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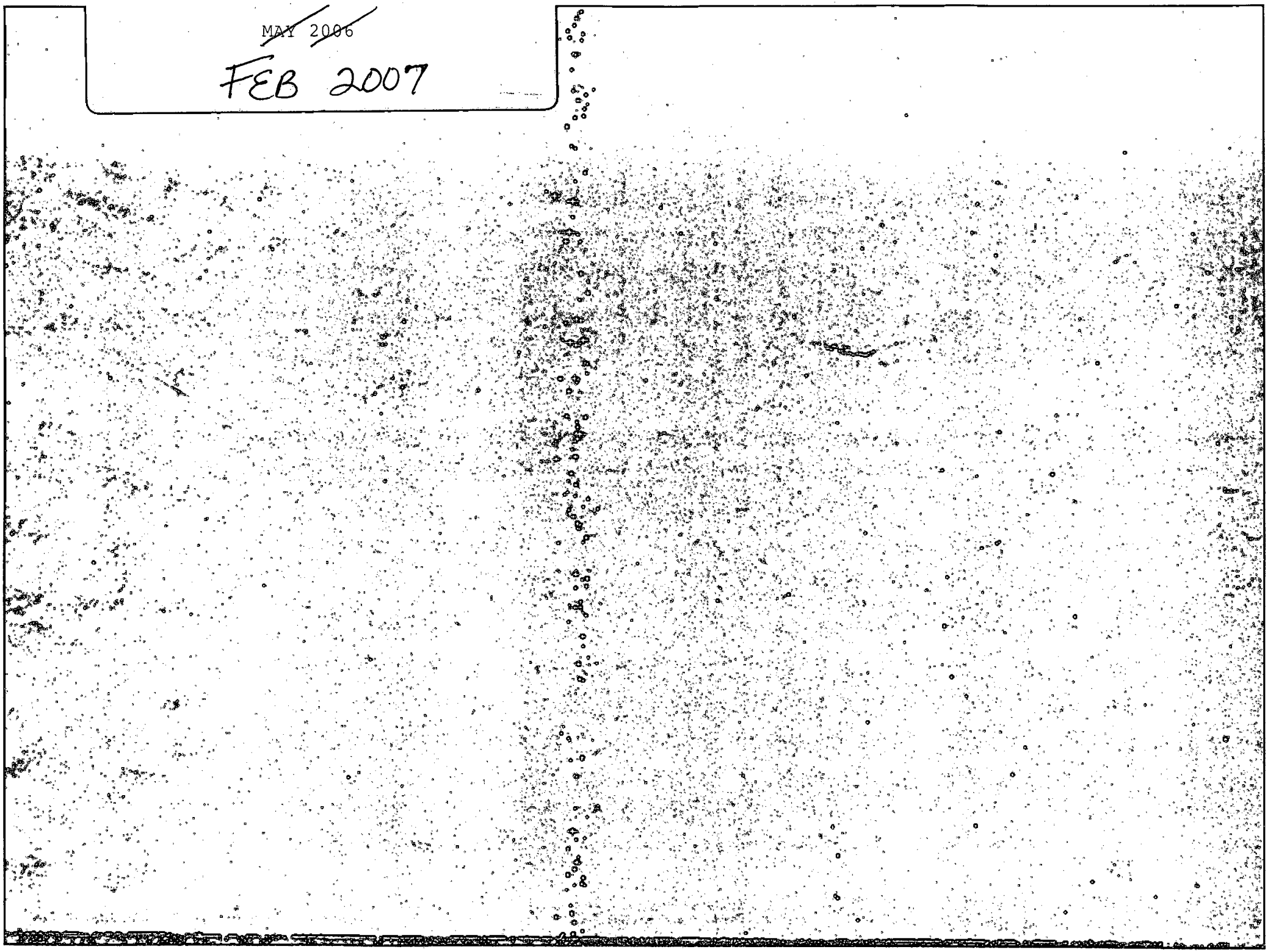


SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for February 2007, with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

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

CHRISTOPHER COX, CHAIRMAN

CYNTHIA A. GLASSMAN, COMMISSIONER

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE L. NAZARETH, COMMISSIONER

1 Document

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
February 8, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12565

In the Matter of	
Airstar Technologies, Inc., Amdiv.com, Inc., ATM Holdings, Inc., Antares Capital Corp., Bre Consulting Group, Inc., and Cerplex Group, Inc.,	**ORDER INSTITUTING PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**
Respondents.	

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Airstar Technologies, Inc. (CIK No. 771160) is a Nevada corporation located in Palm Springs, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Airstar is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1998, which reported net losses from operations of $6 million.

2. Amdiv.com, Inc. (CIK No. 1052924) is a revoked Nevada corporation located in Los Angeles, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Amdiv.com is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended November 30, 1998, which reported a net loss of $1.7 million.

3. ATM Holdings, Inc. (CIK No. 1040199) is a revoked Nevada corporation located in Canoga Park, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). ATM is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB registration statement on March 30, 1998.

4. Antares Capital Corp. (CIK No. 852816) is a Colorado corporation located in Irvine, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Antares is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001, which reported that the company had no assets and a net loss from operations of $3,194 for the prior three months.

5. Bre Consulting Group, Inc. (CIK No. 1056884) is a delinquent Colorado corporation located in Long Beach, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Bre Consulting is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported that the company had a net loss from operations of $41,841 for the prior three months.

6. Cerplex Group, Inc. (CIK No. 319237) is a Delaware corporation located in Irvine, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Cerplex is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 24, 2000, which reported that the company had net losses of over $13 million. On July 27, 2000, Cerplex filed a Chapter 11 bankruptcy petition in the U.S. Bankruptcy Court for the District of Delaware that was converted to a Chapter 7 proceeding on January 31, 2001.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports (Forms 10-K or 10-KSB), and Rule 13a-13 requires issuers to file quarterly reports (Forms 10-Q or 10-QSB).

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

III.

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

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

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities of the Respondents identified in Section II registered pursuant to Section 12 of the Exchange Act.

IV.

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

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

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

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means of verifiable delivery.

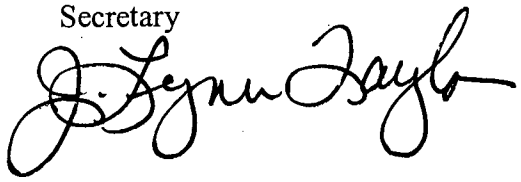
IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

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

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

By the Commission.

Nancy M. Morris
Secretary



By: J. Lynn Taylor
Assistant Secretary

Attachment

Chart of Delinquent Filings
Airstar Technologies, Inc., et al.

Company Name	Form Type		Due Date	Date Received	Months Delinquent (rounded up)
Airstar Technologies, Inc.					
	10-KSB	12/31/97	03/31/98	Not filed	107
	10-KSB	12/31/98	03/31/99	Not filed	95
	10-QSB	03/31/99	05/17/99	Not filed	93
	10-QSB	06/30/99	08/16/99	Not filed	90
	10-QSB	09/30/99	11/15/99	Not filed	87
	10-KSB	12/31/99	03/30/00	Not filed	83
	10-QSB	03/31/00	05/15/00	Not filed	81
	10-QSB	06/30/00	08/14/00	Not filed	78
	10-QSB	09/30/00	11/14/00	Not filed	75
	10-KSB	12/31/00	04/02/01	Not filed	70
	10-QSB	03/31/01	05/15/01	Not filed	69
	10-QSB	06/30/01	08/14/01	Not filed	66
	10-QSB	09/30/01	11/14/01	Not filed	63
	10-KSB	12/31/01	04/01/02	Not filed	58
	10-QSB	03/31/02	05/15/02	Not filed	57
	10-QSB	06/30/02	08/14/02	Not filed	54
	10-QSB	09/30/02	11/14/02	Not filed	51
	10-KSB	12/31/02	03/31/03	Not filed	47
	10-QSB	03/31/03	05/15/03	Not filed	45
	10-QSB	06/30/03	08/14/03	Not filed	42
	10-QSB	09/30/03	11/14/03	Not filed	39
	10-KSB	12/31/03	03/30/04	Not filed	35
	10-QSB	03/31/04	05/17/04	Not filed	33
	10-QSB	06/30/04	08/16/04	Not filed	30
	10-QSB	09/30/04	11/15/04	Not filed	27
	10-KSB	12/31/04	03/31/05	Not filed	23
	10-QSB	03/31/05	05/16/05	Not filed	21
	10-QSB	06/30/05	08/15/05	Not filed	18
	10-QSB	09/30/05	11/14/05	Not filed	15
	10-KSB	12/31/05	03/31/06	Not filed	11
	10-QSB	03/31/06	05/15/06	Not filed	9
	10-QSB	06/30/06	08/14/06	Not filed	6
	10-QSB	09/30/06	11/14/06	Not filed	3
Total Filings Delinquent	33				

Company Name	Form Type		Due Date	Date Received	Months Delinquent (rounded up)
Amdiv.com, Inc.					
	10-QSB	02/28/99	04/14/99	Not filed	94
	10-QSB	05/31/99	07/15/99	Not filed	91
	10-KSB	08/31/99	11/29/99	Not filed	87
	10-QSB	11/30/99	01/14/00	Not filed	85
	10-QSB	02/29/00	04/14/00	Not filed	82
	10-QSB	05/31/00	07/17/00	Not filed	79
	10-KSB	08/31/00	11/29/00	Not filed	75
	10-QSB	11/30/00	01/16/01	Not filed	73
	10-QSB	02/28/01	04/16/01	Not filed	70
	10-QSB	05/31/01	07/16/01	Not filed	67
	10-KSB	08/31/01	11/29/01	Not filed	63
	10-QSB	11/30/01	01/14/02	Not filed	61
	10-QSB	02/28/02	04/15/02	Not filed	58
	10-QSB	05/31/02	07/15/02	Not filed	55
	10-KSB	08/31/02	11/29/02	Not filed	51
	10-QSB	11/30/02	01/14/03	Not filed	49
	10-QSB	02/28/03	04/14/03	Not filed	46
	10-QSB	05/31/03	07/15/03	Not filed	43
	10-KSB	08/31/03	12/01/03	Not filed	38
	10-QSB	11/30/03	01/14/04	Not filed	37
	10-QSB	02/28/04	04/13/04	Not filed	34
	10-QSB	05/31/04	07/15/04	Not filed	31
	10-KSB	08/31/04	11/29/04	Not filed	27
	10-QSB	11/30/04	01/14/05	Not filed	25
	10-QSB	02/28/05	04/14/05	Not filed	22
	10-QSB	05/31/05	07/15/05	Not filed	19
	10-KSB	08/31/05	11/29/05	Not filed	15
	10-QSB	11/30/05	01/16/06	Not filed	13
	10-QSB	02/28/06	04/14/06	Not filed	10
	10-QSB	05/31/06	07/15/06	Not filed	7
	10-KSB	08/31/06	11/29/06	Not filed	3
	10-QSB	11/30/06	01/14/07	Not filed	1

