes, for financial reporting. From the auditor's perspective, scoping is on annual. That is the key, we are talking about financial reporting covering
interim and annual.

COMMISSIONER ATKINS: Good. You are recommending that we put out a release to solicit comments on the definition of "significant deficiencies." I support going out for comment on this definition.

Because I have not seen the draft release language, I was wondering if you could briefly discuss the distinction between significant deficiencies and material weaknesses and how the evaluation processes for material weaknesses and significant deficiencies differ.

MS. PALMROSE: Again, I will start. Let me just give the definition. " Significant deficiency" is a deficiency or a combination of deficiencies in ICFR that is less severe than a material weakness yet important enough to merit attention by those responsible for oversight of a registrant's financial reporting.

Note that it does not include a probability threshold. Having said that, the evaluation that we are talking about here and the guidance for that is really around material weaknesses, but we do remind issuers that if you identified controlled deficiencies, because they do have certification requirements under 302 that require that they certify they have communicated significant deficiencies to the audit committee and the auditors.

There is just a reminder of that existing
communication requirement, but again, this guidance is around material weakness and that is what the ICFR evaluation process is intended to identify, and that is what the disclosures to investors are based on, material weaknesses.

COMMISSIONER ATKINS: This is a point that I consider extremely important. At our last public meeting, we talked about significant deficiencies. I think it is a very important definition. It is important who is going to deal with it and Audit Standard No. 5, if at all. I know we are still discussing that.

I reserve judgment on all of this and I look forward to comments with respect to your definition and with respect to what they may or may not do tomorrow. I think that will affect my ultimate view of AS-5, whether or not it will be a standard that I can vote for.

MR. WHITE: Just as a procedural point, the definition that Zoe-Vonna just read to you and I think was supplied to you yesterday, those are the words for the "significant deficiency" definition that we are recommending you put out for proposal.

COMMISSIONER ATKINS: Senators Kerry and Snow on the House Committee on Small Business and others have called for the SEC to grant non-accelerated filers a further extension in order to give them a chance to consider and absorb all of this new guidance.
Why do you not think that such an extension is necessary at this time?

MS. PALMROSE: Let me just reiterate that we think this guidance is doable and doable in 2007 for companies of all sizes. We have spent a good deal of time and effort thinking about applying it for smaller companies, the comment process and the feedback we have received has informed that thinking, and the guidance that was proposed in December provides a good spring board for non-accelerated filers to think about their evaluation process, and we are just refining it to help them a little bit more here.

They essentially have the information they need to go forward. We think it is doable. That is the basis for our conclusion on that.

COMMISSIONER ATKINS: Ultimately, nothing that we do today precludes our taking action later if it turns out it is really unreasonable, it is going to be difficult for people. You never know what is going to happen. There are always uncertainties in life. I think we should play it by ear.

CHAIRMAN COX: Fair enough. Commissioner Campos is recognized for his opening remarks and questions.

COMMISSIONER CAMPOS: First let me add my congratulations to the entire staffs. I won't go into everyone's name again. I think all of you have been
recognized and heard your name at least twice. In the
interest of time, I just want to congratulate you and also
add my very, very sincere appreciation for all the work.

Beyond work, I think, you have shown extraordinary
creativity, thinking out of the box, all the terms, but it is
very applicable here. I for one am very, very appreciative.
I think investors and our public companies, if they do not
know it, will be very grateful at some point in the near
future.

I have a short statement and a few questions.

In one respect, 404 is one of the toughest
challenges for regulation in general. Everyone acknowledges
the huge potential benefits for investor protection that 404
provides. Indeed, there is evidence of that every day from
executives who reflect benefits from the studies they have
done of their internal controls.

However, as we all know, 404 also has brought
unreasonably high costs for implementation. The key question
today it seems is whether after all this effort and all this
time the SEC and its colleagues at the PCAOB have found a way
to maintain the investor protections of 404 that Congress
intended to provide and to also find a way to make 404 more
efficient and reasonable in its costs.

The approach recommended today essentially tries to
find that elusive sweet spot that accomplishes both goals of
investor protection or effectiveness and efficiency.

In one respect, the approach today is the ultimate application of principles over rules. It also tests whether a principles based approach can actually work in this particular environment. Effectively, it is where the principles essentially are the rubber that meets the road in terms of this area of regulation.

There has been much talk so far today about the efficiencies and the risks based approach, so I will not deal with that as much in my particular statement today.

I will focus on some of the concerns that I believe investors may have and I would focus the staff also to provide assurances where they think it appropriate after my comments.

Many investors, it seems to me, and I have been told, are worried that in this effort, our management guidance has focused too much on efficiency over effectiveness.

Ultimately, only time will prove what we have done to be correct. However, I can say because I have been part of the process and I have observed it, I know that our SEC staff has worked mightily with the PCAOB and its staff and members to find the right balance. I am confident that balance has been struck.

To those who worry about whether efficiency has
been over played here, I would point out a few items that are
in this particular management guidance, and of course, there
is more to come tomorrow with the final AS-5.

First of all, if we stay with our current approach, we will have the majority, the vast majority of public companies, that is the smaller companies, that will be subject to 404 for the first time in fiscal year 2008 with a report due in 2009. That is a major milestone. That has not occurred up to this particular point in time.

Investors will have the benefit of having 404 applied to that huge sector of American public companies.

A few quick items that are in the guidance, and I can't cover them all, but let me mention a few that I think should also provide some degree of comfort to investors.

The management guidance states that the flexibility provided is not meant that evaluations for smaller public companies be conducted with less rigor to provide anything less than reasonable assurance as to the effectiveness of the ICFR of such particular companies.

I note that in the management guidance, the term "professional skepticism" on the part of auditors is used, and it is pointed out that is expected to remain. The profession is not being asked to be less professional and less substantive in their particular audits.

I would also point out that the definition of
"material weakness," "significant deficiencies," have been strengthened and clarified in my view, and auditors are still required to pay attention to the management assessments report to the audit committee and to be aware and note if there are inaccuracies stated therein.

Let me mention one other item that has to do with management or with investor concern. Many believe that the most crucial and important risk to reliable financial reporting is the risk of a very specific breakdown in internal controls, namely intentional fraud by senior management who have overridden internal controls.

As one commentor noted, history has shown that senior management cooking the books has been the most costly of control failures. While no system of controls is perfect, indeed, our rules seek to compel reasonable assurance, internal controls should seek to substantially decrease the likelihood that intentional fraud by senior management will concur.

Let's not forget that Sarbanes-Oxley was passed in the wake of massive frauds perpetrated by senior management at Enron, Worldcom, Adelphia and other companies. When the House passed SOX by a vote of 423-3 and the Senate by 99-0, I don't think they were too concerned with honest errors by lower level accounts receivable clerks.

To that end, a number of very thoughtful commentors
suggested that our guidance be revised to more strongly emphasize management's responsibility to identify and evaluate fraud risks and the controls that address those particular risks.

I am pleased to see that our final guidance has been improved to respond to this comment. In keeping with the principles based approach, the guidance does not contain a list of fraud risks expected to be at companies. This should not be seen as suggesting that we view fraud risks as unimportant. To the contrary, they are too important to be relegated to a "check the box" type of approach, and the guidance, as requested by commentors, specifically cites the significant existing guidance for assessing fraud risks and controls.

Notably, however, what the guidance does do is state that management should recognize that fraud risks exist in every organization and that identification of fraud risks does not mean fraud has occurred. In some respects, this may be obvious. In other respects, it is very important to be stated.

It should give management the confidence to confront the risk of fraud which is the biggest risk that a manager must consider. Management must ask itself how are we going to design controls to prevent fraud by senior management and how are we going to ensure that these controls
operate effectively.

I am not suggesting that the answers to these questions are easy, far from it. If management spends less time worrying about whether their controls ensure that every receivable is reconciled, they should have more time, it seems to me, to consider appropriate fraud controls and testing those fraud controls.

If we take a step back and look at the forest instead of trees, this is what management should be doing. I believe that our particular management guidance goes a long way in encouraging and hopefully producing that result.

Let me ask a few questions and then I will have one final summary item. As you have heard, I have focused here on fraud controls. The staff has indicated that as one of the areas where the guidance has been modified in that area.

Can you highlight further, John or someone else, the impact you think those changes will have on management's evaluations, specifically it is obviously very important to establish controls regarding management's override. Is it realistic to think companies can establish effective controls in this area?

MS. PALMROSE: Let me start and say yes, we recognize there are challenges, but the answer to that is yes. As you mentioned, we did focus greater attention in the area of fraud risks and direct management not just to
implement robust evaluation procedures for those controls that address the risk of fraudulent financial reporting, but we have modified the guidance to clarify that as you said, we would expect all companies to ordinarily have fraud risks for which controls are needed.

We expect that will increase the rigor of our evaluation, but the key here is in a targeted way that focuses on areas that matter most, that is where the fraud risks are present.

Given that management override is one of those risks, we do talk a little bit about that, and it is important to recognize that there are inherent limitations here. They do exist. One of the reasons they exist is because you cannot eliminate all fraud risks including the risk of management override.

Management can surely figure out how to manage that risk and that is our focus. When it comes to management override, the audit committee also has an important responsibility here. In this regard, there are sources that are available out there for more guidance if audit committees would like to consult them, and we have provided some references to that guidance. This gets into -- I am sort of hesitant to bring it up -- it is called an Achilles Heel document. I think we discussed that at our open Commission meeting.
We have provided some references to that literature. It is important to recognize that audit committees have a role here and need to step up to the plate, too.

COMMISSIONER CAMPOS: I appreciate that. That answer was very thorough.

Let me just make a couple of more observations. Our management guidance, it seems to me, is not a guarantee. Instead, it provides, I think, a very, very thoughtful framework that gives public companies and our audit profession the very best opportunity for a system that continues to protect investors through the assessment by management and the attestation by the audit profession of internal controls.

The success of our guidance, it seems to me, will ultimately depend on the good faith and hard work of both management and auditors. It will also depend on the diligence of investors, and always will.

I for one am hopeful and optimistic that all of the players and all the professionals will use the new guidance and the new AS-5 that will be issued to accomplish the purposes and the benefits of 404 and to do so in a way that costs will be very, very reasonable.

I have often stated that the attractiveness of the U.S. markets stems from our focus on reliability and
transparency, which actually draws capital throughout the world. I am told constantly by foreign investors that it is the U.S. systems of protecting capital, including the benefits of 404, that attract much foreign capital.

I am confident that our guidance today will provide both the same reliability and transparency of the financial statements of U.S. issuers while as I said before, reducing costs so that foreign issuers and others contemplating raising capital in the U.S. will not let 404 be a determinative factor as to whether they come to the U.S. or not.

I do not believe that it is today. It certainly will not be after our guidance is implemented.

I am very happy to support your proposal, and once again, thank you for the outstanding job that all of you have done and your dedication to this effort. Thanks.

COMMISSIONER COX: Thank you. Commissioner Nazareth?

COMMISSIONER NAZARETH: Thank you. As others have expressed, I'd like to thank the staff of both the Office of Chief Accountant and the Division of Corporation Finance for a job very well done. I would also like to very briefly recognize Carol Stacey for her very professional service both to the Securities and Exchange Commission and to the American investing public. Thank you very much for that.
I strongly support this principles based interpretative guidance. It encourages innovation instead of an "one size fits all" approach. I hope that it will help liberate companies by allowing them to apply the guidance to their own situations. It will provide over arching principles without forcing companies to fit into a prescribed mold.

The guidance is intended to be scaleable to companies of all sizes by focusing on the practical application of a risk based top down assessment. The scaleability concepts are not limited to smaller sized companies. Both size and complexity are factors in determining a company's financial reporting risks and controls.

In some instances, large companies may not be very complex and may be more akin to smaller companies as far as their internal control of financial reporting is concerned. The interpretative guidance makes clear that each company needs to review its own facts and circumstances and there is no mandated checklist applicable to all companies.

Although I believe that everyone realized that the implementation of Section 404 would entail costs, I don't believe that anyone anticipated that the costs would be so high or that management's assessment would become driven by the PCAOB's Auditing Standard No. 2.
Addressing those costs in the substantive manner has been one of our primary goals. I think that the interpretative guidance and the corresponding rules we are considering today as well as the changes that the PCAOB is considering through its auditing standard will have a significant impact in achieving this result.

Two of these proposals, both management and auditors, will be directed to focus on areas that matter most, including those that pose a higher risk of fraud.

Our staff has worked very closely with the PCAOB in our oversight role and I thought our open meeting in April about proposed AS-5 was very productive. I am optimistic that our guidance and the PCAOB's AS-5 will be better aligned and provide an useful coordinated framework for management and auditors.

I certainly agree that the costs and burdens of implementing Section 404 have been too high. It is important to remember that there are real benefits to both companies and shareholders when issuers comply with Section 404, including management's renewed sense of ownership over controls, innovative ways to make controls more efficient, better financial reporting and disclosure, and the detection of problems before they become more serious.

All of these benefits improve investor confidence and the integrity of our markets.
I am optimistic that issuers will be able to use our interpretative guidance to have quality, well tailored Section 404 evaluations. By helping management focus on the areas of highest risk, I believe we can best achieve meaningful investor protections without excessive costs.

You have answered a great many questions this morning so I do not want to go on too long. I just thought I would ask two very brief ones.

One is that I did refer in my statement to the open meeting of April 4th and how helpful I thought that was. Can you give us some feedback from your perspective on how that open meeting impacted the proposed guidance that we are considering today?

MS. PALMROSE: Yes. It was enormously helpful to us. First of all, in terms of the alignment issue and it actually set the stage for us working with the PCAOB on that issue in a very collaborative and productive manner. We are very appreciative of the efforts there. It did help in terms of the discussion around scaling, and also the discussion around evidence acquisition and judgment that the auditor uses. We did go back and reconsider our guidance in those areas, too, obviously, in terms of the interaction with the auditor and management.

Finally, in terms of the use of work of others, there were issues around objectivity that also sharpened the
way we think about objectivity in the context of management guidance.

It was enormously helpful. We really appreciated the guidance that we were able to have, and the work that we were able to do with the PCAOB staff going forward because of that.

COMMISSIONER NAZARETH: Finally, as we discussed earlier, we are going to be including the definition of the terms "material weakness" and I guess "significant deficiencies" in Commission rules, and in the past, we have basically looked to auditing literature for these types of definitions.

Can you describe again why we decided to put these definitions in our rules as opposed to elsewhere?

MS. PALMROSE: Yes. Again, in the spirit that we want management to be able to look to our guidance rather than an auditing standard. Actually, when you think about it, it is kind of odd that 302 had a requirement for management to communicate significant deficiencies and yet we pointed management to the auditing literature to find out what those were.

It makes sense now sort of from a housekeeping standpoint to get that back into the SEC guidance. Of course, this is all about material weakness. These are terms that are important for us to define. Again, let me reassure
that the PCAOB is using the same definitions for auditors in their audit standard.

MR. WHITE: Let me echo that. Obviously, we have a situation where each CFO and each CEO of a public company has to make a quarterly certification about material weaknesses and significant deficiencies. It really makes sense that we provide those definitions in our rules when they are going to be making these quarterly certifications.

COMMISSIONER NAZARETH: Thank you very much.

CHAIRMAN COX: Thank you. Commissioner Casey?

COMMISSIONER CASEY: Thank you, Mr. Chairman. I would also like to start my remarks by commending the staff this morning. I think it would be an under statement to suggest that it has not been an easy task. I know it has taken tremendous effort on the part of our staff and in cooperation with the PCAOB. Again, I just really want to commend all of you for the tremendous efforts you have put into producing the guidance today and again for the work on the auditing standard that the PCAOB will adopt tomorrow.

Carol, I'd also like to thank you for your tremendous work.

I am also pleased to support the interpretative guidance for management and the amendments before us today. I will discuss that today's release coupled with the anticipated release of the proposed revised audit
standard by the PCAOB tomorrow are only part of the solution of providing greater clarity and flexibility to issuers and auditors in meeting the requirements of Section 404 of the Sarbanes-Oxley Act.

How the regulators and the PCAOB and the Commission will receive the implementation of these new provisions will ultimately be vital for success.

It is my hope that our efforts will result in helping reduce the costs and burdens associated with the law and its implementation to date. This should be particularly true for smaller issuers with a disproportionate cost to benefit ratio.

Today's release and the anticipated AS-5 audit standard tomorrow are designed to produce fundamental changes in the way management and auditors accomplish their responsibilities pursuant to the 404 ICFR review and audit. Going forward, they are to avoid mechanical box checking and instead they are to exercise professional judgment in their efforts to ensure satisfactory ICFR systems and in turn to protect investors.

At the outset, while we have eliminated the need for a separate statement on the adequacy of management's assessment, the rule amendments should provide clarity to auditors that the report on the effectiveness of internal control over financial reporting necessarily includes an
opinion on whether management's assessment is fairly stated,
and this should help to reduce costs associated with yet
another audit report while maintaining a check on the
objectivity of management's assessment of its own internal
controls.

In addition, I am pleased that the staff has been
able to work with the PCAOB to better align management
guidance with the proposed audit standard.

As the commentors made clear, without alignment,
the benefits for our guidance and revisions to the audit
standard would have been completely lost. In particular, it
will be most helpful that the guidance and proposed standard
both allow for a principles based top down approach to
assessing internal controls where professional judgment is
paramount.

Such an approach will allow for scaleability based
on issuer size, which will give much needed relief for
smaller issuers, but scaling will also be possible based
upon other factors by the types of complexity of the business
or the factors relating to the relative risk of material
misstatements due to an internal control's failure.

I know a key area of concern associated with costs
of 404 has been the potential audit work and focus on
significant deficiencies that are not material weaknesses. I
believe in our proposing release related to the definition of
"significant deficiencies," the Commission has sought to adequately address these legitimate and widely raised concerns.

I am going to look very carefully at the comments we receive on this proposal.

Under our proposed guidance and the related rule changes, management in its judgment identifies weaknesses that are less severe than material, but that nevertheless should be brought to the attention of the audit committee.

I am hopeful that we are striking the right balance between assuring the decision makers are made aware of potential deficiencies that should be monitored without burdening management to uncover all deficiencies however remote to the risk.

While I am largely satisfied that these changes and the anticipated AS-5 standard should address many of the concerns raised, this continues to be an area of concern to me, and I look forward to reviewing tomorrow's PCAOB release and to the comment period that our ultimate review will provide to better determine whether the proposed language meets our objectives.

The final standard in our guidance can't be based on subtle nuances as they will surely be lost on issuers, auditors and investors, all of whom are relying on us to provide clarity and certainty on 404.
I also look forward to the practical effects of these changes and this brings me to perhaps my greatest concern, our changes here today and the PCAOB's changes to the audit standard will only be improvements if they are properly implemented.

This will require that the audit community and management respond to our changes with the right spirit. Applying these principles in an honest effort to identify material weaknesses and internal control functions and consider potential weaknesses that can turn material while avoiding unnecessary work designed to merely increase fees or protect against even the most frivolous risk of error.

It will also require that the PCAOB adjust its inspection process to allow for sound audits. Finally, it will require that the Commission is nimble in our oversight of management's exercise of judgment. We cannot on the one hand ask people to use their good judgment and on the other hand second guess that judgment if it is within the appropriate range, so we have more hard work ahead of us.

I do believe again that we are making a very good start, and I think we will get this right.

Again, I would like to very much commend the work of the staff and also note that as we do look forward to the implementation of the 404 audit requirement for smaller companies, it will be extremely important that we have
confidence that the PCAOB auditing standard is not only
adopted in a satisfactory form but it is being implemented
properly.

That actually brings me to my questions. I just
have a few. I think you have covered the field pretty
nicely.

How will we be monitoring implementation in order
to gain confidence that the benefits we expect from our
guidance and the standard are going to be realized?

MS. PALMROSE: In terms of the Commission, one of
the things that we do is first of all we do a lot of public
speaking, so we will be out talking about our guidance and
educating and explaining, and in those forums, we do receive
feedback, too. That certainly will be one way.

Obviously, I could have started off with the
comment process that we are going to have for the definition
as well as the PCAOB's standard itself. I am assuming those.

Then there are other ways that we could technically
use -- we don't have any of them scheduled at this
point -- we do have mechanisms such as roundtables, et
ce tera, if we wanted to use those.

The other thing that we do is in our oversight of
the PCAOB, we do have oversight that involves inspection of
the PCAOB's activities. We are inspecting the inspection
activities this year, and of course, the implementation of
the ICFR audits, even though in terms of timing we are still sensitive to the fact that it is AS-2 that is being operated, that is operational here, but still, there is guidance out there in terms of what AS-2 means that does get reflected in the way audits are performed, and it is important to recognize that inspection does include how the process works that will be the process going forward to inspect under the new guidance.

We will want to make sure that we think about and weigh in on that, obviously, too. One element of that is of course the standard setting group at the PCAOB, training their inspection team in terms of what the standard means and that is part of our inspection process, too.

Those are the top ones on the list in terms of going forward.

MS. STACEY: I will just add to it. We do meet with various groups. The FEI study was brought up earlier that was released last week. My understanding is they intend to continue to do that, at least for next year. I think that will help, too, to have the outside groups weigh in as implementation goes forward. People have not been shy about coming and talking to us. We expect that will probably continue.

There is a good deal of research going on and we do actually monitor the academic literature for findings in
COMMISSIONER CASEY: How quickly will we be able to gauge our success and draw any conclusions about whether any additional delay may be necessary for smaller companies' compliance with the audit requirements of 404?

MS. STACEY: I think there is a short term and a long term. I think in the short term, we do get feedback from a number of sources and forums that gives us a quick read of the temperature of it. There will be some short term feedback here.

Then in the longer term, these mechanisms that we are talking about will provide us some insight into sort of more quantitative or measurable aspects of it.

MR. WHITE: As you know, when 404 was implemented for the larger companies, there were a series of meetings with the auditing firms and some adjustments in terms of phasing it in, limited extensions and so on, that we were able to do as we got input from the auditing firms and their ability to get it all done on time.

I think we have a lot of flexibility.

MS. STACEY: I think that will be helpful, to hear from both the audit community and the corporate community for the smaller companies, the audit requirement obviously, as John talked about earlier, does not kick in until 2008, but they are obviously out there on the ground doing the
financial statement audits. They are also attuned to what is
going on with 404. I do think it is important for us to hear
from both communities in the first year of adoption for
management and I would like to encourage auditors to pay
attention to that, too.

COMMISSIONER CASEY: Again, I commend all of you
for your work. Thank you.

CHAIRMAN COX: Thank you. As we move to our vote,
I just want to conclude by recognizing again Carol Stacey for
your extraordinary work on this project but just as
importantly, your work over such a long period of many years.
What you have done here with the Section 404 guidance is of
course of enormous importance to American investors, to
America's capital markets and participants in the capital
markets around the world. It has been extraordinary service
to American investors over more than a decade.

Thank you very much for your work here.

To conclude our work here on this particular topic,
I will now ask the Commission a complicated question with
five pieces to it, and we are going to vote on all these five
at once.

VOTE

CHAIRMAN COX: First, does the Commission vote to
issue interpretative guidance for management regarding its
evaluation and assessment of internal control over financial
Second, to adopt amendments to Exchange Act Rule 13a-15 and 15d-15, making it clear that an evaluation that complies with the Commission's interpretative guidance would satisfy the annual management evaluation required by those rules.

Third, to adopt amendments to Rules 1-02(a)(2) and 2-02(f) of Regulation S-X, to require the expression of a single opinion directly on the effectiveness of internal control over financial reporting by the auditors in its attestation reports.

Four, to adopt amendments to Exchange Act Rule 12b-2 and Rule 1-02 of Regulation S-X to define "material weakness."

Fifth, propose amendments to Exchange Act Rule 12b-2 and Rule 1-02 of Regulation S-X to define "significant deficiencies."

Commissioner Atkins asked if I could repeat that, backwards.

How do the Commissioners vote?

COMMISSIONER ATKINS: Yes.
COMMISSIONER CAMPOS: Yes.
COMMISSIONER NAZARETH: Yes.
COMMISSIONER CASEY: Yes.
CHAIRMAN COX: Yes. The matters are each approved.
Thank you very much.

(A brief recess was taken.)

CHAIRMAN COX: -- consider as part of this rulemaking package are directly responsive to those advisory committee recommendations. The focus on capital formation and the removal of obstacles that impede the growth of small companies go hand in hand with our responsibility to protect investors because these investors who are injured and money is lost when the small businesses in which they invest can't get affordable access to capital.

One of the things that we do on a recurring basis to advance our capital formation mission is to sponsor an annual forum on small business capital formation.

For more than a quarter of a century now, we have conducted this forum to help promote capital formation, and given the historic importance of small business in the United States as the driver of economic activity, innovation and job creation, the Commission has always supported means to make regulations less burdensome for small business by constantly concentrating on what is truly important for investor protection.

The proposals that we are about to discuss this morning further those objectives. These initiatives begin with simplifying our reporting requirements. For example, in response to one of the advisory committee's recommendations,
we will consider today whether to increase significantly the
number of companies that can qualify to use our scaled
disclosure requirements for smaller companies. We will also
consider simplifying those rules.

Currently, they appear in Regulation S-B. By
integrating them into Regulation S-K, we can eliminate five
forms and the 36 separate items that currently reside in
Regulation S-B.

To further streamline our requirements, we will
consider whether to completely eliminate the 144 filing
requirement for non-affiliates of issuers who rely the Rule
144 safe harbor to re-sell their securities. That would cut
the number of Form 144s that are filed with the Commission by
nearly 60 percent.

Finally, given the Commission's strong interest in
using technology to help investors, I am pleased that the
rulemaking package includes a proposal to move to electronic
filing for Form Ds. A Form D, of course, is the simple
notice to Federal and state regulators about certain
securities offerings that are exempt from registration.

Ironically, while it is used frequently by small
businesses that are especially sensitive to paperwork
burdens, it is one of the few forms that still is filed with
the Commission on paper.

Now that we are coming to the end of the first
decade of the 21st century, it seems an appropriate time to establish an online filing system.

That online filing system is just not going to be an online filing cabinet, it is going to make the form and data interactive and easily searchable, something that is vitally important both to the Securities and Exchange Commission and to state securities regulators.

These proposals required significant effort by the staff of the Division of Corporation Finance, and I want to thank John White, Marty Dunn, Paula Dubberly, Mauri Osheroff, Betsy Murphy, Amy Starr, Gerry Laporte, Mark Green, Corey Jennings, Ray Be, Katherine Hsu, Dan Greenspan, Anthony Barone, Steven Hearne, Kevin O’Neill and Johanna Losert for your outstanding work.

We have a lot of ground to cover in a brief time, so I will turn it over to John White.

ITEMS 2 THROUGH 7

SMALLER REPORTING COMPANY REGULATORY RELIEF AND SIMPLIFICATION, REVISIONS TO THE ELIGIBILITY REQUIREMENTS FOR PRIMARY SECURITIES OFFERINGS ON FORMS S-3 AND F-3, EXEMPTION OF COMPENSATORY EMPLOYEE STOCK OPTIONS FROM REGISTRATION UNDER SECTION 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934, REVISIONS TO LIMITED OFFERING EXEMPTIONS IN REGULATION D, ELECTRONIC FILING AND SIMPLIFICATION OF FORM D, AND REVISIONS TO SECURITIES ACT RULES 144 AND 145 TO SHORTEN HOLDING PERIOD
MR. WHITE: Thank you, Chairman Cox. We are pleased to recommend to the Commission that you issue a series of six proposing releases designed to modernize and improve the Commission's registration and disclosure requirements that apply for smaller companies.