Total Filings Delinquent 32

Company Name	Form Type		Due Date	Date Received	Months Delinquent (rounded up)
ATM Holdings, Inc.					
	10-QSB	06/30/98	08/14/98	Not filed	102
	10-QSB	09/30/98	11/16/98	Not filed	99
	10-KSB	12/31/98	03/31/99	Not filed	95
	10-QSB	03/31/99	05/17/99	Not filed	93
	10-QSB	06/30/99	08/16/99	Not filed	90
	10-QSB	09/30/99	11/15/99	Not filed	87
	10-KSB	12/31/99	03/30/00	Not filed	83
	10-QSB	03/31/00	05/15/00	Not filed	81
	10-QSB	06/30/00	08/14/00	Not filed	78
	10-QSB	09/30/00	11/14/00	Not filed	75
	10-KSB	12/31/00	04/02/01	Not filed	70
	10-QSB	03/31/01	05/15/01	Not filed	69
	10-QSB	06/30/01	08/14/01	Not filed	66
	10-QSB	09/30/01	11/14/01	Not filed	63
	10-KSB	12/31/01	04/01/02	Not filed	58
	10-QSB	03/31/02	05/15/02	Not filed	57
	10-QSB	06/30/02	08/14/02	Not filed	54
	10-QSB	09/30/02	11/14/02	Not filed	51
	10-KSB	12/31/02	03/31/03	Not filed	47
	10-QSB	03/31/03	05/15/03	Not filed	45
	10-QSB	06/30/03	08/14/03	Not filed	42
	10-QSB	09/30/03	11/14/03	Not filed	39
	10-KSB	12/31/03	03/30/04	Not filed	35
	10-QSB	03/31/04	05/17/04	Not filed	33
	10-QSB	06/30/04	08/16/04	Not filed	30
	10-QSB	09/30/04	11/15/04	Not filed	27
	10-KSB	12/31/04	03/31/05	Not filed	23
	10-QSB	03/31/05	05/16/05	Not filed	21
	10-QSB	06/30/05	08/15/05	Not filed	18
	10-QSB	09/30/05	11/14/05	Not filed	15
	10-KSB	12/31/05	03/31/06	Not filed	11
	10-QSB	03/31/06	05/15/06	Not filed	9
	10-QSB	06/30/06	08/14/06	Not filed	6
	10-QSB	09/30/06	11/14/06	Not filed	3

Total Filings Delinquent *34*

Company Name	Form Type		Due Date	Date Received	Months Delinquent (rounded up)
Antares Capital Corp.					
	10-QSB	06/30/01	08/14/01	Not filed	66
	10-QSB	09/30/01	11/14/01	Not filed	63
	10-KSB	12/31/01	04/01/02	Not filed	58
	10-QSB	03/31/02	05/15/02	Not filed	57
	10-QSB	06/30/02	08/14/02	Not filed	54
	10-QSB	09/30/02	11/14/02	Not filed	51
	10-KSB	12/31/02	03/31/03	Not filed	47
	10-QSB	03/31/03	05/15/03	Not filed	45
	10-QSB	06/30/03	08/14/03	Not filed	42
	10-QSB	09/30/03	11/14/03	Not filed	39
	10-KSB	12/31/03	03/30/04	Not filed	35
	10-QSB	03/31/04	05/17/04	Not filed	33
	10-QSB	06/30/04	08/16/04	Not filed	30
	10-QSB	09/30/04	11/15/04	Not filed	27
	10-KSB	12/31/04	03/31/05	Not filed	23
	10-QSB	03/31/05	05/16/05	Not filed	21
	10-QSB	06/30/05	08/15/05	Not filed	18
	10-QSB	09/30/05	11/14/05	Not filed	15
	10-KSB	12/31/05	03/31/06	Not filed	11
	10-QSB	03/31/06	05/15/06	Not filed	9
	10-QSB	06/30/06	08/14/06	Not filed	6
	10-QSB	09/30/06	11/14/06	Not filed	3
Total Filings Delinquent	22				
Bre Consulting Group, Inc.					
	10-KSB	12/31/02	03/31/03	Not filed	47
	10-QSB	03/31/03	05/15/03	Not filed	45
	10-QSB	06/30/03	08/14/03	Not filed	42
	10-QSB	09/30/03	11/14/03	Not filed	39
	10-KSB	12/31/03	03/30/04	Not filed	35
	10-QSB	03/31/04	05/16/04	Not filed	33
	10-QSB	06/30/04	08/16/04	Not filed	30
	10-QSB	09/30/04	11/15/04	Not filed	27
	10-KSB	12/31/04	03/31/05	Not filed	23

Company Name	Form Type		Due Date	Date Received	Months Delinquent (rounded up)
	10-QSB	03/31/05	05/16/05	Not filed	21
	10-QSB	06/30/05	08/15/05	Not filed	18
	10-QSB	09/30/05	11/14/05	Not filed	15
	10-KSB	12/31/05	03/31/06	Not filed	11
	10-QSB	03/31/06	05/15/06	Not filed	9
	10-QSB	06/30/06	08/14/06	Not filed	6
	10-QSB	09/30/06	11/14/06	Not filed	3
Total Filings Delinquent	16				
Cerplex Group, Inc.					
	10-K	09/30/00	12/29/00	Not filed	74
	10-Q	12/30/00	02/13/01	Not filed	72
	10-Q	03/31/01	05/15/01	Not filed	69
	10-Q	06/30/01	08/14/01	Not filed	66
	10-K	09/29/01	12/28/01	Not filed	62
	10-Q	12/29/01	02/12/02	Not filed	60
	10-Q	03/30/02	05/14/02	Not filed	57
	10-Q	06/29/02	08/13/02	Not filed	54
	10-K	09/28/02	12/27/02	Not filed	50
	10-Q	12/28/02	02/11/03	Not filed	48
	10-Q	03/29/03	05/13/03	Not filed	45
	10-Q	06/28/03	08/12/03	Not filed	42
	10-K	09/27/03	12/26/03	Not filed	38
	10-Q	12/27/03	02/10/04	Not filed	36
	10-Q	03/27/04	05/11/04	Not filed	33
	10-Q	06/26/04	08/10/04	Not filed	30
	10-K	09/25/04	12/24/04	Not filed	26
	10-Q	12/25/04	02/08/05	Not filed	24
	10-Q	03/26/05	05/10/05	Not filed	21
	10-Q	06/25/05	08/09/05	Not filed	18
	10-K	09/24/05	12/23/05	Not filed	14
	10-Q	12/31/05	02/14/06	Not filed	12
	10-Q	03/25/06	05/09/06	Not filed	9
	10-Q	06/24/06	08/08/06	Not filed	6
	10-K	09/23/06	12/22/06	Not filed	2
Total Filings Delinquent	20				

SECURITIES AND EXCHANGE COMMISSION

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

CHRISTOPHER COX, CHAIRMAN

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE L. NAZARETH, COMMISSIONER

KATHLEEN L. CASEY, COMMISSIONER

22 Documents

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

January 17, 2007

IN THE MATTER OF FOREST RESOURCES MANAGEMENT CORP.	ORDER OF SUSPENSION OF TRADING
File No. 500-1	

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Forest Resources Management Corp. ("Forest") because of questions raised regarding the accuracy and adequacy of publicly disseminated information concerning, among other things, Forest's assets and Forest's announced contracts and agreements.

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

Therefore, it is ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above-listed company is suspended for the period from 9:30 a.m. EST, January 17, 2007, through 11:59 p.m. EST, on January 30, 2007.

By the Commission.

Nancy M. Morris
Secretary

Document 1 of 22

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8779 / February 1, 2007

SECURITIES EXCHANGE ACT OF 1934
Release No. 55224 / February 1, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12557

In the Matter of

TEMPLE SECURITIES, LTD., and

GREGORY GREATREX,

Respondents.

Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and Cease-and-Desist Orders Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Temple Securities, Ltd., ("Temple Securities") and Gregory Greatrex ("Greatrex")(collectively "Respondents").

II.

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

Sanctions and Cease-and-Desist Orders Pursuant to Section 8A of the Securities Act of 1933 and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

Summary

This matter involves violations of the securities registration provisions by Greatrex and Temple Securities, an offshore broker-dealer which, among other things, offers and sells securities on behalf of its clients through brokerage accounts maintained in the U.S. and Temple Securities' violation of the brokerage registration provisions of the Exchange Act.

Respondents participated in the unregistered, non-exempt distributions of over 900,000 shares of stock of Allixon International Corporation ("Allixon") on behalf of two brokerage customers, who were control persons of Allixon. The proceeds from these sales totaled in excess of $4 million. In addition, Temple Securities participated in the unregistered, non-exempt distributions of stock of PSI-TEC Holdings, Inc., ("PSI-TEC"). Temple Securities, at a customer's request, publicly sold 250,000 PSI-TEC shares on behalf of its customer who received approximately $663,000 in sales proceeds. The shares of both Allixon and PSI-TEC were quoted in the Pink Sheets.

No registration statement was filed with the Commission or in effect at the time of the offers or sales of the Allixon or PSI-TEC securities and the transactions were not exempt from registration. Further, Temple Securities was not registered with the Commission as a broker or dealer.

Respondents

A. Temple Securities is a broker-dealer registered in the Turks and Caicos Islands, BWI. Temple Securities' website advertises its trading and brokerage services and provides information on opening an account.

B. Greatrex is an attorney licensed in Ontario, Canada, and employed in the Turks and Caicos Islands, BWI, by Temple Trust, Ltd., an affiliate of Temple Securities, Ltd.

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

Other Relevant Entities

C. Allixon is a company incorporated under the laws of the State of Delaware whose principal place of business is located in Seoul, South Korea. Allixon's stock is traded in the Pink Sheets under the symbol AXCP. Allixon has not filed a registration statement with the Commission and is not a public reporting company.

D. PSI-TEC is a non-reporting company incorporated under the laws of the State of Delaware whose principal place of business is located Wilmington. PSI-TEC's stock is traded in the Pink Sheets under the symbol PHTO. PSI-TEC was formerly known as Eastern Idaho Internet Services, Inc. PSI-TEC has never registered any securities offerings with the Commission or any state or filed any reports with the Commission.

E. Crescendo Investments, Inc. ("Crescendo Investments"), and Silver Lake Investments, Inc. ("Silver Lake Investments") are corporate entities formed under the laws of the Turks and Caicos. These entities were formed by Sheldon Cohen ("Cohen") and Todd Heinzl ("Heinzl"), Canadian citizens, with the assistance of Greatrex, an employee of Temple Trust Company, Ltd., an affiliate of Temple Securities. After these entities were formed, Cohen and Heinzl opened brokerage accounts at Temple Securities in the name of Crescendo Investments and Silver Lake Investments, respectively.

Background

F. Temple Securities is a broker-dealer authorized to do business in the Turks and Caicos Islands, British West Indies. Temple Securities solicits customers through its website where it advertises its trading and brokerage services. Persons located in the United States have access to Temple Securities' website through the Internet. Temple Securities is not registered with the Commission as a broker or dealer.

G. In the course of its business, Temple Securities, on behalf of its customers, has placed and continues to place securities for sale with brokerage firms in the United States. The firm does not employ persons who have any expertise in the securities laws of the United States nor has it developed and implemented policies or procedures designed to ensure that its activities on behalf of its customers in the U.S. markets comply with the requirements of the U.S. securities laws.

H. Cohen and Heinzl, while acting on behalf of and for the benefit for Allixon and themselves, facilitated a reverse merger between a South Korean entity known as Allixon, Ltd., and Classic Vision Entertainment, Inc., a public shell company traded on the pink sheets. Classic Vision's name was changed after the merger to "Allixon International Corporation, Inc." and Cohen served as the corporate secretary of the public entity after the reverse merger was completed.

I. Contemporaneously with the reverse merger, Cohen and Heinzl caused shares of Allixon to be issued to two corporate entities, Silver Lake Investments and Crescendo Investments,

pursuant to Rule 504 of Regulation D. Prior to the issuance of the shares to Crescendo Investments and Silver Lake Investments, Cohen and Heinzl, with the assistance of Respondents, formed Crescendo Investments and Silver Lake Investments as corporate entities under the laws of the Turks and Caicos. According to Temple Trust's records, Cohen is the sole beneficial owner of Crescendo Investments and Heinzl is the sole beneficial owner of Silver Lake Investments. After these entities were formed, Cohen and Heinzl opened brokerage accounts at Temple Securities in the name of Crescendo Investments and Silver Lake Investments, respectively.

J. In July 2005, Respondents participated in the negotiation of an Escrow Agreement (the "Escrow Agreement") requested by Cohen and Heinzl that specified that shares issued to Silver Lake Investments and Crescendo Investments were to be sold for the purpose of paying the transaction costs of the reverse merger between Classic Vision and Allixon. The Escrow Agreement expressly provided:

> "Shareholders are the owners of an aggregate of 1,300,000 shares of the issued and outstanding Common Stock, (the "Stock"), of Allixon, Inc., a corporation organized under the laws of Delaware (the "Company").
>
> "Shareholders desire to pay the obligation of $235,000 Plus [sic] expenses representing the costs associated with the merger of Classic Vision Entertainment and Allixon (the "Transaction Cost") within a 30 day period, from the resale of a portion of the purchased stock."
>
> "Shareholders agree as a part of this escrow agreement that no sales of Stock are to be sold at a value of less than $1.00 per share. Further, Shareholders agree to authorize a representative (to be determined) to have complete authorization over all the sales of Stock throughout the terms of this escrow agreement."
>
> "Shareholders have requested that the Escrow Agent hold the Stock and distribute the funds Per Exhibit "A" accordingly as created by resale of of [sic] a portion of escrowed Stock, in an effort to pay the transaction cost as well as any other fees and costs, in escrow pursuant to the terms of this Agreement."

K. The Escrow Agreement represented that the shares being acquired by Silver Lake Investments and Crescendo Investments were issued pursuant to Allixon's purported Rule 504 offering under Regulation D and that Silver Lake Investments and Crescendo Investments were acquiring the Allixon shares with a view toward distributing the shares to the public. An officer of Temple Securities signed the document on behalf of Silver Lake Investments and Crescendo Investments and Greatrex signed the document on behalf of Temple Trust.

L. Allixon never filed a registration statement with the Commission or any state in compliance with Rule 504(b)(1)(i), and accordingly, there was never a valid registration statement in effect with respect to the sale of its shares. Allixon caused its transfer agent to issue 500,000 shares in a single certificate to Silver Lake Investments and 800,000 shares in four certificates in the name of Crescendo Investments and, thereafter, to send those shares to Temple Securities'

offices in the Turks and Caicos.[2] The 1.3 million shares represented 94% of the public float of Allixon stock. In July and August 2005, Respondents learned that Cohen and Heinzl intended to sell their Allixon shares in coordination with the issuance of press releases by Allixon and a public relations campaign by an investor relations group.

M. On July 28, 2005, Greatrex asked Cohen to obtain representations from Allixon and its transfer agent that the shares were eligible for trading. On the same day, Temple Securities received letters, purportedly from Allixon, representing that the shares were eligible for trading. On August 5, 2005, persons within the offices of Temple Securities returned two of the share certificates, each in the amount of 500,000 shares, to the transfer agent and requested that the share certificates issued to Silver Lake Investments and Crescendo Investments be re-issued in the name of Temple Securities. On August 8, 2005, the transfer agent caused two new 500,000 share certificates to be issued in the name of and returned to Temple Securities. The certificates returned to Temple Securities bore certificate numbers 2564 and 2565. Each share certificate was signed by Sheldon Cohen as the "Secretary" of Allixon. On or around August 15, 2005, Temple Securities caused both certificates to be delivered to a U.S. brokerage firm where it maintained an account in its own name and claimed to own the full beneficial interest in the account.

N. Greatrex made repeated requests pursuant to then-current policies and controls of Temple Securities that Cohen and Heinzl provide a letter opinion of counsel that the shares held by Crescendo Investments and Silver Lake Investments could be sold into the U.S. markets. Despite not receiving the letter requested or otherwise conducting appropriate due diligence under standards applicable to broker-dealers in the United States, Respondents began selling Allixon shares on August 29, 2005, at the customers' request, coincident with Allixon's issuance of a press release announcing its reverse merger with Classic Vision and the dissemination of spam emails touting the company. Temple Securities continued to sell shares of Allixon through its account at a U.S. brokerage firm and allowed Cohen and Heinzl to access the funds realized from the sale of the Allixon stock.[3] Greatrex also pointed out to Cohen that there was no reliable financial data generally available to investors concerning Allixon.

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[2] The Allixon shares were issued by the transfer agent without a restrictive legend based on instructions from Allixon's outside counsel Hank Vanderkam of Houston, Texas, whose opinion letter of July 15, 2005, advised that the securities were "sold pursuant to Section (sic) 504 of Regulation D." Respondents also received a copy of Vanderkam's letter prior to August 29, 2005. On February 1, 2007, the Commission filed a civil injunctive action against Vanderkam alleging he violated the federal securities laws in connection with his participation in the unregistered distribution of Allixon shares. See Lit. Rel. 19987 (Feb. 1, 2007).

[3] On September 27, 2005, after Respondents had already sold approximately 450,000 Allixon shares into the U.S. market for approximately $2.2 million, Respondents received a "stock certificate information form" from Allixon's U.S. counsel. The form stated, among other things, that there was no restriction on the resale of the Allixon share certificates issued to Crescendo Investments and Silver Lake Investments. However, the law firm further noted on the form that it was "not aware of any persons who would be considered control persons as defined by federal securities regulations." In fact, as the Respondents knew, or were reckless in not knowing, Cohen and Heinzl, and their respective entities, Crescendo Investments and Silver Lake Investments, were control persons of Allixon. As a result, the Allixon shares issued to Crescendo Investments and Silver Lake Investments were control shares as well as restricted securities.

O. Respondents knew, or were reckless in not knowing, that proceeds from Temple Securities' unregistered distribution of Allixon stock were being used to pay for the merger of the company and for the promotional campaign by the investor relations group hired by Cohen and Heinzl. On September 19, 2005, Cohen directed Temple Securities to cause the sum of $175,000 to be paid from his Crescendo Investments account to pay a portion of the merger costs. On September 21, 2005, Greatrex received a letter acknowledging that "all of the terms of the Escrow Agreement dated July 7, 2005, have been satisfied."

P. Temple Securities sold over 943,000 shares of Allixon stock on behalf of its customers for more than $4.3 million in proceeds. Temple Securities received $234,510 in commissions from the sale of the Allixon stock on behalf of Crescendo Investments and Silver Lake Investments.

Q. In or about April 2005, PSI-TEC issued four million shares to seven purported Texas residents pursuant to a Rule 504 offering. In connection with that offering, on or about April 5, 2005, PSI-TEC, filed a "Notice of Sale of Securities Pursuant to Accredited Investor Exemption" with the State of Texas in which it advised it was offering 4 million shares at $.25 per share for a total offering amount of $ 1 million. The filing further stated:

> The issuer reasonably believes that all purchasers are purchasing for investment and not with the view to or for sale in connection with a distribution of the security. Any resale of a security sold in reliance on this exemption within 12 months of sale, except a resale to an accredited investor or pursuant to a registration statement effective under applicable state securities law, shall be presumed to be with a view to distribution and not for investment. Securities issued under this exemption may only be resold pursuant to registration or an exemption under applicable state securities law.

R. On or about April 8, 2005, PSI-TEC was advised by the State of Texas that its filing would not be valid until PSI-TEC filed a "Consent to Service of Process (Form U-2)" with the State. On June 29, 2005, after PSI-TEC had failed to respond to the April 8 letter, the State advised the company that its filing under Texas law was "incomplete and the exemption is unavailable . . . ."

S. On or around April 26, 2005, at a U.S. customer's request, Temple Securities purchased 500,000 PSI-TEC shares from a purported Texas resident who was an initial purchaser in the PSI-TEC Rule 504 offering. Temple Securities, in turn, at its customer's request, immediately sold the 500,000 PSI-TEC shares to its brokerage customer, who purchased the shares directly from Temple Securities and held the same in his Temple Securities account. Between May 11 and October 31, 2005, Temple Securities, at the direction of the customer, publicly sold approximately 250,000 PSI-TEC shares through an account of Temple Securities at a U.S. broker-dealer in approximately 96 transactions for approximately $663,000. In addition, utilizing an account opening form on the Temple Securities website and through emails, at least two other U.S. customers requested Temple Securities to open brokerage accounts for their benefit, through which the customers also sold shares of PSI-TEC stock. Temple Securities received approximately $16,969 in commissions from its PSI-TEC sales on behalf of its brokerage customers.

T. Temple Securities engaged in solicitations of customers through advertisements on its website. Temple Securities failed to implement the guidance given by the Commission to foreign broker-dealers and, as a result, solicited U.S. customers through its website.[4] Temple Securities engaged in these solicitations despite not being registered as a U.S. broker-dealer and not qualifying for any exemption from U.S. broker-dealer registration requirements.

U. No registration statement was filed with the Commission or was in effect as to the transactions in Allixon and PSI-TEC shares described above. Further, because Temple Securities obtained the Allixon stock from a person directly or indirectly controlling or controlled by Allixon, or under direct or indirect control with Allixon, with a view to distributing the stock to the public, the stock was not exempt from registration. Further, because Temple Securities obtained the PSI-TEC from a person directly or indirectly controlling or controlled by PSI-TEC, or under direct or indirect control with PSI-TEC, with a view to distributing the stock to the public, the stock was not exempt from registration. Therefore, the securities transactions described above violated Sections 5(a) and 5(c) of the Securities Act.

Violations

V. As a result of the conduct described above, Respondents willfully[5] violated Sections 5(a) and 5(c) of the Securities Act, which prohibit the offer and sale of securities through the mails or in interstate commerce, unless a registration statement is filed or in effect as to such securities.