As you noted, these proposals are responsive to several key recommendations contained in the final report of the Advisory Committee on Smaller Public Companies to the SEC that was issued April a year ago.

They also address a number of changes suggested by the American Bar Association's Committee on Federal Regulation of Securities in a March 2007 letter to the Commission requesting that we bring the requirements applicable to private securities offerings into line with modern market practices and communications and technology.

In a moment, three of my colleagues on the Corp Fin staff will deliver an overview of these six releases, but I thought maybe I would at least weigh in briefly on a couple of the highlights.

One of the releases includes a proposal to expand eligibility for the Commission's disclosure and reporting requirements that are scaled for smaller public companies by actually defining a new term called "smaller reporting companies," and that new term will now apply to all companies
with a common equity public float below $75 million.

Currently, there are about 3,500 reporting companies with a public float and revenue below $25 million that qualify to use our scaled disclosure requirements.

We estimate that slightly more than 5,000 companies will be eligible under the proposal, an increase of over 40 percent, in terms of companies that need this definition of "smaller reporting companies."

I guess we are talking about a fairly substantial increase of the number of companies that will have the benefit of a scaled report, scaled disclosure.

One of the reasons in terms of how we chose this threshold is this moving to the $75 million standard will have the benefit of aligning the public float threshold that we are using for defining smaller public companies with the rules that we are using currently for drawing the line between accelerated filers and non-accelerated filers, that we are really getting rules that apply to smaller public companies in line with what we are doing elsewhere.

A second of the proposals will modify the public float eligibility requirements in order to do primary offerings on Form S-3 for the first time in actually about 15 years, so that companies that have a public float below $75 million will actually be able to use S-3 for primary offerings for the first time.
We think this will assist and facilitate efforts by companies, smaller companies, that tend to have fewer financing options open to them today, fewer than larger companies.

The releases also include proposals to establish three new exemptions. Two of them from the Exchange Act registration requirements for compensatory stock options and the third is a new exemption that would be added to Regulation D for sales of securities to a new category of so-called Rule 507 qualified purchasers.

Companies relying on this new exemption would be able to actually engage in a limited amount of advertising targeted to these new Rule 507 qualified purchasers.

Finally, we are recommending that you issue a release proposing revisions to existing Rule 144 in a manner that is likely to be of particular benefit to smaller companies by shortening the holding period for restricted securities.

I guess that is the highlights of these proposals. We will turn to the details in a moment.

As usual, I feel like I have to read the list as well, all of us here in Corp Fin. It is a long list, because there are six releases and there are a lot of pages here.

First to my left, Marty Dunn, who has led this effort. Marty has been just invaluable in putting this
altogether.

The rest of the team, Paula Dubberly, Mauri Osheroff, Gerry Laporte, Betsy Murphy, Kevin O'Neill, Johanna Losert, Anthony Barone, Steven Hearne, Mark Green, Dan Greenspan, Amy Starr, Ray Be, Kathy Hsu, and it goes on beyond that. It has really been tremendous work on this.

The Office of Chief Counsel in Corp Fin, the Office of Liaison. Also we have gotten a lot of very useful help from the Office of Economic Analysis, and of course, as always, General Counsel's office, and I also obviously want to recognize that we hit them with over 500 pages in a very short period of time, and they have been incredibly helpful and responsive to us, plus the Divisions of Market Regulation and Investment Management have been working hand in hand with us on a number of these releases.

There has been really a tremendous effort going on by the staff.

With that, I will turn the microphone over to Kevin O'Neill, Tony Barone and Kathy Hsu, who will actually give you the details.

MR. O'NEILL: Good morning. In March 2005, the Advisory Committee on Smaller Public Companies was chartered by the Commission to assess the current regulatory scheme for smaller public companies under the Federal securities laws and make recommendations for change.
The charter directed the Advisory Committee to conduct its work in connection with the Commission's investor protection mandate and to consider whether the costs imposed by the current regulatory system are proportionate to the benefits, to identify methods of minimizing costs and maximizing benefits, and to facilitate capital formation by smaller companies.

I will describe a group of three separate rulemakings that stem from the final report of the Advisory Committee, the three proposals which are similar but not identical to recommendations in the Advisory Committee's final report.

First, the Division of Corporation Finance recommends that the Commission propose amendments to its disclosure and reporting requirements under the Securities Act and the Exchange Act that would increase the number of companies eligible for the Commission's disclosure and reporting requirements for smaller reporting companies.

The Commission's current regulatory scheme for small businesses adopted in 1992 modifies some of the disclosure requirements for these companies. This should not be thought of as lesser disclosure but as scaling our requirements to the characteristics of the smaller companies, to assure that the burdens of regulations are commensurate with the benefits.
The proposals would expand the system by allowing most companies with a common equity public float of less than $75 million to qualify for these smaller reporting company requirements, up from $25 million for most companies today. The proposals would combine the small business issuer and the non-accelerated filer categories for smaller companies in our current rules into a new category of smaller reporting companies.

In addition, the proposals would simplify the regulations by integrating the disclosure requirements for smaller reporting companies which currently are contained in Regulation S-B into Regulation S-K.

The smaller reporting companies which file registration statements and Exchange Act reports on the Commission's regular forms would be able to choose on an item by item basis whether to take advantage of the disclosure requirements or provide the same disclosures as larger companies.

We believe this proposal would benefit smaller companies while maintaining appropriate disclosure standards for investor protections.

The Division next recommends that the Commission propose amendments to Form S-3 and Form F-3 that would revise the eligibility requirements for those forms for companies with a public float below $75 million and take advantage of
the benefits, subject to a restriction on the amount of
securities those companies may sell in an one year period.

The amendments are intended to allow smaller public
companies that have been timely in filing their reports for
at least one year to benefit from the greater flexibility in
assessing the public securities markets qualified for Forms
S-3 and F-3.

Specifically, the Division recommends that the
Commission amend the instructions to Form S-3 and Form F-3 to
allow companies with less than $75 million in public float to
register primary offerings of their securities on those
forms, provided such companies meet the other eligibility
conditions for use of the Form S-3 or Form F-3, and are not
shell companies and have not been shell companies for at
least one year before filing the registration statement, and
do not sell more than the equivalent of 20 percent of their
public float in primary offerings registered on Form S-3 or
Form F-3, as applicable, over any one year period.

If the amendments are adopted as proposed, this
will be the first time in 15 years that the Commission has
modified the eligibility requirements for primary offerings
on Form S-3s and with respect to Form F-3s.

We are recommending that the Commission propose two
new exceptions to the registration provisions of the Exchange
Act, Section 12(g), for compensatory employee stock options.
Under Section 12(g) of the Exchange Act, an issuer with 500 or more holders of record of a class of equity securities and assets in excess of $10 million at the end of its most recently ended fiscal year must register that class of equity securities unless an exemption is available.

Stock options are a separate class of equity securities under the Exchange Act. An issuer with 500 or more option holders with more than $10 million in assets is required to register that class of options.

Given differences in the nature of the trading -- the first exemption was applied to compensatory employee stock options issued under written compensatory stock option plans from a non-reporting issuer. Eligible option holders are limited to employees, directors, consultants and advisors. Transferability of shares received on exercise of the options and shares of the same class underlying the options is restricted, and risk and financial information is provided to option holders and holders of shares received on exercise of the options.

We also recommend that you propose a separate exemption for compensatory employee stock options of issuers that are subject to the Exchange Act reporting. In this case, option holders would have access to publicly filed Exchange Act reports.

In addition, Exchange Act Sections 14 and 16 would
apply to options in securities issuable.

Thank you. You will now hear from Tony Barone to discuss the additional proposing releases.

MR. BARONE: Good morning. The Division further recommends that the Commission publish proposals to amend Regulation D, Form D, to conform better to modern market practices and technology without compromising investor protection.

Regulation D is heavily relied upon by smaller companies to reach capital. The immediate focus of our recommendation is the reduction of unnecessary regulatory burdens on companies that rely on Regulation D.

Specifically, we recommend that you propose to establish a new exemption of the regulation provisions of the Securities Act in Rule 507 of Regulation D. The new exemption would allow most issuers to sell their securities without registration and engage in limited advertising, so long as they sell only to a new category of investors, called Rule 407 qualified purchasers.

A proposed definition of Rule 507 "qualified purchasers" would include individuals with $2.5 million in investments or have annual individual income of $400,000 or aggregate income of $600,000 with their spouse.

The $2.5 million in investment threshold is based upon the Commission's December 2006 proposal for accredited
Institutional investors generally would qualify if they owned $10 million in investments. Institutional investors not subject to a monetary threshold would qualify as accredited investors and similarly could qualify as Rule 507 qualified purchasers without regard to a monetary threshold.

Likewise, any director, executive officer or general partner of the issuer could qualify as a Rule 507 qualified purchaser without regard to a monetary threshold.

We also recommend proposing revisions to the existing accredited investor definition in Regulation D. We recommend adding an alternative way to qualify for accredited investor status. In addition to the total current assets, net worth and income statements, there would be a new investments owned standard of $750,000 for individuals and $5 million for institutions.

In addition, we recommend adding several new categories of entities to the list of approved accredited investors. These proposals would increase the number of investors qualified as accredited investors and increase the pool of capital available to companies that engage in private placement relying on Regulation D.

We also recommend proposing to adjust for inflation the thresholds for accredited investors and Rule 507
qualified purchasers in Regulation D on a going forward basis
starting on September 1, 2012.

Our last recommended change to Regulation D is to
decrease the time frame for the innovation of safe harbor in
Regulation D from six months to 90 days, and to provide
uniform updated bad actor disqualification for all offerings
under Regulation D. Currently, disqualification provisions
are only in Rule 505 of Regulation D.

We also recommend that the Commission in a separate
release propose rules to mandate electronic filing of Form D
and to refine and simplify the form. Form D is a notice
required to be filed by companies that have sold securities
without registration under the Securities Act based on a
claim of exemption under Regulation D or Section 4-6 of the
Act.

The current version of Form D was developed jointly
by the Commission and state securities regulators in the
mid-1980s as an uniform Federal and state form. It continues
to be accepted by many states to satisfy their filing
requirements and it has played a significant role in
eliminating duplicative and unnecessary burdens of dual
Federal and state securities regulations.

The vast majority of Form D filings are made by
private companies. Form D filings were intended to serve
important data collection objectives. They contain basic
information about the issuer, the offering, and the exemption claim. The data is used by regulators in enforcement activities. It also enables the Commission to evaluate the effectiveness of Regulation D as a capital raising device, and to tailor its rules to provide appropriate support for both capital formation and investor protection.

Currently, Form D filings may be made only on paper. They are one of the Commission's few remaining paper filings. The Commission received approximately 25,000 Form D filings last year. The interactive on line filing system that the staff intends to develop for electronic Form D filings will be accessible from any computer with Internet access.

Filers could input data which would be tagged automatically and easily searchable by regulators and members of the public who may choose to view it.

Improvements to the Commission's rules resulting in better information availability of Form D information could result in significant benefits to companies that rely on Regulation D exemptions, especially smaller companies, as well as to investors.

Thank you. Kathy Hsu will now summarize the final release.

MS. HSU: Good morning. The final release that we are presenting for your consideration this morning proposes
amendments to Rules 144 and 145 of the Securities Act. We recommend that the Commission propose to shorten the Rule 144 holding period applicable to restricted securities from one year to six months for the issuer of the securities is subject to Exchange Act reporting obligations and has been for at least 90 days before the sale of the securities.

Securities holders with restricted securities of non-reporting companies continue to be required to hold their securities for one year before any public re-sell, pursuant to the existing requirements.

We believe that shortening the holding period in this manner would increase the liquidity of privately held securities, reduce the liquidity discount for the securities, and thus decrease the cost of capital for issuers.

We further recommend that the Commission propose to re-introduce a tolling provision that suspends the holding period while the security holder has a short position or has entered into a put equivalent position with respect to the securities in connection with the proposed six month holding period for restricted securities of reporting companies.

This is due to the recognition that the shorter holding period could make it significantly easier and less costly to enter into hedging arrangements.

However, the proposed tolling provision would not apply if the securities holder has held the securities for
one year or more, regardless of any hedging activity, so that the effect of the proposed tolling provision would be no more restrictive than the existing provision.

Accordingly, the proposed tolling provision would in no event require a security holder relying on Rule 144 to hold their securities for more than one year prior to publicly selling the securities.

We also recommend that the Commission propose to substantially simplify compliance with Rule 144 by a person who is not an affiliate of the issuer and has not been an affiliate for three months prior to the sale of the securities.

Currently, a non-affiliate is required to comply with all the conditions of Rule 144 for an additional year after the holding period is met. Only then is a non-affiliate able to re-sell securities freely and without any restrictions.

Under the proposed amendments, a non-affiliate with restricted securities of a non-reporting company could re-sell freely after the requisite one year holding period is met. A non-affiliate with restricted securities of an Exchange Act reporting company could re-sell freely after the six months holding period, subject to the tolling provision, as long as current information regarding the issuance of securities is publicly available as required by Rule 124c.
The current public information requirement would be applicable for up to one year after the acquisition of the securities. We believe that the proposals reduce the complexity of Rule 144 for non-affiliates as well as further increases liquidity of restricted securities.

In addition, with respects to sales by affiliates, we recommend that the Commission propose to eliminate the manner of sell limitations with respect to debt securities, raise the thresholds triggering a Form 144 filing requirement, and codify staff interpretations relating to Rule 144.

We believe that the combined effect of our proposals, to eliminate the Form 144 notice requirements for non-affiliates and raise the Form 144 filing thresholds, would significantly decrease the number of Form 144 filings that are required to be filed annually.

We also recommend that the Commission solicit comments on whether to coordinate Form 144 filing requirements with Form 4 filing requirements.

Under the proposed amendments to Rule 144, only affiliates are required to file the notice of a proposed sale of securities on Form 144, and many of these affiliates are also required to file a Form 4 under Section 16 of the Exchange Act, to report changes in beneficial ownership of their securities.
In order to reduce duplicative paperwork requirements on individuals who are required to file both Form 144 and Form 4, we recommend that the Commission solicit comment on whether to revise the Form 144 filing deadline to coincide with the Form 4 filing deadline to permit affiliates subject to Section 16 requirements to have the option to satisfy their Form 144 filing requirements by timely filing a Form 4 reporting the sale of securities.

The proposing release also solicits comment on whether the Commission should revise Item 701 of Regulation S-K to require additional disclosure about the re-sell status of securities issued in unregistered transactions at the time the company first issues the securities.

Finally, we recommend that the Commission propose to eliminate the presumptive underwriter provision in Rule 145, except with regard to transactions involving shell companies.

Under the proposed amendment, only a party to a Rule 145(a) transaction involving shell companies, other business combination related shell companies, or an affiliate of the parties be deemed a presumed underwriter of the transaction. Those deemed presumed underwriters are permitted to re-sell their securities under the provisions in Rule 145(d.)

We recommend that the Commission propose to
harmonize the re-sell restrictions in Rule 145(d) to the
re-sell restrictions for securities of shell companies as
opposed in Rule 144.

I will now turn it back to John White. Thank you.

MR. WHITE: Thank you. You probably have gotten
the idea that this is a big package of releases. We would be
pleased to take your questions in any order.

CHAIRMAN COX: Thank you. Any time we get an
opportunity to streamline regulations at the same time as we
can increase investor protection, we want to seize that
opportunity, and that is clearly what we are doing today.

All of us and the staff have a great interest in
furthering transparency and promoting clarity, including
plain English, and regulatory simplification in all our
rulemaking.

Let me ask to begin with with respect to the
elimination of paperwork in connection with Form D, since
this is a benefit not just to us in a regulatory way, but
also in an enforcement way, since it reduces paperwork --
(Inaudible due to background activities.)

MR. BARONE: That is John's fault.

This is actually something that has been
percolating around for years and years. It is one of those
things that kind of waits for its time to come. We have been
building on it. I think the key inertia to getting it done
is when the 3s, 4s and 5s went on line. That gave us a framework to build off of. Since then --

CHAIRMAN COX: Our experience in that area, because it was so positive, gave us confidence this was the way to go.

MR. BARONE: It also gave us the format that is easily used.

CHAIRMAN COX: I mentioned earlier the data is going to be interactive. I think it was Kathy Hsu who was explaining that the tagging is automatic.

MR. BARONE: These guys can help me more with that. They know 3, 4 and 5 better than I do. The notion is it goes in there. The tagging is XML. It works better than XBRL and it gives you the full searchability of everything, and you just fill out the form and it is searchable.

From the small businesses' standpoint, they never need to know about data tagging, it just happens. Our goal is to make it easy.

I want to make it really clear why we decided to make this proposal. About two weeks ago, the job of opening those 25,000 envelopes a year and entering these Form Ds into our EDGAR system was assigned to Corp Fin.

CHAIRMAN COX: That's good. While we are at it, the number, for record purposes here, the number of pieces of paper that don't have to be filed any more, the number of
forms that do not have to be filed any more is each year 25,000, except they are now electronically filed. No more paper.

MR. BARONE: In terms of this whole package, there are lots of more things. There is reducing the number of Form 144s by 60 or 70 percent.

CHAIRMAN COX: If we cut the number of Form 144s by 60 percent, roughly, how many forms a year would that be?

MR. BARONE: She says about 30,000. We are looking at probably 50,000 forms.

CHAIRMAN COX: That is remarkable. Let me ask a question just to flush out what I think I understand. From an enforcement standpoint, from a regulatory standpoint, why is being able to access these things in electronic form, especially after it is tagged and interactive and so forth, important?

STAFF SPEAKER: It is important because we have statistical data now that we can find more easily, and we hope that Enforcement will find this useful. Now, you have trouble even tracking down who files the Form D let alone the data that is in them. We will be able to identify specific industries and look at those industries. We will be able to look at companies that generate particular amounts of revenue and in general, we will be able to do searches across a wide database as well as finding specific companies.
CHAIRMAN COX: Excellent. Because so many of these recommendations come to us courtesy of the Advisory Committee on Smaller Public Companies, have we communicated with the leadership of the Advisory Committee in furthering their recommendations?

MR. WHITE: Yes, we have. I spoke to Herb Wander earlier this week actually to explain to him we would be getting the final results of what we were planning on doing today. Unfortunately, he could not be here today, but I certainly want to extend our thanks to both Herb and Jim Thyen for their tremendous work, both leading the committee and helping us with this whole process.

CHAIRMAN COX: Indeed, we need to thank all the members of that Advisory Committee for their exceptional public spirited work. It is nice to be able to have quality recommendations that we can act upon. I am very pleased. I don't have any other questions. Commissioner Atkins?

COMMISSIONER ATKINS: Thank you very much, Mr. Chairman. So many individuals have devoted significant time and energy to thinking about how our private offering rules could be improved. You mentioned 500 pages. This is why so many people have been involved.

Although private offerings are utilized by issuers of all sizes, they most significantly affect smaller
companies who do not have the variety of options available that larger companies have at their disposal to raise capital.

For many years, the Commission has held an annual forum on small business capital formation to discuss these issues. Gerry Laporte and others have been very much involved in that.

The Advisory Committee on Smaller Public Companies also, of course, focused, as we heard a portion of their report, on capital formation for smaller companies, and various committees and a task force of the American Bar Association have focused on smaller companies as have our regulatory counterparts in states through the North American Securities Administrators Association.

I very much appreciate the staff effort in quickly turning around these proposals. It was a big task. I do not think anyone here has felt greater frustration about private offering reform than the Division of Corporation Finance, but for the past five years, of course, the Commission has been preoccupied with implementing and then of course now today taking a step towards fixing Sarbanes-Oxley and public companies' securities offering reform, and of course, executive compensation.

I am pleased that we can now turn our attention to private offering reform as well. I support the efforts being
proposed today by the Division. If adopted, I think they will provide more flexibility for raising capital, especially for smaller public companies.

More importantly, today's proposals go far towards promoting efficiency, competition and capital without compromising investor protection.

Today's proposals also address many of the concerns facing smaller public companies. Having been at the SEC back in 1991 and 1992 when we adopted Form S-B, I feel as if I have now come full circle. Our regulatory relief proposal will allow more companies to take advantage of the scaled disclosure and financial reporting requirements.

Our proposals on Form S-3 and Rule 144 will provide additional alternatives to raise capital for smaller public companies seeking it and hopefully on more favorable terms.

Issuers seeking to raise capital not only from persons who have significant existing investments or financial wherewithal will have an easier ability to solicit financial customers.

Finally, I think we cannot under state the importance of changes to Form D. Electronic Form D will provide the Commission and other interested persons data about the private offering market in a format that is easier to compile and easier to analyze.

I am a strong component of using cost/benefit
analysis to guide regulatory actions, and I believe that an
electronic Form D will provide much more concise information
about what is going on in the marketplace.

The proposals today are an excellent start for
updating our rules governing private offerings. Many
provisions are substantially the same as when they were first
adopted back in 1982, but as the capital markets have changed
over the years, so should our rules.

I mentioned that these proposals make an excellent
start because I do not believe that the Commission's work in
this area is going to be finished after today or even after
we adopt these particular sets of proposals.

Our proposals do not address other issues brought
up by the Advisory Committee, the forum, or the ABA, such as
finders and private placement broker/dealers, expanding and
testing the waters provision that we first put in back in the
early 1990s, clarifying the definition of "control" for
certain purposes, or revising Rules 504 and 505.

I think more work needs to be done by the
Commission to achieve an optimal level of investor protection
and capital formation for smaller companies.

The staff has only been significantly engaged on
these rulemakings since the beginning of this year. I would
encourage you all to continue your fine work in this area and
present some additional ideas. I look forward to seeing this
I just have a couple of questions about the proposals. First, I wanted to look at the proposal to separate the S-B forms from the regular S forms. Right now, a small business issuer can choose to file a form on S-B or on a regular form. The regular forms have a higher standard of disclosure.

If we have a single form, will that cause confusion?

MR. DUNN: That is one of the things to think about. As Kevin was saying and others have said, we don't think there is a higher level of disclosure. We like to think it is better and can actually be more useful there.

One of the things we are saying is on the front of the form, you have to mark whether you are relying on the smaller reporting companies, so hopefully there will not be confusion as to what is there.

Within the form, what we are saying in the release is the companies have this lower level base line. They are allowed always to do more, but what they are held to is that lower level. I really think that on the front, indicating they are a smaller reporting company, and therefore, at that lower level, I do not think folks will be confused, and I think it will have the added benefit of -- for some reason, some firms and underwriters will not use S-B forms, they
won't go near them, and I think that has lessened the
effectiveness of it.

I think we have dealt with the possibility of
confusion and hopefully eliminated whatever stigma might be
there.

COMMISSIONER ATKINS: That is the ala carte nature
of this and that destination on the cover will then tip
people off as to whether it's an S-1 with the highest amount
of disclosure or an S-1 somewhere in between.

MR. DUNN: Correct.

COMMISSIONER ATKINS: We propose to allow all
issuers to use Form S-3 in a primary offering so long as they
are current with their Exchange filings. Why should we
extend this privilege to companies that are trading on the
Bulletin Board and pink sheets, and not limit it solely to
issuers on national securities exchanges?

STAFF SPEAKER: The recommendation we made today
would require that companies meet all the non-float
requirements of Form S-3, so that would include the basic
timely reporting of all their Exchange Act reports during the
last year so all their filings would have been made with us
electronically on EDGAR in a timely fashion. Investors would
have had all that information available to them.

We think that combined with the limitations on 20
percent of their float being offered per year and excluding
shell companies or ceased to be a shell company for a year,
should take care of any other concerns.

COMMISSIONER ATKINS: I think the comments will be
very instructive. I look forward to that.

For smaller business issuers registering securities
on Form S-3, how are we going to monitor whether they are
staying within their 20 percent limitation?

MR. DUNN: The way we are looking at that is the
same way we look at people doing 424s off the shells all the
time now, they have come in with unallocated shells,
universal shells, or if they just come in with the regular
shell, and 424s reflect each take down, and that is how we
can tell. It is a similar notion to what we are going to see
here.

The question is are they taking down more than they
are allowed and they have to reflect it.

COMMISSIONER ATKINS: I would like to pose a
question to our economists. The new electronic Form D, I was
curious if you think there might be some additional data that
can be collected and analyzed from these electronic filings
that might prove useful.

STAFF SPEAKER: We actually have been looking at
the possibility of getting other data tagged through the Form
D filings. Certainly, there are private offerings
that -- Form D is part of that offering process. Having
information like that tagged or possibly the asset value of
the offerer, not just of that filer, not just a check box of
whether it was less than $5 million, I think, would be
useful, but at the same time, we are cognizant of the
possible burden on costs, and have been suggesting that there
could be questions put in the release, if there are not some
already, about how useful those additional requirements would
be and what the costs are.

I would like to comment relatedly, all of these
releases that our group has been working on, from an OEA
perspective, they are very difficult to analyze because there
is not a lot of good data out there on smaller issuers.

When the work with the Advisory Committee first
started getting into improving the quality of data, the work
our group has done has reflected that, and I would like, if
you don't mind, take the opportunity to thank Alan Herrell,
Jeannie Frensky, Katherine Handley and Jennifer Westberg for
the outstanding job they have done in putting together some
background information for the proposals on very short
notice.

COMMISSIONER ATKINS:  Great.  Thank you.

With respect to Form D, have we talked to the
states?  Originally, this was a joint form.

MR. DUNN:  We have been speaking to them on and off
for a good while about it, about what they would like to see
in it. We have talked to them about it. We have not
coordinated the development of it. They have definitely seen
it and talked to us about it. We are looking forward to
comments on it.

I think you always run into the natural intention
of from our side, we want to view it more as a notice, and on
the state side, they want more information. So, we try to
find the right balance. That is why it is so important that
we talk to them. I think we have probably had at least a
half a dozen or dozen conversations with them as we have gone
along.

You are never going to reach the perfect balance
because people have different views. The notion of this
being electronic and the means it gives them to better dig
into the database to see what is at the state level, they are
very encouraged by that. They have let us know they are
going to comment on this and we are definitely going to work
with them.

COMMISSIONER ATKINS: Okay. I look forward to
their comments. I wanted to also give the General Counsel
people time here. We are basing the super accredited
investor standard on Section 28 and not Section 4-2, and the
Commission and its staff have a long history of equating
general solicitation is not compatible with a private
offering, all the way back to the 1930s.
I think one can argue as the Advisory Committee and others have that this approach might not be correct. I think the Advisory Committee said that we focused on purchasers and not offerees.

I was curious what our General Counsel's Office thinks in order to address these interpretations.

MR. DUNN: Let me say at the outset that we are entirely comfortable with the approach that the Division is taking here which I think achieves the objectives that the Division of Corporation Finance has in its recommendations.

For at least present purposes, the approach taken here enables the Commission not to confront the very long-standing and very large body of law that you referred to.

We think the Division has taken the proper course. I don't think we want to preclude or pre-judge what might be determined to be appropriate in other circumstances.

COMMISSIONER ATKINS: We got a nice supplemental memo yesterday. I guess this will be a work in progress over the next few days to finalize it.