W. Section 3(a)(4) of the Exchange Act defines a broker generally as any person engaged in the business of effecting transactions in securities for the account of others. Temple Securities, as a broker-dealer registered in the Turks and Caicos Islands, BWI, was clearly engaged in the business of effecting transactions in securities for the account of others. Moreover, it used the means and instrumentalities of interstate commerce to conduct its business, as reflected in the services advertised in its website. In particular, Temple Securities acted as a broker when it solicited, through website advertisements, the U.S. customers involved in the PSI-TEC transactions in exchange for transaction-related compensation.

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[4] Temple Securities' advertisements on its website were solicitations that prohibit Temple Securities from relying on Exchange Act Rule 15a-6(a)(1)'s 'unsolicited' exemption from U.S. broker-dealer registration requirements. See Statement of the Commission Regarding Use of Internet Web Sites to Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore, Release Nos. 33-7516, 34-39779, IA-1710, IC-23071, 63 FR 14806 (March 27, 1998) ("Foreign broker-dealers that have Internet Web sites and that intend to rely on Rule 15a-6's 'unsolicited' exemption should ensure that the 'unsolicited' customer's transactions are not in fact solicited, either directly or indirectly, through customers accessing their Web sites. In particular, these broker-dealers could obtain, as a precaution reasonably designed to prevent that result, affirmative representations from potential U.S. customers that they deem unsolicited that those customers have not previously accessed their Web sites.").

[5] "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, Cf. Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965). There is no requirement that the actor also be aware that he is violating one of the Rules or Acts.

X. Subject to limited exemptions, Section 15(a)(1) of the Exchange Act makes it unlawful for any broker or dealer "to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered" in accordance with Section 15(b) of the Exchange Act. During the process of advertising on its website, opening accounts on behalf of two U.S. customers, and facilitating the purchase of the PSI-TEC securities by its brokerage customer, Temple Securities made use of instrumentalities of U.S. interstate commerce to induce and to effect securities transactions in PSI-TEC.[6] Temple Securities was not registered with the Commission pursuant to Section 15(b) of the Exchange Act, and did not qualify for any exemption from U.S. broker-dealer registration requirements with respect to the PSI-TEC transactions. As a result of the conduct described above, Temple Securities willfully violated Section 15(a)(1) of the Exchange Act.

Remedial Actions

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

Undertakings

Z. Respondent Temple Securities undertakes to:

1. Within 15 days after the entry of this Order, Temple Securities will engage an Independent Consultant, who is not unacceptable to the Commission staff, to review, design and assist Temple Securities in implementing policies and procedures to prevent and detect violations of Sections 5(a) and (c) of the Securities Act and Section 15(a) of the Exchange Act. Temple Securities agrees to retain the Independent Consultant at its own expense and it shall implement the policies and procedures recommended by the Independent Consultant within 90 days of the entry of this Order, unless extended by the staff for good cause. Temple Securities further agrees that it will authorize and direct the Independent Consultant to certify in writing to the Commission staff of the Fort Worth District Office whether Temple Securities has implemented the recommended policies and procedures within 90 days of the entry of this Order.

2. For a period of two years following the entry of this Order, Temple Securities shall not hold with any U.S. broker-dealer or offer or sell in the U.S. capital markets any security quoted or traded other than on a national securities exchange or the NASDAQ (including the OTC Bulletin Board), unless (i) it first obtains a written opinion from the Independent Consultant that its conduct does not violate Sections 5(a) or (c), or (ii) Temple received such securities through the Depository Trust & Clearing Corporation and its subsidiaries,

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[6] See Registration Requirements for Foreign Broker-Dealers, Release No. 34-27017, 54 FR 30013 (July 18, 1989) ("virtually any transaction-oriented contact between a foreign broker-dealer and the U.S. securities markets or a U.S. investor in the United States involves interstate commerce and could provide the jurisdictional basis for broker-dealer registration.").

including the Deposit/Withdrawal at Custodian system (DWAC), and the securities are unrestricted.

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

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in Respondent Greatrex and Respondent Temple Securities' Offers.

ACCORDINGLY, IT IS HEREBY ORDERED:

A. Respondent Temple Securities shall cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act or Section 15(a) of the Exchange Act.

B. Respondent Greatrex shall cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act.

C. IT IS FURTHERED ORDERED that Respondent Temple Securities shall, within 45 days of the entry of this Order, pay disgorgement of $251,479 and prejudgment interest of $1,867 for a total amount of $253,346 to the Clerk of Court, U.S. District Court for the Northern District of Texas, to be held in such Court's Court Registry Investment System account established for the matter of *Securities and Exchange Commission v. Allixon International Corp., et al.,* until further order of such Court. Against this amount, Respondent shall be credited $234,510.16, in disgorgement paid, representing funds previously tendered into the registry of the court.

D. IT IS FURTHER ORDERED that Respondent Temple Securities shall, within 45 days of the entry of this Order, pay a civil money penalty in the amount of $15,000 to the Clerk of Court, U.S. District Court for the Northern District of Texas, to be held in such Court's Court Registry Investment System account established for the matter of *Securities and Exchange Commission v. Allixon International Corp., et al.,* until further order of such Court.

E. Respondent Temple Securities shall comply with the undertakings enumerated in Section III.Z. above.

By the Commission.

Nancy M. Morris
Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 55227 / February 2, 2007

Admin. Proc. File No. 3-12245

In the Matter of the Application of

RAGHAVAN SATHIANATHAN
c/o S.T. Allen & Co.
336 Bloomfield Avenue
Montclair, NJ 07042

For Review of Action Taken by

NASD

ORDER DISMISSING PETITION TO REVIEW DENIAL OF "MOTION TO ACCEPT 'AS IS' THE SECOND AMENDED BRIEF IN SUPPORT OF MOTION TO RECONSIDER" ISSUED PURSUANT TO DELEGATED AUTHORITY

Raghavan Sathianathan, formerly associated with Salomon Smith Barney Inc. and Morgan Stanley DW Inc., NASD member firms, petitions for Commission review of an order denying his "Motion to Accept 'As Is' the Second Amended Brief in Support of Motion to Reconsider" issued pursuant to delegated authority. We decline to review the denial of Sathianathan's motion.

On November 8, 2006, the Commission issued an opinion finding that Sathianathan made unsuitable recommendations to two customers in violation of NASD Conduct Rules 2310 and 2110, and exercised discretion in the account of one of those customers without the customer's written authorization in violation of NASD Conduct Rules 2510(b) and 2110 (the "November 8, 2006 Opinion"). 1/ We further found that the sanctions imposed by NASD, barring Sathianathan from associating with any member firm in any capacity, were not excessive or oppressive.

1/ Raghavan Sathianathan, Securities Exchange Act Rel. No. 54722 (Nov. 8, 2006), __ SEC Docket ____.

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On November 20, 2006, Sathianathan filed an illegible facsimile copy of a "Notice of Motion and Motion to Reconsider" the November 8, 2006 Opinion. On November 22, 2006, after the ten-day period for filing such motions had expired, Sathianathan filed a "Notice of Motion and Motion to Reconsider (Amended Version)." Along with the motion, Sathianathan filed a certification referencing the Commission's 14,000-word limit for opening briefs 2/ and stating that his brief contained fewer than 14,000 words. In a letter dated November 29, 2006, the Secretary's Office informed Sathianathan that, because his submission was a motion to reconsider and not an opening brief, it was governed by the length limitations contained in Commission Rule of Practice 154(c). 3/ The Secretary directed Sathianathan to file a certification stating the number of words in the motion to reconsider, which pursuant to Rule 154(c) cannot exceed 7,000, or to submit a modified motion to reconsider conforming to the length limitations in Rule 154 by December 4, 2006. The Secretary informed Sathianathan that no further extensions would be granted.

On December 4, 2006, Sathianathan filed a document entitled "Notice of Motion and Motion to Accept 'As Is' the Second Amended Brief in Support of Motion to Reconsider" and a "Second Amended Brief" which was fifty-four pages long (the "Motion to Accept As Is"). Sathianathan also filed a certification as to the number of words in the document that stated that it contained: "(1) less than 5,100 words in Part A (which is the whistleblower portion of this brief); and (2) less than 5,500 words in Part B (which is the portion of this brief which addresses factual errors made in the SEC's opinion)." The certification also stated that the brief accompanying the Motion to Accept As Is had been divided into two parts, each under the 7,000-word limit, so that the Commission "can consider only one of the two parts, if that is the SEC's preference." The certification did not specify which of the two parts the Commission should consider. On December 20, 2006, the Secretary's Office, acting pursuant to delegated authority, denied Sathianathan's Motion to Accept As Is and informed him that, because the ten-day time limit to file a motion for reconsideration had expired, no further filings would be accepted (the "December 20, 2006 Order").

On December 29, 2006, Sathianathan filed a "Motion to Reconsider December 20, 2006 Order," along with a brief and an affidavit. Sathianathan did not expressly invoke the Commission Rules of Practice governing the appeal of actions made pursuant to delegated authority, and his petition was not made within the required five-day period for such appeals. 4/ Nevertheless, as a matter of our discretion, we will consider his motion as a petition for the

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2/ See Commission Rule of Practice 450(c), 17 C.F.R. § 201.450(c).

3/ 17 C.F.R. § 201.154(c).

4/ See Commission Rules of Practice 430 and 431, 17 C.F.R. §§ 201.430 and 201.431.

Commission to review the December 20, 2006 Order issued by the Secretary's Office pursuant to delegated authority. 5/

We determine whether to review actions taken pursuant to delegated authority under the standards set forth in Commission Rule of Practice 431(b). 6/ Under this Rule, the denial of Sathianathan's Motion to Accept As Is made pursuant to delegated authority is subject to discretionary Commission review. 7/ In determining whether to grant such review, we consider whether the applicant has shown either that "a prejudicial error was committed in the conduct of the proceeding" or that the decision embodies "a finding or conclusion of material fact that is clearly erroneous," "a conclusion of law that is erroneous," or "an exercise of discretion or decision of law or policy that is important and that the Commission should review." 8/

Sathianathan contends that the decision by the Secretary's Office was erroneous in several respects. He argues that the Secretary's November 29, 2006 letter establishes that the Commission accepted and filed his motion to reconsider and that, therefore, he should be allowed to amend his filing. He supports this argument by selectively quoting language in that letter stating that "We are in receipt of your Motion to Reconsider filed on November 22, 2006. This motion was not timely filed, . . . but was accepted in lieu of an illegible facsimile copy that was timely filed." The purpose of the November 29 letter, however, was to inform Sathianathan that his submission did not comply with the length limitations contained in the Commission's Rules of Practice and to provide him with an opportunity to submit a modified brief that conformed to those limitations. Thus, the letter establishes that the acceptance for filing of Sathianathan's motion to reconsider was conditioned on his bringing his brief into compliance with the Commission's Rules of Practice, a condition which he failed to meet.

Sathianathan attempts to distinguish between his motion for reconsideration and his brief in support of the motion and argues that, because his motion was only one page long, it meets the requirements of Commission Rule of Practice 154. This argument is contradicted by the terms of Rule 154. Rule 154(a) provides that "a motion . . . shall be accompanied by a written brief of the

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5/ On January 31, 2007, Sathianathan filed a "Request For Expedited Ruling on the Pending Motion to Reconsider December 20, 2006 Order." That motion is denied as moot.

6/ 17 C.F.R. § 201.431(b).

7/ See 17 C.F.R. §§ 201.431(b)(2), 201.411(b)(2). Sathianathan has not argued that this action is subject to mandatory review, and the denial of his Motion to Accept As Is does not appear to meet any of the requirements for mandatory review set forth in Commission Rule of Practice 411(b)(1). See 17 C.F.R. §§ 201.431(b)(1), 201.411(b)(1)(i)-(iii).

8/ 17 C.F.R. § 201.411(b)(2); see also 17 C.F.R. § 201.431(b)(2) (directing the Commission to consider the factors in Rule 411(b)(2) in determining whether to exercise discretionary review of action taken pursuant to delegated authority).

points and authorities relied upon." Rule 154(c) provides that "[n]o motion (together with the brief in support of the motion) . . . shall exceed 7,000 words . . . ." Rule 154 is unambiguous that the motion and the brief must be considered together for purposes of the length limitations contained in the rule and that the motion is not complete without the accompanying brief. Despite the opportunity afforded by the Secretary's Office, Sathianathan failed to make a filing that conformed with the requirements of Rule 154.

Sathianathan next asserts that his Motion To Accept As Is tolls the time for making the filing at issue and he should be given further opportunity to amend the filing. He cites no authority for this proposition and nothing in the Commission's Rules of Practice provides for such tolling. Moreover, the Secretary's Office already provided Sathianathan with the opportunity to provide two amended filings beyond the ten-day period required for such filings. The Secretary explicitly informed Sathianathan of the length limitations in Rule 154, instructed him to file a brief that conformed to those requirements, and advised that no further extensions would be permitted. Instead of submitting a conforming filing, Sathianathan attempted to circumvent those requirements by dividing his motion into two portions, each of which complied with the length limitations in Rule 154, and then asking the Commission to choose one of the two parts for consideration, "if that is the SEC's preference." Sathianathan is not entitled to have this proceeding indefinitely tolled while he makes repeated non-conforming filings.

In his brief, Sathianathan notes that the Secretary's December 20, 2006 Order does not rule on his motion to reconsider the November 8, 2006 Opinion. Even though Sathianathan was afforded multiple opportunities, he has never made a filing in compliance with the Rules of Practice and, therefore, no motion to reconsider is pending before the Commission. Thus, Sathianathan has failed to establish that the fact that the December 20, 2006 Order does not rule on his motion to reconsider constitutes prejudicial error that necessitates our review.

Accordingly, IT IS ORDERED that the petition of Raghavan Sathianathan for review of the December 20, 2006 Order denying his "Motion to Accept 'As Is' the Second Amended Brief in Support of Motion to Reconsider," issued pursuant to delegated authority be, and it hereby is, dismissed.

By the Commission.

Nancy M. Morris
Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249b

[Release No. 34-55231; File No. S7-04-07]

RIN 3235-AJ78

Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations

AGENCY: Securities and Exchange Commission ("Commission").

ACTION: Proposed rule.

SUMMARY: The Commission is proposing for comment rules to implement provisions of the Credit Rating Agency Reform Act of 2006 (the "Act"), enacted on September 29, 2006. The Act defines the term "nationally recognized statistical rating organization," provides authority for the Commission to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies, and directs the Commission to issue final implementing rules no later than 270 days after its enactment (or by June 26, 2007).

DATES: Comments should be received on or before [***insert date that is 30 days after date of publication in the Federal Register***].

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-04-07 on the subject line; or

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- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-04-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 551-5525; Thomas K. McGowan, Assistant Director, at (202) 551-5521; Randall W. Roy, Branch Chief, at (202) 551-5522; Rose Russo Wells, Attorney, at (202) 551-5527; Sheila Swartz, Attorney, at (202) 551-5545, Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION:

I. BACKGROUND

The credit rating business has expanded significantly over the last 100 years. Credit rating agencies now issue credit ratings for debt securities of public companies, sovereign governments, and municipalities, and for structured products such as asset backed securities. They also issue ratings on money market instruments such as commercial paper and with respect to obligors (that is, a credit assessment of an entity as opposed to the entity's securities). Obligor ratings are issued on, among other entities, public companies, sovereign governments, and non-public companies such as banks and insurance companies.

The scope of the credit rating business reflects the importance of credit ratings to securities market participants and other creditors. Investors use credit ratings to make investment decisions. Large public institutions, such as pension funds, also use credit ratings to prescribe the types of securities the institution is permitted to hold. Creditors, such as commercial and investment banks, use credit ratings to manage credit risk and govern transactional agreements. For example, credit agreements frequently contain trigger provisions requiring more collateral if the creditor's credit rating drops.

In addition, regulatory bodies have come to rely on credit ratings. In 1975, the Commission adopted the term "nationally recognized statistical rating organization" or "NRSRO" as part of amendments to its broker-dealer net capital rule[1] under the Securities Exchange Act of 1934 ("Exchange Act").[2] The net capital rule requires a broker-dealer to maintain a level of net capital generally defined as net worth plus

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1 See Adoption of Amendments to Rule 15c3-1 and Adoption of Alternative Net Capital Requirement for Certain Brokers and Dealers, Exchange Act Release No. 11497 (June 26, 1975), 40 FR 29795 (July 16, 1975) and 17 CFR 240.15c3-1.

2 15 U.S.C. 78a et seq.

subordinated debt less illiquid assets and less percentage deductions on proprietary securities.[3] The net capital rule prescribes specific percentage deductions for various classes of securities based on the liquidity and volatility of the type of security.[4] These deductions, known as "haircuts," are intended to provide a financial buffer against risks arising from the broker-dealer's business activities, including potential losses arising from market fluctuations in the prices of, or lack of liquidity in, the securities.

The Commission's incorporation of the term "nationally recognized statistical rating organization" into the net capital rule provided a means to distinguish between different classes of debt securities for the purpose of prescribing applicable haircuts.[5] Thus, the net capital rule permits a broker-dealer to apply lower haircuts to certain types of debt securities that are rated in one of the four highest categories (known as the "investment grade" categories) by at least two NRSROs.[6]

Although the Commission used the term "nationally recognized statistical rating organization" in the net capital rule, it did not provide a definition. The Commission staff has identified NRSROs through no-action letters.[7] In response to a request for a no-action letter from a credit rating agency, the Commission staff would review information and documents submitted by the credit rating agency concerning its financial and managerial resources, methodologies for determining ratings, policies for managing

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3 See 17 CFR 240.15c3-1(c)(2).

4 See 17 CFR 240.15c3-1(c)(2)(vi).

5 See, e.g., 17 CFR 240.15c3-1(c)(2)(vi)(E), (F), and (H).

6 See Id.

7 See, e.g., Letter from Gregory C. Yadley, Staff Attorney, Division of Market Regulation, SEC, to Ralph L. Gosselin, Treasurer, Coughlin & Co., Inc. (November 24, 1975).

activities that could impact the impartiality of the credit ratings, and recognition in the marketplace. Based on this review, the Commission staff would determine whether the credit rating agency had the financial and managerial resources and appropriate policies and procedures to consistently issue credible and reliable credit ratings. The Commission staff also would determine whether the predominant users of credit ratings considered the credit rating agency to be credible and reliable.

If these assessments were both positive, the Commission staff, after seeking the advice of the Commission, would issue a no-action letter informing broker-dealers that they could treat the credit rating agency as an NRSRO for purposes of the net capital rule.[8] Since 1975, the Commission staff has identified nine credit rating agencies as NRSROs. However, as a result of consolidation, only five credit rating agencies currently are identified as NRSROs – Moody's Investors Service, Inc., Fitch, Inc., the Standard and Poor's Division of the McGraw-Hill Companies Inc., A.M. Best Company, Inc., and Dominion Bond Rating Service Limited.[9]

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[8] See Letter from Nelson S. Kibler, Assistant Director, Division of Market Regulation, Commission, to John T. Anderson, Esquire, of Lord, Bissell & Brook, on behalf of Duff & Phelps, Inc. (February 24, 1982); Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to Paul McCarthy, President, McCarthy, Crisanti & Maffei, Inc. (September 13, 1983); Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to Robin Monro-Davies, President, IBCA Limited (November 27, 1990) and Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to David L. Lloyd, Jr., Dewey Ballentine, Bushby, Palmer & Wood (October 1, 1990); Letter from Michael A. Macchiaroli, Assistant Director, Division of Market Regulation, Commission, to Gregory A. Root, President, Thomson BankWatch, Inc. (August 6, 1991) and Letter from Michael A. Macchiaroli Assistant Director, Division of Market Regulation, Commission, to Lee Pickard, Pickard and Djinis LLP (January 25, 1999); Letter from Annette L. Nazareth, Director, Division of Market Regulation, Commission, to Mari-Anne Pisarri, Pickard and Djinis LLP (February 24, 2003); and Letter from Mark M. Attar, Special Counsel, Division of Market Regulation, Commission, to Arthur Snyder, President, A.M. Best Company, Inc. (March 3, 2005).

[9] Moody's and Standard and Poors represent over 80% of the industry market share as

Over time, the Commission has imported the NRSRO concept into a number of other rules.[10] For example, definitions in Commission Rule 2a-7 under the Investment Company Act of 1940 include the term NRSRO to prescribe the type of securities a money market fund can hold.[11] In addition, regulations adopted by the Commission under the Securities Act of 1933 permit offerings of certain nonconvertible debt, preferred, and asset-backed securities that are rated investment grade by at least one NRSRO to be registered on Form S-3 – the Commission's "short-form" registration statement – without the issuer satisfying a minimum public float test.[12]

The term "NRSRO" also has been incorporated into a wide range of federal legislation.[13] For example, when Congress defined the term "mortgage related security" in Section 3(a)(41) of the Exchange Act as part of the Secondary Mortgage Market

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measured by revenues according to the Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006) ("Senate Report").

10 See Commission rules 17 CFR 228.10(e), 229.10(c), 230.134(a)(14), 230.436(g), 239.13, 239.32, 239.33, 240.3a1-1(b)(3), 240.10b-10(a)(8), 240.15c3-1(c)(2)(vi)(E), (F), and (H), 240.15c3-1a(b)(1)(i)(C), 240.15c3-1f(d), 240.15c3-3a, Item 14, Note G, 242.101(c)(2), 242.102(d), 242.300(k)(3) and (l)(3), 270.2a-7(a)(10), 270.3a-7(a)(2), 270.5b-3(c), and 270.10f-3(a)(3).

11 17 CFR 270.2a-7.