With respect to the various standards for natural persons and legal entities and considering what we did back in December regarding the accredited investor changes, we have very inconsistent approaches here across the board in 506 and the proposed 507 and then this proposed 509.
The fact that we have now a higher level for institutions under 507 and under 506 for the hedge funds, and after seeing all the comments that have come in on that and proposed 509, I am not really sure I would support what we came out with.

My hope is that we are going to get this consistent here, and if we have to re-propose the hedge fund rule, then that is probably what we have to do to get it in sync. I just have a concern with where we are going. I don't know if you have any comments on that.

STAFF SPEAKER: I am not completely sure what your question is. The rules as proposed today are not to be reviewed with the rules that the Commission proposed back in December.

COMMISSIONER ATKINS: For example, under proposed 509, there is a $5 million total net asset test, the same as under 506, but you now have proposed 507, we have a $10 million net investment test. Basically, we have a higher standard under 507 than we do under 509 or 506.

I just think these need to be harmonized in some way and especially with the net asset test. We have a choice now under 507 to account for the net investment test.

STAFF SPEAKER: One thing I can comment on is I was looking at exactly the same issues you are raising right now and trying to figure out whether there is any inconsistency.
I appreciate all the work we have done with Corporation Finance and with the Office of General Counsel in harmonizing the two rules.

If I could go back to the rules proposed in December, all those rules are -- what those rules do is re-define accredited investors who are natural persons who seek to invest in a special type of hedge fund, the hedge fund that relies on 3(c)(1). Those are hedge funds that have less than 100 investors and are not presently making and do not propose to make a public offering.

All that we did or all the Commission has proposed to do in the December proposals is to re-define natural persons for those types of hedge funds to be persons who have $2.5 million in investments.

The rules that Corporation Finance -- Rule 507 that Corporation Finance is proposing today is not a safe harbor under Reg D. It is not a new type of private offering. It is an exemption -- jump in, please -- it is where we overlap and I am sure I will say it a little bit different than Mauri's group would -- it is an exemption from the registration requirements.

It is in no way saying that an issuer that relies on 507 is not making a public offering. It is simply saying you are exempt from registration if you meet the requirements of 507 and you do a tombstone ad.
Hedge funds would not be allowed to use that provision. They are by definition restrained, prohibited from making a public offering, so that because the exemption doesn't address that question, 507 simply doesn't apply to them.

COMMISSIONER ATKINS: I agree with that. I guess my point is not necessarily a technical one, but how we are adding a third one. It doesn't seem to be harmonized. I think that is one thing that I think we have to work out, we have to listen to the comments coming in, and we are probably going to have to, in my opinion, re-address that hedge fund proposal.

MR. DUNN: What we are trying to accomplish in it is work in alternative definitions so whatever the Commission decides to do on the hedge fund piece, we can adopt to match. That is our goal, because we realized a key thing here is there has to be one best answer.

COMMISSIONER ATKINS: I think you have done an exemplary job. I just think as our thinking changes with time and as we have the benefit of substantial comments, I think a lot of this will be very well put. We need to incorporate that.

With that, thanks.

CHAIRMAN COX: Thank you. Commissioner Campos?

COMMISSIONER CAMPOS: Thank you. I also would like
to congratulate the staff of our Division of Corporation
Finance for all of its hard work and all the other staffs
that have contributed to these six proposals.

While I am told this is not a record, it is not
often that you see six proposed rulemakings from one division
in one calendar. I guess the number actually is eight or
nine perhaps if we include the three releases from management
guidance. That must be some sort of record.

I know the Corp Fin staff has put in tremendous
amounts of hours, and as we said, that has also caused our
staffs to put in a tremendous number of hours. All that
together has produced the good work here today.

I just have a short statement.

One of the Commission's missions is, as we all
know, to promote capital formation. It is especially
important to both smaller public companies and also private
companies.

As a former owner of a privately held company, I
understand how important this is. If our rules are out of
date, unnecessarily vague, or overly restrictive, smaller
public and private issuers will face certain obstacles.

There has been much discussion recently about the
allegedly evidence of the decline of competitiveness in the
U.S. markets. What is missing from this discussion in my
view is talk of capital raising that occurs in the United
States. In particular, private capital raising by foreign companies.

I would think that trends in this regard are as important as IPO trends if not more so. For example, it seems to me the trends with respect to unregistered offerings by private companies correspond much more closely than IPOs with respect to critical measures of our economy, such as where jobs are created and where technology is developed, the sort of companies with unregistered offerings formed the backbone of our system.

If the private offering process is streamlined, these companies, it seems, would have greater capacity to innovate and grow. And to bring us back to IPOs, statistics that show that the vast majority of companies go public in their home market. It stands to reason that if private companies in the U.S. thrive, so, too, will ultimately the U.S. IPO market.

With that said, let me turn to a few specific points. First, I am glad to see that the staff is proposing to revise the content of Form D and mandate electronic filing of the form. There is no reason that we should be stuck in the paper when virtually all of the other required Commission filings are electronic.

In addition, our staff has heard that Form D is confusing, complicated, and apparently many issuers are
choosing simply not to file the form.

By simplifying Form D and making it easier to file, we can hopefully reduce the burden on issues. Moreover, this should make Form D a better tool to collect empirical information, so we can measure private offering trends and report on capital raising.

These are important trends, as I have said, that we should be measuring.

Second, I think the proposal to allow limited advertising to occur in an offering solely to Rule 507 qualified purchasers via Rule 507 is very promising. On the one hand, it would relax one of the primary restrictions currently imposed on private offerings. On the other hand, by limiting the offering to an even narrower class of investors, the rule would seek to minimize the potential for fraud by unscrupulous issuers.

It will be interesting to see the comments that we receive on this. I am also curious to see what the commentors have to say about our revisions to the definition of "accredited investor."

I know our proposal last December to amend this definition generated significant commentary and we should be mindful of the comments that we received in that regard. I also should not overlook the fact that we are also proposing to remove some limitations on the ability of
smaller public companies to conduct offerings on Form S-3s. This seems appropriate given the more comprehensive real time disclosure regime put in place over the last few years.

Again, however, we are trying to balance investor protection interest here as well by limiting the amount of securities that can be sold by smaller public companies and by not allowing shell companies to take advantage of this proposed rule.

I hope this is an appropriate balance. Again, I look forward to the comments.

Again, let me congratulate the staff for this very fine and very comprehensive work, and I know it is at least a record in terms of the weight I had to carry to this particular open meeting for me. Thank you again.

CHAIRMAN COX: Thank you. Commissioner Nazareth?

COMMISSIONER NAZARETH: Thank you, Mr. Chairman. I'd also like to congratulate the staff on the good job with respect to this package of small business proposals.

(Inaudible due to background noise/activities.)

COMMISSIONER NAZARETH: Commissioner Atkins had some concerns about the intersection between this proposal and the December 2006 proposal from the Division of Investment Management with respect to Rule 509. I also share an interest in to the full extent possible aligning at least definitions. I can understand there may be some policy
reasons to employ different standards for safe harbor versus
the exemption, although I don't think we have fully had that
discussion prior to this meeting.

There are opportunities, it seems to me, in some of
the definitions to ultimately align these. I think what
happened in the drafting process is we have now tried to
align them because we have an existing proposal out there,
when in fact it may be based on some of the comments that we
received, that some of the things that are now raised as
questions for today's proposal -- (inaudible) -- what was
done in the December proposals before we adopt or take those
improvements into account. If what that means is that we
have to in some way re-propose parts of the December
proposal, that is fine with me. If it is possible to do that
by raising the questions in this document. I do not know
what the procedural rules will be on that.

Ultimately, we want to end up with the best result,
and something that is easy to apply and not with multiple
definitions simply because these things were done at
different times.

Again, I agree with what Commissioner Atkins
expressed there.

I had one or two other sort of quick comments. One
I think relates to Form D. Obviously, this is something that
NASA has a great interest. Have you received input from NASA
MS. OSHEROFF: We received some informal input from a project group working on Form D. We also spoke to them about it a few weeks ago. We understand their concern. They understand ours. I think they will be very happy with it. In fact, when I answered the question a few minutes ago on why this electronic form would be helpful to Enforcement, I should have also mentioned state enforcement efforts. The states similarly will be in a better position once they have an easy way to search for and identify data, and the states will be able to receive forms that are targeted at their own state. This will be helpful with their enforcement efforts as well as ours.

We expect they will give us more input after the proposal. I am sure we will get comments from them. We do not want to represent that they have signed off on the form. I think they will be pleased with it.

As I think Marty mentioned a few minutes ago, there is a certain balance in terms of the information that we ask for. We want information that will be useful to us for statistical and enforcement purposes and we want the states to feel that they also have useful information. We do not want the form to be a many, many page form, although since it's electronic, I am not sure pages have any meaning, but we do not want it to be burdensome.
We would like to achieve the right core of information, and we are looking forward to hearing from them and working with them on that.

COMMISSIONER NAZARETH: Thank you. I also have a question on Form 144, on the tolling periods. Do we think that security holders and brokers will have difficulty calculating tolling periods?

STAFF SPEAKER: No, we are not anticipating they will. They already have to make reasonable inquiry about a number of things.

COMMISSIONER NAZARETH: Thank you.

MR. WHITE: I might just make one procedural comment here. There have been a couple of comments about a lot of documents floating around here.

In terms of what you are voting on today, you have a draft release which is in the stack you have, and then there is an action memo that went around, or supplemental action memo’s that went around yesterday that outlines a number of changes in the draft release we had sent you, but it outlines the material terms of those changes, and that will also reflect a number of questions.

It is laid out so that we have complete flexibility when it comes to adopting the final release.

CHAIRMAN COX: Thank you. Commissioner Casey?

COMMISSIONER CASEY: In the spirit of the time
limits that we have with the meeting and the next agenda item, I will also limit my comments.

As a general matter, I would like to say that I am very supportive of the proposals that are being put forward today. As has been noted, they are intended to facilitate capital formation by liberalizing and modernizing certain of our registration reporting requirements, and they should benefit companies of all sizes, but particularly aimed at smaller companies. I think that is extremely important, as they are the engines in our economy and responsible for a great deal of job growth and creation in our economy.

I think as a general matter I would say I am really pleased that given the fact that we have modernized many of our other rules and forms, which you related to, Marty, that we are focusing our attention now on certain rules for private or limited offerings in Reg D.

I would love us to continue to look across our rules and regulations in other areas to ensure that we are continuing to achieve the goals and our mission, and that we should give consideration to whether they need to be updated or revised.

I would also note that I also share the views of both Commissioners Atkins and Nazareth as it relates to 507 and the December release. While I appreciate the fact that what we have before us today allows us the flexibility to
give consideration to the appropriate approach, I think it is
going to be extremely important that we take the value of the
comments that we get on the proposal today, that we are
adopting today.

If that requires any additional reconsideration of
the December proposal, I think we should do so. I think the
end result, the policy, should definitely take advantage of
the comments. I thought the comments we received on the
December proposal were extremely informative.

Again, I commend all of you. I know it was a
tremendous amount of effort. We are realizing the benefits
today. Thank you.

VOTES
CHAIRMAN COX: Thank you. If there is no further
questions or discussion, we will move to four separate
questions on adopting each of these changes.

The first question is does the Commission vote to
propose amendments to its disclosure and reporting
requirements under the Securities Act and the Exchange Act
that would allow most companies with a common equity public
float of less than $75 million to qualify for the
Commission's scaled disclosure and reporting requirements for
smaller reporting companies?

COMMISSIONER ATKINS: Yes.

COMMISSIONER CAMPOS: Aye.
Second, does the Commission vote to propose amendments to its disclosure and reporting requirements under the Securities Act and Exchange Act that would integrate the disclosure requirements for smaller reporting companies which currently are contained in Regulation S-B into Regulation S-K?

Third, does the Commission vote to propose amendments to the disclosure and reporting requirements under the Securities Act and Exchange Act that would combine for most purposes the current two categories of smaller companies into one category called "smaller reporting companies?"

Fourth, do the Commissioners vote to propose
amendments to the disclosure and reporting requirements under
the Securities Act and Exchange Act to rescind the
Commission's S-B form for smaller companies?"

COMMISSIONER ATKINS: Yes.
COMMISSIONER CAMPOS: Yes.
COMMISSIONER NAZARETH: Yes.
COMMISSIONER CASEY: Yes.

CHAIRMAN COX: Yes. That matter stands approved.
Thank you very much once again for excellent work.

I'm sorry. Does the Commission vote to propose
amendments to the eligibility requirements of Form S-3 and
Form F-3 under the Securities Act to permit registration of
primary offerings by companies with a public float of less
than $75 million, subject to a restriction on the amount of
securities those companies may sell pursuant to the expanded
eligibility standard in any 12 month period?

COMMISSIONER ATKINS: Yes.
COMMISSIONER CAMPOS: Yes.
COMMISSIONER NAZARETH: Yes.
COMMISSIONER CASEY: Yes.

CHAIRMAN COX: Yes. That matter stands approved.

Does the Commission vote to propose two exemptions
from the registration requirements of the Exchange Act for
compensatory employee stock options, the first exemption for
issuers that are not required to file periodic reports under
the Exchange Act, and the second exemption for issuers that are required to file those reports because they have registered under the Exchange Act, Section 12, the class of the equity security underlying the compensatory employee stock options.

COMMISSIONER ATKINS: Yes.
COMMISSIONER CAMPOS: Yes.
COMMISSIONER NAZARETH: Yes.
COMMISSIONER CASEY: Yes.

CHAIRMAN COX: Yes. That matter stands approved. Does the Commission vote to propose a new Regulation D exemption from the registration provisions of the Securities Act for sales of securities to a newly defined category of qualified purchasers that will permit limited advertising and propose other revisions to Regulation D, including changing the definition of "accredited investor," adding revised disqualification conditions to all exemptions under Regulation D and shortening the timing required by the integration of safe harbor in the regulations, and finally, to propose interpretative guidance regarding the integration of current public and private offerings?