12 Form S-3 (17 CFR 239.13).

13 See, e.g., 15 U.S.C. 78c(a)(41) (defining the term "mortgage related security"); 15 U.S.C. 78c(a)(53)(A) (defining the term "small business related security"); and 15 U.S.C. 80a-6(a)(5)(A)(iv)(I) (exempting certain companies from the provisions of the Investment Company Act of 1940"); Gramm-Leach-Bliley Act, Pub. L. No. 106-102 (1999); Transportation Equity Act for the 21st Century, Pub. L. No. 105-178 (1998); Reigle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325 (1994); Department of Commerce, Justice, and State, The Judiciary, and Related Agencies Appropriations Act, FY2001, Pub. L. No. 106-553 (2000); Higher Education Amendments of 1992, Pub. L. No. 102-325 (1992); Housing and Community Development Act of 1992, Pub. L. No. 102-550 (1992); Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242 (1991); and Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-72 (1989).

Enhancement Act of 1984,[14] it required, among other things, that such securities be rated in one of the two highest rating categories by at least one NRSRO.[15]

Further, a number of other federal, state, and foreign laws and regulations have incorporated the term "NRSRO." For example, the U.S. Department of Education uses ratings from NRSROs to set standards of financial responsibility for institutions seeking to participate in student financial assistance programs under Title IV of the Higher Education Act of 1965, as amended.[16] Several state insurance codes rely, directly or indirectly, on NRSRO ratings in determining appropriate investments for insurance companies.[17] Canada and El Salvador also have employed the concept.[18]

II. THE CREDIT RATING AGENCY REFORM ACT OF 2006

The Act[19] seeks to address two important issues that have arisen with respect to credit rating agencies.[20] First, the practice of identifying NRSROs through staff no-action letters has been criticized as a process that lacks transparency and creates a barrier

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14 Pub. L. No. 98-440, § 101, 98 Stat. 1689 (1984).

15 15 U.S.C. 78c(a)(41).

16 20 U.S.C. 1070 et seq. and 42 U.S.C. 2751 et seq., 34 CFR 668.15(b)(7)(ii) and (8)(ii).

17 For example, the California Insurance Code relies on NRSRO ratings in allowing California-incorporated insurers to invest excess funds in certain types of investments. See Cal. Ins. Code 1192.10.

18 See, e.g., National Instrument 71-101, The Multi-jurisdictional Disclosure System (Oct. 1, 1998) (Can.) and Law of the Securities Market, El Salvador, Title VI, Chapter II, Section 88(a). D.L. Not. 374, Published in the Official Newspaper No. 149, Volume 340 of August 14, 1998.

19 Pub. L. No. 109-291 (2006).

20 See Section 2 of the Act and the Senate Report.

to entry for credit rating agencies seeking wider recognition and market share.[21] Second, the importance of credit ratings to the financial markets has raised the question of whether greater supervision of credit rating agencies is warranted.[22] The failures of Enron and WorldCom – which led to new laws and regulations governing a host of market participants including public companies, securities analysts, and accountants[23] – increased concerns that credit rating agencies were operating outside the scope of any meaningful regulatory supervision.[24]

Over the years, the Commission has made attempts to address these issues[25] and has participated in international initiatives to address similar issues.[26] However, the

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21 See Senate Report.

22 Id.

23 See e.g., Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002).

24 See Senate Report.

25 See e.g., Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 34616 (August 31, 1994), 59 FR 46314 (September 7, 1994); Capital Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934, Exchange Act Release No. 39457 (December 17, 1997), 62 FR 68018 (December 30, 1997); Order In the Matter of the Role of Rating Agencies in the U.S. Securities Markets Directing Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934, and Designating Officers for Such Designation (March 19, 2002); The Current Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, Hearings Before the U.S. Securities and Exchange Commission (Nov. 15 and 21, 2002) ("Commission 2002 CRA Hearings") (Transcripts available on the Commission's Web site at http://www.sec.gov/spotlight/ratingagency.htm); Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Markets, As Required by Section 702(b) of the Sarbanes-Oxley Act of 2002, U.S. Securities and Exchange Commission, January 2003 ("Commission CRA Report"); Concept Release: Rating Agencies and the Use of Credit Ratings Under the Federal Securities Laws, Securities Act Release No. 8236, 68 FR 35258 (June 12, 2003) ("Commission CRA Concept Release"); and Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization, Securities Act Release No. 8570 (April 22, 2005), 70 FR 21306 (April 25, 2005).

26 See Statement of Principles Regarding the Activities of Credit Rating Agencies, Technical Committee, International Organization of Securities Commissions ("IOSCO") (September 25, 2003); Report on the Activities of Credit Rating Agencies, The Technical Committee, IOSCO (September 2003); and Code of Conduct Fundamentals

Commission's efforts have been hindered by limitations to its authority.[27] Congress ultimately found that legislation was necessary and enacted the Act to provide for voluntary registration and oversight of NRSROs.[28]

In overview, the Act adds definitions to Section 3 of the Exchange Act,[29] creates a new Section 15E of the Exchange Act,[30] and amends Section 17 of the Exchange Act.[31] These new statutory provisions, and the grants of Commission rulemaking authority under these provisions, establish a registration and regulatory program for credit rating agencies opting to have their credit ratings qualify for purposes of laws and rules using the term "nationally recognized statistical rating organization." These credit rating agencies would be required to register with the Commission, make public certain information to help persons assess their credibility, make and retain certain records, furnish the Commission with certain financial reports, implement policies to manage the handling of material non-public information and conflicts of interest, and abide by certain prohibitions against unfair, coercive, or abusive practices. The Commission notes that international standards, such as those promulgated by the Technical

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for Credit Rating Agencies, Technical Committee of IOSCO (December 2004).

27 See Testimony of Commissioner Annette L. Nazareth, then Director, Division of Market Regulation, Commission, Before the House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, Regarding Credit Rating Agencies (April 12, 2005) (Available on the Commission's Web site at http://www.sec.gov/news/testimony/ts041205aln.htm).

28 See Section 2 of the Act and Senate Report.

29 15 U.S.C. 78c.

30 15 U.S.C. 78o-7.

31 15 U.S.C. 78q.

Committee of the International Organization of Securities Commissions ("IOSCO"), are generally consistent with the Act and the rules the Commission is proposing.[32]

The statutory provisions of the Act prohibit reliance on Commission staff no-action letters identifying NRSROs.[33] These statutory provisions become effective on the earlier of June 26, 2007 (270 days after the date of enactment of the Act) or the date the Commission issues final rules under the Act.[34] However, as a transitional measure, no-action letters issued before the effective date may continue to be relied upon by regulatory users of credit ratings after the effective date if the credit rating agency identified in the letter has a pending application for registration before the Commission.[35] In this case, the letter becomes void after the Commission has acted on the application.[36]

III. DESCRIPTION OF THE PROPOSED RULES

A. Overview

The Act mandates that the rules adopted to implement its provisions be "narrowly tailored" to meet the Act's requirements.[37] Moreover, it provides that the

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32 See e.g., IOSCO Statement of Principles Regarding the Activities of Credit Rating Agencies, September 25, 2003; Code of Conduct Fundamentals for Credit Rating Agencies (IOSCO Technical Committee), December 2004.

33 See Section 15E(l) of the Exchange Act (15 U.S.C. 78o-7(l)). This provision of the Act renders moot the Commission's earlier proposals to define the term "NRSRO" by rule and, consequently, they are withdrawn. See Capital Requirements for Brokers or Dealers Under the Securities Exchange Act of 1934, Exchange Act Release No. 39457 (December 17, 1997), 62 FR 68018 (December 30, 1997); Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization, Securities Act Release No. 8570, (April 22, 2005), 70 FR 21306 (April 25, 2005).

34 Section 15E(p) of the Exchange Act (15 U.S.C. 78o-7(p)). The Act was enacted on September 29, 2006 and June 26, 2007 is 270 days after that date.

35 Section 15E(l)(2) of the Exchange Act (15 U.S.C. 78o-7(l)(2)).

36 Id.

37 Section 15E(c)(2) of the Exchange Act (15 U.S.C. 78o-7(c)(2)).

rules adopted by the Commission may not "regulate the substance of credit ratings or the procedures or methodologies by which an NRSRO determines credit ratings."[38]

Under the proposed rules,[39] in conjunction with the statutory provisions of the Act, a credit rating agency seeking to register as an NRSRO would need to apply to the Commission using Form NRSRO.[40] The information furnished to the Commission in the form would fall broadly into two categories. First, the form would elicit information the credit rating agency would need to make public upon registration and thereafter update to keep the information current.[41] As the Senate Report noted, making this information public would "facilitate informed decisions by giving investors the ratings quality of different firms."[42] The second category of information would be submitted on a confidential basis to the extent permitted by law and the credit rating agency would not need to make it public or update it on the form (but would have to keep it current through proposed financial reporting requirements).[43]

After registration, the credit rating agency (now an NRSRO under the Act) would need to promptly update the information on its Form NRSRO to the extent an item or

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38 Id.

39 The proposed rules would be codified respectively at 17 CFR 240.17g-1 ("Rule 17g-1"); 17 CFR 240.17g-2 ("Rule 17g-2"); 17 CFR 240.17g-3 ("Rule 17g-3"); 17 CFR 240.17g-4 ("Rule 17g-4"); 17 CFR 240.17g-5 ("Rule 17g-5"); and 17 CFR 240.17g-6 ("Rule 17g-6"). Further specifics of this proposed regulatory program – including citations to provisions in the proposed rules and statutory provisions of the Act – are provided in the following sections describing the proposed rules individually.

40 Proposed Rule 17g-1.

41 See Sections 15E(a)(1)(B) and (b)(1) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B) and (b)(1)), Proposed Rule 17g-1, Form NRSRO, and instructions for the form.

42 See Senate Report.

43 See Sections 15E(a)(1)(B)(viii) and (ix) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(viii) and (ix)), proposed Rule 17g-3, Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b-2, 17 CFR 200.80, and 17 CFR 200.83.

exhibit becomes materially inaccurate, with certain exceptions.[44] In addition, on a calendar year basis, the credit rating agency would need to furnish the Commission with an annual certification on Form NRSRO that the information and documents in the form continues to be accurate and listing any material changes that occurred during the year.[45] The most recently furnished Form NRSRO (initial, amended, or annual certification) and public exhibits would be the operative registration application and would need to be made public by the NRSRO (with exceptions for certain confidential information).

After registration, the NRSRO would be subject to several substantive rules. First, the NRSRO would be subject to a recordkeeping rule, under which the NRSRO would be required to make and retain certain records relating to the business of issuing credit ratings.[46] These records would assist the Commission, through its examination process, in monitoring whether the NRSRO complies with the requirements of the Act. Other required records would assist the Commission in monitoring whether the NRSRO follows its established policies and procedures.

On an annual fiscal year basis, an NRSRO would be required to furnish the Commission with audited financial statements.[47] This requirement is designed to assist the Commission in monitoring whether the credit rating agency continues to maintain adequate financial resources to consistently produce credit ratings with integrity. The financial reports also would include a schedule of the NRSRO's largest customers. This

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44 See Section 15E(b)(1) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B) and (b)(1)), proposed Rule 17g-1, Form NRSRO, and instructions for the form.

45 Section 15E(b)(2) of the Exchange Act (15 U.S.C. 78o-7(b)(2)), proposed Rule 17g-1, Form NRSRO, and instructions for the form.

46 Proposed Rule 17g-2.

47 Proposed Rule 17g-3.

would assist the Commission in monitoring for potential conflicts of interest arising from dealings with the NRSRO's largest customers.

Finally, all NRSROs would be subject to requirements designed to protect their impartiality with respect to issuing credit ratings. First, they would be required to establish, maintain, and enforce specific written policies designed to prevent the misuse of material non-public information.[48] Second, they would be subject to requirements to avoid, manage, and disclose conflicts of interest.[49] Third, NRSROs would be prohibited from engaging in certain unfair, coercive, or abusive practices.[50]

B. Proposed Rule 17g-1 – Registration Requirements

The provisions of proposed Rule 17g-1 would implement rulemaking authority under the Act with respect to how a credit rating agency must apply to be registered as an NRSRO, make the non-confidential information in its application public, apply to add an additional category of credit ratings to its registration, update its application, furnish the annual certification, and withdraw its registration.

1. Entities Eligible to Apply for Registration

The Act, by adding definitions to Section 3 of the Exchange Act,[51] identifies the types of entities that may apply for registration with the Commission as an NRSRO.[52] First, it defines a "nationally recognized statistical rating organization" as a credit rating agency that:

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48 Section 15E(g) of the Exchange Act (15 U.S.C. 78o-7(g)), proposed Rule 17g-4.

49 Section 15E(h) of the Exchange Act (15 U.S.C. 78o-7(h)), proposed Rule 17g-5.

50 Section 15E(i) of the Exchange Act (15 U.S.C. 78o-7(i)), proposed Rule 17g-6.

51 15 U.S.C. 78c.

52 See Section 3 of the Act.

(A) has been in business as a credit rating agency for at least the three consecutive years immediately preceding the date of its application for registration under section 15E [of the Exchange Act];

(B) issues credit ratings certified by qualified institutional buyers, in accordance with section 15E(a)(1)(B)(ix) [of the Exchange Act], with respect to

(i) financial institutions, brokers, or dealers;

(ii) insurance companies;

(iii) corporate issuers;

(iv) issuers of asset-backed securities (as that term is defined in [17 CFR 229.1101(c)]);

(v) issuers of government securities, municipal securities, or securities issued by a foreign government; or

(vi) a combination of one or more categories of obligors described in any of clauses (i) through (v); and

(C) is registered under section 15E [of the Exchange Act].[53]

Section 3 of the Exchange Act also defines the term "credit rating agency" as any person:

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53 Section 3(a)(62) of the Exchange Act (15 U.S.C. 78c(a)(62)). Section 3(a)(64) of the Exchange Act defines the "qualified institutional buyer" ("QIB") as having the "meaning given such term in [17 CFR 230.144A(a)] or any successor thereto." 15 U.S.C. 78c(a)(62).

(A) engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;

(B) employing either a quantitative or qualitative model, or both, to determine credit ratings; and

(C) receiving fees from either issuers, investors, or other market participants, or a combination thereof.[54]

Finally, Section 3 of the Exchange Act defines the term "credit rating" to mean "an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments."[55]

Taken together, these three definitions limit the type of entity eligible to be registered with the Commission as an NRSRO. First, the entity must meet the definition of "credit rating agency" in Section 3 of the Exchange Act, which means, among other things, it must issue "credit ratings" as that term is defined in the act. Thus, an entity that issues "credit ratings" but does not receive compensation from issuers, investors, or other market participants would not be eligible for registration as an NRSRO because it would not meet the third prong of the definition of "credit rating agency."[56] Similarly, an entity would not be eligible for registration based solely on the fact that it has issued recommendations with respect to equity securities (for example, buy, sell, or hold) or ratings with respect to the quality of a company's management. In either case, the entity would not have been issuing "credit ratings" as the term is defined because the

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54 Section 3(a)(61) of the Exchange Act (15 U.S.C. 78c(a)(61)).

55 Section 3(a)(60) of the Exchange Act (15 U.S.C. 78c(a)(60)).

56 See Section 3(a)(61)(C) of the Exchange Act (15 U.S.C. 78c(a)(61)(C)).

recommendations and ratings are not assessments of the creditworthiness of an obligor or of specific securities or money market instruments.[57]

Another component of the first prong in the definition of "credit rating agency" is that the entity must be engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.[58] The statute does not define "reasonable fee." As a preliminary matter, the Commission believes that the fees contemplated by the definition are those charged by a credit rating agency, if any, for a customer to access or receive the credit ratings of the credit rating agency. The fees a credit rating agency charges for other services are not part of the definition, since regulatory users of credit ratings would not need access to these other services to comply with statutes and regulations using the term "NRSRO." These other fees would include fees charged to issuers, obligors, or underwriters to determine or maintain a credit rating, fees charged to subscribers for credit analysis reports, and fees charged for consulting or other services.

Additionally, the Commission preliminarily believes that the determination of whether a fee for accessing or obtaining credit ratings is reasonable would depend on the facts and circumstances. The Commission requests comment on the issue of determination of the reasonableness of fees charged by NRSROs for accessing or obtaining their credit ratings; in particular, the Commission requests comment on this issue in the context of users of credit ratings for regulatory purposes.

Finally, if an entity meets the definition of "credit rating agency," the entity must have been in the business of issuing credit ratings for the three years immediately

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57 See Section 3(a)(60) of the Exchange Act (15 U.S.C. 78c(a)(60)).

58 See Section 3(a)(61)(A) of the Exchange Act (15 U.S.C. 78c(a)(61)(A).

preceding the date of its application for registration to be eligible to apply to register with the Commission as an NRSRO.

2. Description of Proposed Registration Rule (Rule 17g-1)

A credit rating agency that elects to be treated as an NRSRO must apply to the Commission to be registered as an NRSRO. Section 15E(a)(1)(A) of the Exchange Act provides that a credit rating agency applying for registration must furnish the Commission with an application in a form prescribed by Commission rule.[59] In addition, Section 15E(a)(1)(B) of the Exchange Act prescribes certain minimum information the credit rating agency must provide in the application.[60] This includes information regarding the categories of credit ratings set forth in the definition of "NRSRO" in Section 3(a)(62)(B) of the Exchange Act with respect to which the credit rating agency "intends to apply for registration."[61]

Paragraph (a) of proposed Rule 17g-1 would implement these provisions by providing that a credit rating agency applying to be registered with the Commission as an NRSRO would be required to furnish the Commission with an application on Form NRSRO. As discussed below, a credit rating agency would be able to apply to be registered for less than all five of the categories of credit ratings identified in Section 3(a)(62)(B) of the Exchange Act.[62] For example, the credit rating agency might not meet the definitional thresholds discussed above with respect to a particular category of credit

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59 15 U.S.C. 78o-7(a)(1)(A).

60 15 U.S.C. 78o-7(a)(1)(B).

61 See Section 15E(a)(1)(B)(vii) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(vii)).

62 15 U.S.C. 78c(a)(62)(B).

rating because it has not issued credit ratings in that category for the three years preceding the date of its application.[63]

Paragraph (b)(1) of proposed Rule 17g-1 provides that an application would be considered furnished to the Commission on the date that the Commission receives a complete and properly executed Form NRSRO that follows all applicable instructions for the form.[64] The requirement that an application must be accurate and complete comports with the requirements imposed on other classes of registrants under the Exchange Act.[65] In addition, Section15E(a)(2)(A) of the Exchange Act requires the Commission to grant the application for registration or commence proceedings on whether to deny it within 90 days from the date the application is furnished to the Commission or a longer period if the applicant consents.[66] Moreover, if proceedings are commenced, Section 15E(a)(2)(B) of the Exchange Act[67] requires the Commission to conclude them within 120 days of the date the application was furnished to the Commission.[68] As a result, the Commission must have a complete application before the 90-day and 120-day periods begin to run.

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63 See definition of "NRSRO" in Section 3(a)(62) of the Exchange Act (15 U.S.C. 78c(a)(62)).

64 This provision would be implemented under the Commission's authority in Section 15E(a)(1)(A) of the Exchange Act to prescribe the form of the application (15 U.S.C. 78o-7(a)(1)(A)).

65 See e.g., 17 CFR 240.15b1-1 and 17 CFR 240.15b3-1 (broker-dealers); 17 CFR 240.15Ba2-1 (municipal securities dealers); 17 CFR 240.17Ab2-1 (clearing agencies); and 17 CFR 240.17Ac2-1 (transfer agents).

66 15 U.S.C. 78o-7(a)(2)(A).

67 15 U.S.C. 78o-7(a)(2)(B).

68 Under Section 15E(a)(2)(B)(iii) of the Exchange Act, the Commission can extend this period for an additional 90 days for good cause or for such other period as the applicant consents (15 U.S.C. 78o-7(a)(2)(B)(iii)). Practically, an applicant would need to consent to extend both the period for the Commission to make the initial determination and the 120-day period to conclude proceedings, since the 120-day period begins when the

Paragraph (b)(1) of proposed Rule 17g-1 also provides that information submitted with the application on a confidential basis would be accorded confidential treatment to the extent permitted by law. As discussed in detail below, the information proposed to be required in Form NRSRO includes information which an NRSRO would need to make public after registration and information that is submitted on a confidential basis to the extent permitted by law. Some of the confidential information is required by Section 15E(a)(1)(B) of the Exchange Act.[69] The Commission also would require certain additional information under authority conferred by Section 15E(a)(1)(B)(x) of the Exchange Act.[70] The Commission believes that it would be appropriate to provide confidential treatment to some of this information as well. Because the statute does not specifically grant confidential treatment to the additional information, the Commission would provide it through paragraph (b)(1) of proposed Rule 17g-1 to the extent permitted by law.

Paragraph (b)(2) of proposed Rule 17g-1 would provide a mechanism for a credit rating agency to withdraw its application before the Commission takes final action on it.[71] Specifically, it would require the credit rating agency to furnish the Commission with a written notice of withdrawal executed by a duly authorized person. The proposed requirement for execution by a duly authorized person is designed to ensure that the withdrawal notice reflects the intent of the credit rating agency.

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application is furnished to the Commission, not when the Commission determines to commence proceedings.

69 See Sections 15E(a)(1)(B)(viii) and (ix) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(viii) and (ix)).

70 15 U.S.C. 78o-7(a)(1)(B)(x).

71 The withdrawal of a granted registration is discussed separately below.

Paragraph (c) of proposed Rule 17g-1 would provide that if information on the application becomes materially inaccurate before the Commission has granted or denied the application, the credit rating agency must promptly notify the Commission and amend the application with accurate and complete information by submitting an amended initial application on proposed Form NRSRO.[72] Because preparing and furnishing an amended form may take time, this proposed notification provision is designed to alert the Commission as soon as possible that the application before it is materially inaccurate or incomplete. The intent is to avoid situations where the Commission continues to review an application that is no longer materially accurate.