COMMISSIONER ATKINS: Yes.
COMMISSIONER CAMPOS: Yes.
COMMISSIONER NAZARETH: Yes.
COMMISSIONER CASEY: Yes.
CHAIRMAN COX: Yes. The recommendations are approved.

Does the Commission vote to propose revisions to Form D to mandate electronic filing of Form D, which is the notices filed by companies that have sold securities without registration under the Securities Act based on a claim of exemption under Regulation D?

COMMISSIONER ATKINS: Yes.

COMMISSIONER CAMPOS: Yes.

COMMISSIONER NAZARETH: Yes.

COMMISSIONER CASEY: Yes.

CHAIRMAN COX: Yes. That recommendation is approved.

Does the Commission vote to propose amendments to Rule 144 that would shorten the holding period for the re-sale of restricted securities where the issuer of the securities is subject to the Exchange Act reporting requirements, to simplify compliance with the rules for non-affiliates to sell restricted securities after satisfying the holding period, raise the Form 144 filing thresholds, eliminate the manner of sale restrictions with respect to debt securities and codify certain staff interpretations relating to Rule 144?

COMMISSIONER ATKINS: Yes.

COMMISSIONER CAMPOS: Yes.
COMMISSIONER NAZARETH: Yes.

COMMISSIONER CASEY: Yes.

CHAIRMAN COX: Yes. That recommendation is approved.

Finally, does the Commission vote to propose amendments to Rule 145 to harmonize the holding period of Rule 145 with the proposed Rule 144?

COMMISSIONER ATKINS: Yes.

COMMISSIONER CAMPOS: Yes.

COMMISSIONER NAZARETH: Yes.

COMMISSIONER CASEY: Yes.

CHAIRMAN COX: Yes. That recommendation is approved. Are there any other proposals that the Commissioners seek to vote on?

(No response.)

CHAIRMAN COX: If not, all of those recommendations are approved. Thank you very much.

ITEM 8

OVERSIGHT OF CREDIT RATING AGENCIES REGISTERED AS NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATIONS

CHAIRMAN COX: Our next item is Credit Rating Agency Reform Act of 2006. These are recommendations from the Division of Market Regulation. In giving the Commission statutory authority to oversee the credit rating industry, Congress explicitly found that this kind of oversight would
serve the interest of investor protection.

The new regulatory framework is intended to ensure we carry out the intent of Congress and to benefit investors. President Bush signed the Credit Rating Agency Reform Act into law on September 29th of last year. By its terms, the Act gave the Commission 270 days to adopt rules to implement the new law. That deadline will arrive on June 26th, about a month from now.

To meet that deadline, we proposed rules back in February, on February 2, 2007, just four months after the law was signed, by proposing our regulations five months before the deadline, we put ourselves on track to meet the legislative schedule.

Today, we are preparing to adopt final rules more than a month before the statutory deadline. I want to generously congratulate the staff for their exceptional good work in that respect.

The Act states that the basis for its provisions included the Commission's 2003 report and public comment letters on the Commission's concept released rule proposals. The goal of the new law is to improve credit rating's quality by fostering competition and accountability, and transparency for the industry.

The replacement of the transparent voluntary Commission registration system favors no particular business
model. For the first time, the Commission has been given statutory responsibility to oversee the NRSROs.

The Act prescribes a specific time line within which the Commission must act on an application and requires that our implementing rules are narrowly tailored to achieve their purpose.

The rules that the Commission is considering today are intended to faithfully implement the statutory mandate.

I particularly would like to thank the following people for all your efforts in getting this new regulatory framework to the Commission well within the time frame specified by Congress.

Director and Deputy Director of the Division of Market Regulation, Eric Sirri, Bob Colby, Mike Macchiaroli, Tom McGowan, Randall Roy, Sheila Schwartz, Rose Russo Wells, as well as Janice Mitnick in the Office of the General Counsel. I particularly want to thank the Commissioners and their counsels for their comments and work.

I will turn the floor over to Eric Sirri, the Director of the Division of Market Regulation for a more detailed description of the recommended final rules on NRSROs.

MR. SIRRI: Thank you, Mr. Chairman. Good afternoon, Commissioners.

The Division of Market Regulation recommends that
the Commission adopt final rules to implement the Credit Rating Agency Reform Act of 2006. As instructed by Congress, the final rules before you are narrowly tailored and are designed to promote the quality and integrity of the credit ratings by fostering accountability, transparency, and competition in the credit rating industry.

The Commission proposed rules for comment on February 2, 2007. We are pleased to have received 62 comments during what was a very short comment period.

The final rules before you today incorporate changes responsive to those comments. We have prepared six rules and a registration form for consideration.

First, we recommend that the Commission adopt Rule 17g-1, the registration procedures for the nationally recognized statistical rating organizations or NRSROs, and the Form NRSRO.

Rule 17g-1 will require a credit rating agency to apply to the Commission for registration as an NRSRO and if approved, to provide updated information when certain information provided becomes materially inaccurate and an annual certification on Form NRSRO.

The credit rating agency will be required to provide the information on Form NRSRO such as the classes of credit ratings for which it is applying to be registered, credit rating's performance measurements statistics, a
general description of the procedures and methods for
determining credit ratings, organizational structure,
procedure to prevent misuse of information, conflicts of
interest, procedures to address and manage conflicts of
interest generally, a description of the minimum
qualifications of its credit analysts and credit analyst
supervisors, and information regarding the designated
compliance officer.

Second, we recommend that the Commission adopt Rule
17g-2 concerning the records to be made and retained by
NRSROs. Rule 17g-2 will require NRSROs to make and retain
certain records related to its business as a credit rating
agency. The rule will also prescribe the time periods and
manner in which the records must be maintained.

Third, we recommend that the Commission adopt Rule
17g-3 requiring annual financial reports to be furnished by
NRSROs. The rule will require NRSROs to furnish to the
Commission on a confidential basis certain financial reports
on an annual basis, included audited financial statements.

In addition to the audited financial statements,
the rule also required NRSROs to furnish separate unaudited
financial reports that will assist the Commission in carrying
out its statutory responsibilities under the Credit Rating
Agency Reform Act.

Fourth, we recommend that the Commission adopt Rule
17g-4 which seeks to prevent the misuse of material non-public information. Rule 17g-4 will require an NRSRO to have written policies and procedures reasonably designed to prevent (1) the inappropriate dissemination within and outside the NRSRO of material non-public information obtained in connection with the performance of credit rating services. (2) a person within the NRSRO from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person is in possession of material non-public information obtained in connection with the performance of credit rating services that affects the securities or money market instruments. (3) the inappropriate dissemination within and outside the NRSRO of a pending credit rating action before issuing the credit rating.

Fifth, we recommend that the Commission adopt Rule 17g-5 to address conflicts of interest. Rule 17g-5 will require an NRSRO to disclose and manage those conflicts of interest that arise in the normal course of engaging in the business of issuing credit ratings.

For example, one conflict of interest for NRSROs would include being paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.

Finally, we recommend that the Commission adopt
Rule 17g-6 to address certain prohibitive acts and practices as directed by Congress.

Rule 17g-6 will prohibit the NRSRO from engaging in certain unfair, coercive, or abusive practices. For example, an NRSRO could not threaten to issue a credit rating that is not determined in accordance with the NRSRO's established procedures and methodologies for determining credit ratings, based on whether the rated person will purchase or purchases another product of the NRSRO.

Rule 17g-6 also would prohibit an NRSRO from issuing or threatening to issue a lower credit rating, lowering or threatening to lower an existing credit rating, refusing to issue a credit rating or withdrawing or threatening to withdraw a credit rating with respect to securities or money market instruments issued by an asset pool or as part of any asset backed or mortgage backed securities transaction, unless all or a portion of the assets within such pool or part of such transaction also are rated by the NRSRO, where such practice is engaged in by the NRSRO for an anti-competitive purpose, a practice that is known as "notching."

Proving anti-competitive intent in this regard will be difficult, particularly where an NRSRO has analysis to support the contention that its methodology is not arbitrary and designed to make the credit rating of a structured
product more accurate.

Nonetheless, we believe this prohibition when combined with the enhanced recordkeeping requirements of Rule 17g-2 would serve as an important deterrent against anti-competitive practices.

We recommend that the Commission adopt three recordkeeping requirements in this area. These requirements would assist the Commission to better understand how these practices are developed and employed and this information may provide a basis for the Commission to determine whether it should find a specific practice to be unfair, coercive, or abusive.

With regard to unsolicited ratings, in the proposal release, the Commission has preliminarily determined that it would be unfair, coercive or abusive for an NRSRO to issue an unsolicited credit rating and then attempt to induce the rated person to pay for the rating or for another product or service of the NRSRO or its affiliates.

Consequently, paragraph (a)(5) of proposed Rule 17g-6 would prohibit this practice.

Commentors have raised a number of concerns with respect to how this prohibition will operate. For the most part, commentors were concerned that it was over broad and consequently would prohibit legitimate business activities that are not coercive.
We would like to gain a better understanding through our examination function of how credit rating agencies define "unsolicited credit ratings" and the practices they employ with respect to these ratings. We believe we should gain this understanding before recommending that the Commission prohibit any practice in this area, and therefore, we recommend that the prohibition be eliminated from Rule 17g-6.

I would also like to discuss the issue of whether credit rating agencies that register as NRSROs should be required to disclose certain performance statistics, such as standardized inputs, time horizons and metrics to allow for greater comparability among NRSROs.

The Commission requested comment on whether other performance measurement statistics would be appropriate as an alternative or an addition to historical default and down grade rates.

For example, the Commission requested comment on whether Exhibit 1 should require a measurement of the performance of a given credit rating by comparing or mapping it to the market value of a rated security or to screen the clients on the market value of the security after the rating. Commentors generally questioned whether standardizing performance statistics would be appropriate. For example, the credit rating agencies may have different
definitions for their credit ratings, which would make it much more difficult to develop common metrics for evaluating the performance among credit rating agencies.

Accordingly, at this time, the staff is not recommending that the Commission take action in this regard. However, we intend to study these issues and consider possible action in the future.

Another issue we wish to bring to your attention is the concerns of timing of the release. Under the Rating Agency Act, the Commission must issue final implementing rules no later than 270 days after its enactment, or by June 26, 2007.

The provisions of the Rating Agency Act that relate directly to the registration and oversight of NRSROs becomes effective on the earlier of June 26, 2007 or the date the Commission issues final rules under the Act.

However, once the Rating Agency Act is effective, a credit rating agency that has received an NRSRO no action letter can only represent itself as an NRSRO if it has an application for registration pending before the Commission.

Pursuant to the release of the final rules being considered today, credit rating agencies that are currently the subject of a Commission staff no action letter identifying themselves as NRSROs would have a period of time to submit applications for registration as NRSROs before the
provisions of the Rating Agency Act and the recordkeeping reporting and conduct rules issued under the Act become effective.

This will avoid a gap of time when no NRSRO exists which would disrupt the regulatory use of the terms and applicable statutes and regulations that would be consistent with Congressional intent.

Our recommendations today represents the culmination of efforts by staff from several divisions and offices. I would like to thank Janice Mitnick, Michael Plasi from the Office of General Counsel, Tony Tri and Chuck Dale and Lauri Walsh from the Office of Economic Analysis. Melanie Jacobson and Nancy Salisbury from the Office of the Chief Accountant, and the following members from my staff, Bob Colby, Mike Macchiaroli, Tom McGowan, Randall Roy, Rose Russo Wells, and Sheila Schwartz.

I would be happy to answer any questions.

CHAIRMAN COX: Thank you. I just have two questions, and I want to compliment you for a very thorough presentation, but also preparation. A lot of work has gone into doing this in a very timely way and we are very appreciative.

The Act requires the Commission to prohibit practices that it determines are unfair, abusive or coercive. In our proposing release, the Commission preliminarily
determined to prohibit a practice that is frequently referred to as "notching."

The vast majority of comments that we received address this issue. I wondered if you could more fully explain what the staff's plans are for addressing that issue going forward and how these rules before us today address that issue.

MR. MACCHIAROLI: Yes, Mr. Chairman. First, we recommend that the abusive practices actually be one where the one rating the pool -- intends the notching practice to be anti-competitive. In effect, tracks what we think is the legislative intent.

This will give us the burden of determining whether or not somebody intentionally is doing something for anti-competitive purposes.

We have asked the Commission to adopt a series of rules which will give us information about the practices. That is we will ask the firm as to each security it rates, each pool it rates, where it does not rate all the securities, to identify those and to identify how it rated those particular instruments, that is how it incorporated those instruments into its pool rating, and to also give us information about its notching practices, how it determines how to notch a particular NRSRO.

We will in effect use this information to try to
build a bridge for determining whether or not they did this
for rational purposes, that is for non-competitive purposes,
for solely for anti-competitive purposes.

The Office of Economic Analysis has in effect
agreed to work with us in formulating some sort of approach
to this problem. We are going to determine whether or not we
are collecting sufficient information through this process
and whether we need to go back and get more information from
the rating agencies.

CHAIRMAN COX: I take it that consistent with the
statute, which required the Commission to prohibit practices
that are in and of themselves unfair, abusive or coercive,
that you will infer anti-competitive intent from the practice
itself.

MR. MACCHIAROLI: We could not recommend to the
Commission that any particular notching itself was
anti-competitive. It may be, but we determined it would be
better that we make any abusive practice to be one where
there is an anti-competitive intent and then determine
whether or not in the notching area they are doing that.

MR. SIRRI: Just to elaborate, I think
anti-competitive behavior is an economic practice. I think
in this context, I think ultimately it is going to be an
empirical issue.

CHAIRMAN COX: That is a very helpful answer.
MR. SPRATT: One of the things that is striking in this area is there is a phenomenon called "rating shopping." A lot of times what happens is the issuers approach a number of different rating agencies. They get preliminary indications of what their ratings are going to be, and then make a business judgment as to which ratings they would like on their issue and which ratings they just paid for the preliminary evaluation and say we don't need the final report.

What an issuer typically would do in such a situation is they might accept the higher ratings and basically say thank you very much for the lower ratings. There is actually information in the implicit ratings that are provided by the rating agencies themselves, and I think that information may be important to understanding if it is associated with notching.

I think this is a very important economic issue, and certainly our office has met with a number of the agencies, and I think what is striking is it is ultimately going to be -- in order to get a handle on this, one really has to study and examine this carefully, which is going to be very important in the implementation of the rules.

MR. SIRRI: Let me add a couple of things. I agree with what Chester said. Notching is really one of the most difficult issues that was presented by this release. I would
say about three-quarters of the comment letters addressed notching. It was a tough problem.

The finding that needed to be made that it was anti-competitive, we felt we could not do with the information that we had. We have considered a number of possible ways to proceed, and the result we have here is one that is based on intent.

As we have said, intent is a hard thing to show. You asked the question, Mr. Chairman, how you would make that inference, was it just from the practice. I think that is a very difficult inference to make. The empirical regularities is part of that, but it goes beyond that because if you simply look at a set of outcomes, those could rise either to anti-competitive or non-anti-competitive practices. It is a difficult thing.

One thing that I will say is that we will going forward focus our attention empirically on notching. We have agreed as a staff and in talking to OEA that is one of the things we should look at early on. When I say look at this, I mean outside of our normal inspection cycle.

I think we need to look at the books and records, information that we are going to have, that have been carefully crafted to give us good information, and I think we intend to look at this issue early on to see what practices we find.
CHAIRMAN COX: Thank you. The only other question I have concerns criticisms in the Senate report on the Act regarding the process that had been in effect in prior legislation.

First, they complained that the process was taking too long, that it was subject to delays. Another legislative concern was that the Commission was not formally involved itself in the decision.

To deal with those concerns, the law requires that all applications for registration be approved within 90 days or alternatively, that within that time period there be proceedings to disapprove them, and it requires that this be done by an act of the Commission.

I wondered if you would explain how these rules will work to ensure that the 90 day time period or 90 day deadline is met, and second, that the period begins to run when it is supposed to, and third, that the Commission itself will be in a position to act properly on all applications.

MR. MACCHIAROLI: We are going to use everyone in our office, we expect at least seven applications initially for the folks with no action letters within the first month, so we expect those to come in.

We are not set up yet, but we intend to use all of our resources to look at these as quickly as possible, to make sure they are complete. We are not going to be able to
examine all the applications. We intend to get it to the
Commission at least in 30 days of the 90 day period. That
gives us 60 days to examine the materials and make sure they
are complete and then do whatever analysis is necessary under
the Act and forward it to the Commission with our
recommendations.

CHAIRMAN COX: Excellent. Thank you. Commissioner
Atkins?

COMMISSIONER ATKINS: Thank you, Mr. Chairman.

Thank the staff for all your hard work and for working with
me and my staff over the last few weeks in this regard. I am
really pleased that we are finally able to promulgate rules
that provide transparency, consistency and accountability to
the NRSRO designation process.

Under the language of the release, and the rules
are still not final, we have gotten a few versions here
recently, I look forward to taking a hard look at the latest
version and talking to the staff before it finally makes its
way to be published in the Federal Register.

I do have a few questions. First, for Mr. Sirri,
Dr. Sirri, are you confident that the NRSRO rules including
Form NRSRO are narrowly tailored as is required by the
statute?

MR. SIRRI: Yes, I am. I think as a staff we
worked very hard to craft a set of rules that adhere to the
purpose of Congress and Congress' intent. I think what you have here are things that stick as closely as possible to what we were required to do and really go no further.

COMMISSIONER ATKINS: I am hoping it will remain narrowly tailored. I see a lot of references to further analysis of issues before we take action. I assume this will be full Commission action.

MR. SIRRI: That is our intent. I think what we are saying is both the release and the comments we receive, we want to be responsive to those. They raised some difficult issues. We thought it would be responsible to look at the issues empirically, as Chester alluded to, once we go forward and get some more information, and that would relate to issues like the notching practice, but also it could relate to consideration of perhaps additional performance statistics.

We are not saying we are going to do those things or not do those things, but we thought the issues were substantial and we should just take a look at them as a staff and if we came to a conclusion, we would bring that to the Commission.

COMMISSIONER ATKINS: What representations, if any, must a credit rating agency make about their clients?

MR. MACCHIAROLI: There is not a reference regarding that.
COMMISSIONER ATKINS: When will a Form NRSRO be complete? Is it just all the blocks are filled in?

MR. MACCHIAROLI: All the exhibits and blocks are filled out.

COMMISSIONER ATKINS: Is there a qualitative review of the information as part of that?

MR. MACCHIAROLI: No. Our intent is just to make sure the documents are complete as required by the rules.

COMMISSIONER ATKINS: If there is any dispute between the staff and applicants regarding completeness of the forms, who would arbitrate that?

MR. MACCHIAROLI: I guess initially we would have discussions, but ultimately with the Commission. We have no delegated authority.

COMMISSIONER ATKINS: Could you explain exactly what policies and procedures the credit rating agencies will have to disclose and what you all are going to look for to determine accuracy?

MR. MACCHIAROLI: We have been discussing that with some of the rating agencies. Some of the larger ones have literally thousands and thousands of pages of rating methodologies, depending on the instrument that is to be rated. I want them to disclose how that is done without getting into proprietary information, for example, how the models are run, or such detail that it would over burden.
In some cases we have been told that literally they would have to file thousands of pages. We do not want that. We have agreed to have some much lesser standard on how the ratings are being done. We will not be judging the rating. It will not be a vigorous test.

COMMISSIONER ATKINS: We need to be clear and I think Congress made it clear that it should not be subjective determinations. If we are going to be requiring disclosure of their policies and procedures -- beyond that --

MR. MACCHIAROLI: We will make sure it is their policies and procedures, that is they are telling us in effect what their policies and procedures are and that they have not made them up. There will be an examination to test whether or not these are in fact the policies and procedures.

COMMISSIONER ATKINS: A danger inherent in this is you get into a complete circle back and forth and you haven't disclosed properly about this or that. It could almost be a never ending thing.

MR. SIRRI: I think what we are clear about is that the intent of Congress was not for us to evaluate the quality of the processes, and I think the staff is clear about that. It seems like the way this was crafted was to say disclose how you come to these ratings and let the market judge.

I think the import of what Mike was saying was if there is a procedure that is laid out there, we will make
sure you are adhering to that procedure, whatever it is.

COMMISSIONER ATKINS: What representations would QUIBs have to make when they send applications in, and with regard to different languages.

(Inaudible due to background noise/activities.)

COMMISSIONER ATKINS: I was just curious what they have to do.

(Inaudible due to background noise/activities.)

MR. MACCHIAROLI: (Inaudible.) That they have seriously considered the credit ratings of the applicant. They are certifying and they have not received any compensation.

COMMISSIONER ATKINS: I see that in the recordkeeping rules we have excluded drafts from certain required books and records. Are there any recordkeeping requirements that mandate drafts be kept?

MR. MACCHIAROLI: That would be very unusual. We obviously do not require drafts. I was surprised to hear the comment, but we agreed that rather than have an argument about it later, that we take it out so it is clear that is not included. Generally, we would not.

(Inaudible due to background noise/activities.)

COMMISSIONER ATKINS: Per the statutory requirement for disclosure of organizational information we are requiring it looks like organizational charts.
MR. MACCHIAROLI: We will leave it at their discretion and then discuss it. That was our intention. Generally speaking, it has been no serious problem.

COMMISSIONER ATKINS: I also see that we are using our ancillary signatory authority to require a chart reflecting reporting lines and the compliance officer. What is the purpose of that?

MR. MACCHIAROLI: The statute specifically requires there be a compliance officer. We just thought there should be some information about the compliance officer so the public could judge whether or not the compliance officer will be effective. The statute specifically requires that there be a compliance officer. We thought there should be some further information.

COMMISSIONER ATKINS: We are not requiring a particular reporting line?

MR. MACCHIAROLI: No.

COMMISSIONER ATKINS: That is up to the firm.

MR. MACCHIAROLI: Yes.

COMMISSIONER ATKINS: What are the requirements for auditors of credit rating agencies' financial statements?

MR. MACCHIAROLI: That they do an audit in accordance with general principles. It would depend on the particular jurisdiction. We did not want to pick up all of the rules of every agency even in the United States, so we
had to trim it. We want them to be independent, but we do not recommend they be independent in accordance with all the issuer rules, for example. That might be too burdensome for some of the smaller entities.

Some of the larger entities are audited by PCAOB qualified auditors. Others may not be when you get further down the chain. We wanted to make sure we had an audit with generally accepted standards.

The independence was a key question. Then we will see what we get as we go along.

COMMISSIONER ATKINS: I agree with that. I think generally accepted auditing standards incorporate that an auditor has to look at what he is auditing.

Thank you very much. I look forward to finalizing this in the next couple of days. Thanks.

CHAIRMAN COX: Thank you. Commissioner Campos?

COMMISSIONER CAMPOS: Thank you. I would also like to start out by thanking our hard working staff in the Division of Market Regs for their efforts in successfully implementing this particular proposal, the Credit Rating Agency Reform Act of 2006, and responding in small time.

I remember frequently predicting that if we did not reach an agreement voluntarily in the industry, that Congress would act, and sometimes I am right. Congress did act.

We are here today to implement this. I think
sometimes you need a nudge, and this is where we are. I think this particular proposal is actually a very good one. I have a short statement and then I have one item that I want to push a little bit with the staff on. Let me just begin. I want to first commend Congress in its decision to mandate the oversight of the NRSROs by creating this registration and disclosure regime. The Commission now is providing greater transparency in their registration process as well as laying out the objective standards. Indeed, our rulemaking complies with Congress' mandate to improve ratings' quality for the protection of investors.
It seems to me it should apply for accountability, transparency and competition. The rulemaking was fashioned, as we all know, after years of review, public comment, and examination. Further, in Congressional intent, the proposed rules are narrowly tailored.
The proposed rules do so without regulating substance of credit ratings or the procedures or methodologies by which an NRSRO determines credit ratings. The implementation of the Act addresses the concerns raised regarding the no action letter process, which many viewed as creating a barrier to entry for credit rating agencies seeking wider recognition.
Among other things, the rulemaking also addresses
the issue of supervision of credit rating agencies. Conflicts of interest and the use of non-public information. It is not an overstatement to say credit rating agencies play an important and valuable role in the efficiency of our capital markets. The impact credit rating agencies have, as we all know, can be tremendous. Credit ratings are used by investors, issuers, investment banks, broker-dealers, and by governments. Investors make purchases or not, deals are made or not, schools are built or not, all based many times on the existence or the type of a rating. In today's world, there is an increased appetite for credit ratings and a corresponding demand for objectivity, independence and transparency. The globalization of our financial markets has also effectively expanded the impact credit ratings have. In fact, the asymmetry of the global financial marketplace is the very thing that gives credit rating agencies their grounding. By providing a system of relative creditworthiness, the credit rating agencies give market participants a key to unlock a heavy door. Inherent in the system of granting credit ratings is trustworthiness and impartiality on the part of rating agencies. Confidence, therefore, in the credit rating agencies and the ratings they issue is critical to the efficient operation of our nation's and indeed the
world capital markets.

I have also maintained over the years that having rules in the U.S. through the SEC would also effectively create a boundary and a model that other countries in the world would like to have, and I believe that is a benefit for the credit rating operations.

I also believe that this rulemaking will have a positive impact on the industry. The changes made by this rulemaking may very well result in the expansion of the number of NRSROs. Competition may also emerge for developing markets outside the United States over the next number of years as the number of rating agencies grows.

On the international front, there have been several developments as well. In 2004, the IOSCO Committee published a Code of Conduct Fundamentals for credit rating agencies, the so-called IOSCO Code. The Commission played an active role in this process through chairing the committee and assisting with the drafting of the final language.

I believe that the rulemaking before us today is generally consistent with existing international principles governing the activities of credit rating agencies and the intent underlying the IOSCO Code. This rulemaking today represents a major leap forward.

While we received several comments and suggestions for change at the proposing stage, overall, there has been
strong support from a number of market participants,
investors and other interested parties.
I believe the proposed rules reflect the extensive research and thoughtful deliberations of the staff.
I just have one question that I want to explore, and it has been brought up, but I'm not sure that I totally understand where we are going.
As to notching, a question would be before the agency as to whether it is indeed anti-competitive or some sort of abusive practice. I understand we do not feel we have the data right now to make that determination, but get me to an end. When will we? What will we do? What process is likely to be suggested? We have already complaints about this area.
I think it is appropriate for the agency to be able to tell them how we will eventually resolve that issue.
MR. SIRRI: I think the reason it is a difficult question is that the practice of notching could rise for anti-competitive reasons or for other reasons, and given that we have a rule that is based on intent, we are going to have to make an inference, and to do that fundamentally we need data.
You asked where would we go and how would we do something like this. The records that are going to be required to be kept here are going to help us. For example,
for every deal in which a structured project is done in which
another NRSRO has rated some of the underlying assets, the
record of that will have to be kept. There will also have to
be records kept with regard to how notching calculus, if you
will, is done, if those records are made at all.

In other words, if you go through an analytical
process as an NRSRO and come to a basis for saying I need to
lower a credit rating, then you will have to make that record
and you are going to have to keep it.

The reason why I think these are effective is the
NRSROs will have an obligation to justify how they came to
their down grading, their selective down grading practices,
and we will look for support for why that is reasonable, and
we will probably be relying on records for that.

Once we have those, we will be able to look at them
analytically, the data, and their records, do these seem
reasonable or not. That is information we do not have today.

What I am really saying is there will be some light
shed on the process.

COMMISSIONER CAMPOS: Let me again push you a
little bit. If there were to be a complaint of notching or
maybe that is not what triggers it, you are saying there is
an examination process, that there will be an examination of
the records justifying the lowering of a rating because
another agency was also involved in the rating, and then that
data is analyzed by whom and how and what standards would be used to decide whether it is abusive or anti-competitive?

MR. SIRRI: I think to be frank, we would have to learn as we go. This is a new business. This is not something we have looked at. We have the ability to request those records and that is something that I think we would do. It would be an analytical process that would happen within the staff. I think people who might participate in that would include people from the Office of Economic Analysis, people from the staff of Market Regulation, and probably people from the Office of Compliance.

Finding anti-competitive practices is very difficult, a difficult task. You have to look for the indicia of that. I can't tell you right now exactly what they would be, it is a facts and circumstances sort of thing. We just have to look very carefully for a collection, a set, a pattern, a set of findings that would lead us to become concerned.

Frankly, I must say the mere fact that some light is being shed upon this may have some positive benefit. I do not know. I can't tell you today whether anti-competitive practice is going on or not because we were not able to come to a finding. It may be just the knowledge in the industry, the credit rating industry, that we are looking at this actively may help remove any anti-competitive practice, if in
fact one was there.

COMMISSIONER CAMPOS: I appreciate that. Again, just to push a little bit more. It seems to me that if that were to be done, organize a committee, an inter-divisional committee of some sort, I suppose that would be proposed internally somehow that is the process, then I suppose there is some finding that has to be made, and then if there is a finding that has to be made, I suppose there is some process because that has some legal implications and some issues having to do with the rights of those against potentially, assuming a finding was made.

I just see this as a far more detailed and adjudicatory type of system that we are going to have to go down. There may not be any other way. I would think that is something that needs to be vetted and worked with the Commission.

MR. SIRRI: I completely agree. We would work with the Commission and let you know what our processes are. Let me point out one other thing. It is rather unusual that we have something quoted in a statute where we are actually looking at anti-competitive behavior. This is somewhat unique for us.

I think maybe what you are sensing and quite correctly is this is new ground for us.

MR. SPRATT: The Commission has a lot of tools if
it does find a violation.

COMMISSIONER CAMPOS: I think you get my drift. It smacks of a lot of due process issues, of a hearing, to decide, let their views be known, to defend their position. There is just a lot here. I just would expect this is an area that would be worked with the Commission and I am sure our General Counsel have views about what is appropriate with respect to any type of finding and adjudication aspects of that and whether we have a hearing and what is the form, administrative process, and so forth.

MR. SPRATT: If there were a violation, it would be an enforcement action. It would be a normal enforcement process.

COMMISSIONER CAMPOS: Ultimately, it would be a referral to Enforcement?

MR. SPRATT: Yes.

COMMISSIONER CAMPOS: Those are all my questions.

CHAIRMAN COX: Thank you. Commissioner Nazareth?

COMMISSIONER NAZARETH: Thank you. I am pleased to support the adoption of these rules that implement the Credit Rating Agency Reform Act of 2006.

The rules are designed to preserve and foster the integrity of the credit rating process which is critical in light of the ever increasing reliance on ratings over the years, particularly with structured debt and derivative
products.

Market participants use credit ratings as a proxy for the in depth analysis and their reliance increases for integrity, transparency and accountability of the credit rating process.

Through the legislation, Congress established a clear and transparent set of standards. For the first time, the SEC will have a formal regulatory program for registering and supervising credit rating agencies, and they must have their ratings recognized.

The legislation also calls for recordkeeping and examination authority over NRSROs, something that it did not have previously, as well as requirements to provide financial reporting to the Commission and to have policies and procedures to prevent the misuse of material non-public information, to manage and address conflicts of interest.

This past January, the Commission had proposed rules that were narrowly tailored to satisfy statutory requirements. As Eric said, we received over 60 comments and a significant number of these addressed acts and practices, such as notching. The comment process was productive and I believe the staff presented today the final rules that sensibly respond to the concerns of commentors as well as meeting the Congressional objectives.

Commentors were helpful in pointing out some
practical considerations such as the requirements that would apply to all associated persons or affiliates. The staff reconsidered its proposals in light of the statute and the comments and where appropriate, narrowed the requirements to persons within the credit rating agency or to affiliates engaged in the rating system.

With regard to notching and other activities that may be unfair, coercive or abusive, the Commission has created specific recordkeeping requirements and will endeavor to rigorously examine NRSRO practices with a view to taking action against those who engage in anti-competitive practices.

Congress has clearly armed the Commission with the authority to prohibit anti-competitive activities and it will be incumbent on us to more aggressively scrutinize practices that may have an anti-competitive impact.

I am also pleased that both the legislation and the proposed rulemaking are largely consistent, as Commissioner Campos said, with international codes of conduct for credit rating agencies. Indeed, the credit rating business crosses national boundaries and consistency with international norms minimizes the costs to regulated entities, which is certainly something that we all favor to the fullest extent possible.

I just have one or two sort of thoughts and questions. Again, I know we are all very concerned about the
notching. As I noted in my remarks, notching has a very big impact. It seems to me that what we really need to make clear is that these kinds of practices that have such a high impact, we will give heightened scrutiny with respect to our oversight of these practices.

We talked about recordkeeping. Is it clear that even in the absence of a record, we can scrutinize these practices and ask for data in order to determine whether these practices are anti-competitive?

MR. SIRRI: Yes, it is. I think the mention of recordkeeping was to ensure that the information would be available. When we went to an NRSRO and said we want to investigate whether there is an anti-competitive version of notching going on here, that records would be kept that would aid us in coming to a determination.

COMMISSIONER NAZARETH: Can we specifically ask these NRSROs to provide us with data to justify why they are engaging in these practices?

MR. SPRATT: The Commission has the same authority under this rule as under broker-dealer to require reports and to examine all the books and records. The Commission has the right to examine all their records and to require reports.

COMMISSIONER NAZARETH: There may not be books and records that have been created that justifies this practice. It may be the economic data that would show in fact there is
not a justification for the level of notching, for instance, that is occurring.

MR. SPRATT: The agency can say they can justify their notching practice based on their prior history. We can test whether or not they are notching. We know their notching schedule is something they will have. We can then compare that and see what their rationale is, to see whether or not their notching is justifiable.

COMMISSIONER NAZARETH: I think a point that Eric made earlier is very important. It has not sort of traditionally been so clearly in our mandate as this legislation is, for us to look at anti-competitive practices. It is going to be incumbent on us to embrace that responsibility and to develop whatever internal expertise is necessary to do this appropriately. We are an agency that has no shortage of securities lawyers, and the economists will help us a bit.

MR. SPRATT: In that spirit, we tried to identify the types of data that would be relevant to this sort of analysis, and have requested that data be included in the books and records requirement. I think that is why Eric summarized it in the way that he did.

COMMISSIONER NAZARETH: Thank you.

I know there was a suggestion earlier and concerns raised about the staff not doing a qualitative analysis with
respect to what comes in on these applications. I understand the tension that we have between not having this process held up inordinately.

Clearly, if we are going to keep to these time frames and the staff sends these packages to the Commission, somewhere along the line Congress intends for this process to have integrity and they intended this legislation and the rulemaking under it to further the goals of integrity.

I assume that when the staff sends these packages to the Commission, they will make a recommendation. I, for one, if I get a package that has all the requisite number of pages and purports to satisfy the requirements of the rules but does not, I will not vote in favor of it.

Rest assured, somewhere along the line, a decision will be made based on the qualitative determinations of what is in that package. I just wanted to make that point.

Thank you.

CHAIRMAN COX: Thank you. Commissioner Casey?

COMMISSIONER CASEY: I would like to start as well by commending the staff for the work that they have done with a fairly ambitious time table. I commend you on all that you have put forward in the rules we see today.

As I stated when we voted to proposals that were in final form before us, passage of the Credit Rating Agency Reform Act of 2006, it sends a clear and unmistakable message
from Congress that it is dissatisfied with the status quo, and expected the Commission to use its new authority under the Act to promote accountability, transparency and competition in the credit rating industry.

Keeping this message clearly in mind, it is incumbent on the Commission to adopt rules for NRSROs that mirror the intent of Congress as closely as possible. Congress wished the registration process for NRSROs to become more transparent, and I believe the process under the new rules does more clearly identify the criteria to become an NRSRO, and narrow the time frames for the processing of applications.

I am pleased that the staff has eliminated or reduced some of the information requests from Form NRSRO as well as the ongoing books and records requirements. There were commentor views in whether the rules pertained to any vestitures and the anti-competitive effects of the prior regulatory approach to NRSROs.

The statute's definition of "credit rating agency" speaks in terms of agencies that make their credit ratings accessible via the Internet or other readily accessible means for free or for a reasonable fee. The adopting release does not define the term "reasonable fee." Instead, citing the need for additional experience to assess the bounds and what is reasonable.
The Commission will require the disclosure of fees by credit rating agencies that do not make their ratings available for free.

While I support the proposals today, I do question this approach. In addition to the obvious disadvantages of having the Commission involved in deciding the appropriate level of fees, the Commission scrutiny of fees -- agencies that charge fees for ratings that are subsidized by the issuers and make their ratings available for free will not be caught up in the "reasonable fees" determination.

Credit rating agencies that operate on a subscription basis, bundling their ratings and their analysis, and charging one fee for both, will run into a real problem. I question a rule that treats business models differently, whether that truly levels the playing field that was anticipated under the law.

Going forward under our new process, I hope that the Commission will interpret the statute's reasonable fee language broadly. I am certain that Congress did not intend that the reference to a reasonable fee would provide a basis for making it more difficult for subscription model credit rating agencies to gain NRSRO status. If the consequences of our interpretation is to support the goal of increasing competition, I question
whether we are achieving the spirit if not the letter of the law.

I found the comments received very helpful in providing an initial assessment of our success in achieving the goals Congress set. The most common area was the notching issue, as many of the Commissioners have noted.

Notching is a very difficult issue and there is no easy answer. While we recognize the concerns expressed by the various NRSROs of the effects of this practice, we do not have sufficient capability or experience at this time to make the findings of unfair, abusive and coercive practices required by Congress.

Therefore, I believe the modified approach we have taken is a sensible one. Additional recordkeeping by NRSROs and scrutiny by Commission examiners will provide a basis for further Commission actions if that is deemed necessary.

All and all, I believe that the rules that we adopt today will go far towards improving our oversight of credit rating agencies to the extent provided under the Act, credit rating agencies play an important role in our securities markets and Congress has placed on us the responsibility to ensure that NRSROs meet certain minimum standards, disclosure of their policies and procedures, including policies for managing conflicts of interest and handling material non-public information is accurate, and that certain unfair
and coercive practices are prohibited.

As we move forward, we must exercise our oversight authority cautiously and judicially. Having said that, I very much support the oversight system, and to better our understanding of NRSROs practices including notching practices, the more effective our oversight will be.

I have one question and one comment. I very much appreciate the response to the questions put forward regarding when an application is considered complete and properly executed. I think there was a concern that the application process takes an inordinate amount of time in order to be considered complete and executed.

I appreciate the response in that regard.

I also have one question. In the proposing, again, in the adopting releases, the information required on Form NRSRO and the exhibits is necessary to assess the adequacy of an applicant’s financial or managerial resources, yet we do not have an indication of what the standards for accepting financial or managerial resources are.

What are our standards?

MR. SPRATT: The idea that they have the managerial and financial resources to do the role which they are actually doing, that is they have enough of that to do what they are actually doing, and taking that into the foreseeable future.
It is a facts and circumstances thing. In this case, what are they doing with the money and the management they have. I think we have to determine that after examination and based on our experience with these folks.

I do not think that will be a difficult thing in most cases.

COMMISSIONER CASEY: The only concern I have, as we discussed, that other commentors have raised, whether or not we would be trying to say you have to have a certain amount of personnel.

MR. SIRRI: I think the standard here would be -- we would expect there to be a number of models that come to the floor. There might be a very labor intensive model, where you meet with management and you have a lot of analysts who crunch numbers. There could very well be other models that we don't have at least very often today at the NRSRO level that are purely analytical, number crunching on a computer. There, your resources would be the number of people you have, both managerial and financial would be a fraction of that, which is required in the other.

I think what Mike was saying is it is a portionality factor. You look at what their technology is, do they have the resources, both financial and managerial, and the other, which makes no sense, to require a lot of financial and managerial resources with a small amount of
people and a small amount of technology.

COMMISSIONER CASEY: I appreciate that very much.

I have no further questions.

VOTE

CHAIRMAN COX: If there are no further questions, the question now is on approving implementation of the provisions of the Credit Rating Agency Reform Act of 2006.

Does the Commission vote to adopt rules to implement provisions of the Credit Rating Agency Reform Act of 2006, define the term "nationally recognized statistically rating organization," provide authority for the Commission to implement registration recordkeeping, financial reporting and oversight rules with respect to registered credit rating agencies, and direct the Commission to issue final implementing rules?

COMMISSIONER ATKINS: Yes.

COMMISSIONER CAMPOS: Yes.

COMMISSIONER NAZARETH: Yes.

COMMISSIONER CASEY: Yes.

CHAIRMAN COX: Yes. The recommendation is approved. Thank you very much for your presentations and helping us with questions and answers.

There is no further business to come before the meeting, so the meeting is adjourned.

I will just announce that our annual awards
ceremony will be starting in this room in a short while, and then we have several special guests, including five former Commissioners -- I should say five former Chairmen of the Securities and Exchange Commission, so I look forward to seeing you all there.

(Whereupon, at 1:40 p.m., the opening meeting was adjourned.)