Section 15E(a)(3) of the Exchange Act provides that the Commission, by rule, shall require an NRSRO, after registration, to make the information submitted in its completed application and any amendments publicly available on its Web site or through another comparable, readily accessible means.[73] It also permits the Commission to determine by rule the information that shall be made publicly available.[74]

Paragraph (d) of proposed Rule 17g-1 would require that the information be made publicly available within five business days of the NRSRO being registered or furnishing an amendment or annual certification. The five business-day period is intended to provide the NRSRO with sufficient time to make the information public while also designed to ensure that users of credit ratings would have access to

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72 This provision would be implemented under the Commission's authority in Section 15E(a)(1)(A) of the Exchange Act to prescribe the form of the application (15 U.S.C. 78o-7(a)(1)(A)).

73 15 U.S.C. 78o-7(a)(3).

74 Section 15E(a)(3) of the Exchange Act (15 U.S.C. 78o-7(a)(3)). As discussed below, the Commission proposes not to require an NRSRO to make public certain information required in the application, including the information about the applicant's 20 largest issuer and subscriber customers and the QIB certifications.

information within a reasonably short timeframe. Under the proposed rule, certain additional information submitted pursuant to Commission rulemaking authority also would not need to be made publicly available after registration.[75] In addition, an applicant could seek confidential treatment for information in the application under existing law and rules governing confidential treatment.[76] The Commission would accord this information confidential treatment to the extent permitted by law.

While Section 15E(a)(3) of the Exchange Act[77] does not require an applicant to make the public information in its application publicly available until after registration, this information typically would be made available by the Commission to members of the public before the application is acted on by the Commission. As noted above, an applicant could seek confidential treatment for information in the application under existing laws and rules governing confidential treatment.[78] This would be consistent with how the Commission treats applications of other entities.

As noted, a credit rating agency may apply to be registered for fewer than all five categories of credit ratings described in Section 3(a)(62)(B) of the Exchange Act.[79] Paragraph (e) of proposed Rule 17g-1 would create a mechanism for an NRSRO registered for fewer than the five categories to apply to be registered with respect to an

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75 See discussion below with respect to Exhibits 10 through 13 of proposed Form NRSRO.

76 See 17 CFR 200.80 and 17 CFR 200.80a.

77 15 U.S.C. 78o-7(a)(3).

78 See Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b-2, 17 CFR 200.80 and 17 CFR 200.83.

79 Section 15E(a)(1)(B)(vii) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(vii)) provides that a credit rating agency must submit information with its application regarding the categories of credit ratings described in Section 3(a)(62)(B) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)) for which it "intends to apply for registration."

additional category.[80] The proposed rule provides that the NRSRO would need to furnish an amended Form NRSRO and indicate where appropriate on the form the additional category for which it is applying to be registered.[81] The proposed rule also provides that the application to register for an additional category would be subject to the requirements in proposed Rule 17g-1 and Section 15E of the Exchange Act[82] applicable to an initial application. For example, the provisions of paragraph (b)(1) of proposed Rule 17g-1 regarding when an application is deemed to have been furnished to the Commission would apply, as would the provisions of paragraph (c) with respect to amending the application prior to registration being granted. The time periods for the Commission to act on the application set forth in Sections 15E(a)(2)(A) and (B) of the Exchange Act also would apply to the amended form.[83]

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if, after registration, any information or document provided as part of the application becomes materially inaccurate.[84] The statute further provides that the information on credit ratings performance statistics (discussed more fully below) need only be updated on an annual basis and that the QIB certifications need not be updated.[85] Paragraph (f) of proposed Rule 17g-1 provides that an NRSRO would need to meet the statutory requirement to amend an application if information

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80 This provision further implements Section 15E(a)(1) of the Exchange Act, which requires the Commission, by rule, to prescribe the form of an application for registration (15 U.S.C. 78o-7(a)(1)).

81 The specific requirements for completing the Form NRSRO in this circumstance are described in the next section.

82 15 U.S.C. 78o-7.

83 15 U.S.C. 78o-7(a)(2)(A) and (B).

84 15 U.S.C. 78o-7(b)(1).

85 Id.

becomes materially inaccurate by promptly furnishing the amendment to the Commission on Form NRSRO.[86] The Act does not define the term "promptly." The Commission believes the amendment should be furnished as soon as reasonably practicable after the NRSRO determines the information has become materially inaccurate. In most cases, the Commission believes that completing Form NRSRO, attaching any amended information and documents, and submitting the amendment package to the Commission should not take more than two days.

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish the Commission with an amendment to its registration not later than 90 days after the end of each calendar year in a form prescribed by Commission rule.[87] This section further provides that the amendment must (1) certify that the information and documents provided in the application for registration (except the QIB certifications) continue to be accurate and (2) list any material change to the information and documents during the previous calendar year.[88] Paragraph (g) of proposed Rule 17g-1 would implement these statutory provisions by requiring an NRSRO to furnish the amendment on Form NRSRO.

Finally, Section 15E(e)(1) of the Exchange Act provides that an NRSRO may withdraw from registration, subject to terms and conditions the Commission may establish as necessary in the public interest or for the protection of investors, by

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86 This provision further implements Section 15E(a)(1) of the Exchange Act (15 U.S.C. 78o-7(a)(1)), which requires the Commission, by rule, to prescribe the form of an application for registration.

87 15 U.S.C. 78o-7(b)(2).

88 Id.

furnishing the Commission with a written notice of withdrawal.[89] Paragraph (h) of proposed Rule 17g-1 would provide that the notice must be executed by a person duly authorized by the NRSRO. The proposed requirement for execution by a duly authorized person is designed to ensure that the registration withdrawal notice reflects the intent of the credit rating agency. Section 15E(e)(1) of the Exchange Act also provides the Commission with the authority to establish additional terms and conditions with respect to the withdrawal of a credit rating agency's NRSRO registration as necessary in the public interest or for the protection of investors.[90] Such conditions potentially could include a requirement that the NRSRO provide public notice that its credit ratings will cease to be eligible for regulatory use.

The Commission generally requests comment on all aspects of this proposed rule. The Commission also seeks comment on whether the five-day time limit for making the non-confidential information in the application publicly available should be longer or shorter. For example, the Commission seeks comment on whether five days is a sufficient amount of time to make an initial application public, given the volume of information that may need to be posted on a Web site or made public through another comparable means. Additionally, the Commission requests comment on ways other than the Internet that the information could be made public that would be comparable to posting the information on a Web site, particularly in terms of ensuring that users of credit ratings would have a comparable ease of access to the information. Further, the Commission seeks comment on whether it should define the term "promptly" in Section

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89 15 U.S.C. 78o-7(e)(1).

90 15 U.S.C. 78o-7(e)(1).

15E(b)(1) of the Exchange Act[91] to mean a specific time period such as two, five, or ten business days or some other period.

C. Proposed Form NRSRO

1. Overview of How the Form Would be Used

The Commission is proposing a new form, "Form NRSRO," the "Application for Registration as a Nationally Recognized Statistical Rating Organization." The form is designed to serve four functions: to apply for initial registration, to amend the scope of registration, to amend public information required by the form, and to make an annual certification. Instructions for the form describe how an applicant, and after registration, an NRSRO, should complete the form in each of these circumstances. The Commission construes the Act's requirement that implementing rules be "narrowly tailored" to also apply to proposed Form NRSRO.[92]

The Commission believes that having just one form (and one set of instructions) would reduce the burden on applicants, NRSROs, and Commission staff. For example, it would reduce the complexity of having different forms for the application, amendments, and annual certification. Using one form also would allow NRSROs to more quickly become familiar with the form and its instructions, which would reduce the potential for making mistakes in completing the form. It also would assist users of credit ratings in understanding the form and public exhibits and where to look on the form for specific information.

A credit rating agency applying for registration as an NRSRO would need to complete the form by providing the required information in all the items (except Item

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91 15 U.S.C. 78o-7(b)(1).

92 Section 15E(c)(2) of the Exchange Act (15 U.S.C. 78o-7(c)(2)).

7)[93] and attaching all exhibits. The credit rating agency also would need to attach a minimum of 10 certifications from QIBs (with at least two addressing each category for which registration is sought), and a non-resident credit rating agency would need to attach the undertaking required under proposed Rule 17g-2 (discussed below).

The Commission would use the information provided on the form to make the threshold determination whether the applicant is a "credit rating agency" as defined in Section 3(a)(61) of the Exchange Act and would meet the definition of "NRSRO" in Section 3(a)(62) of the Exchange Act.[94] The Commission also would use the information on the form to determine whether the applicant meets the statutory requirements for registration.[95] Specifically, the Commission would use the information to determine whether the applicant has adequate financial and managerial resources to consistently produce credit ratings with integrity and to comply with its established policies and methodologies (e.g., policies for determining credit ratings, managing material non-public information and conflicts of interest, and complying with applicable laws and regulations).[96] The Commission also would use the information to determine whether the credit rating agency, if granted registration, would not be subject to having its registration suspended or revoked under Section 15E(d) of the Exchange Act.[97]

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93 As discussed below, an NRSRO would need to complete Item 7 when furnishing an amendment to the form or the annual certification required under Section 15E(b)(2) of the Exchange Act (15 U.S.C. 78o-7(b)(2)).

94 See 15 U.S.C. 78c(a)(61) and 15 U.S.C. 78c(a)(62).

95 See Section 15E(a)(2)(C) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C)).

96 See Section 15E(a)(2)(C)(ii)(I) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C)(ii)(I)).

97 Section 15E(a)(2)(C)(ii)(II) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C)(ii)(II)) directs the Commission to deny a credit rating agency's application for registration as an NRSRO if the Commission finds that the applicant, if granted registration, would be subject to suspension or revocation of its registration under Section 15E(d) of the

After registration, an NRSRO would use Form NRSRO if it sought to apply for registration with respect to an additional category of credit ratings. In this case, the NRSRO would not need to update the non-public exhibits, and it also would not need to update the public exhibits to the extent that information or documents previously provided remained materially accurate. However, the fact that the NRSRO was seeking to expand the scope of its registration to an additional category of credit ratings likely would mean certain information provided in the public exhibits would no longer be materially accurate. For example, the NRSRO may have established new or additional methodologies to determine credit ratings in the category for which it was seeking registration. These would need to be provided as an update to Exhibit 2.[98] Finally, the NRSRO would need to provide two QIB certifications for each category of credit rating for which it is applying to be registered.[99]

An NRSRO also would use Form NRSRO to amend the information on the form and in the public exhibits after registration.[100] The need to amend the form would arise whenever there was a material change to information in one of the items on the form (except for Items 6 and 7)[101] or to information or a document provided in a public

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Exchange Act (15 U.S.C. 78o-7(d)).

98 As discussed below, Exhibit 2 would elicit the methodologies used by the credit rating agency to determine credit ratings.

99 Section 15E(a)(1)(C)(ii) of the Exchange Act requires an applicant to provide at least 2 QIB certifications for each category of credit rating for which the credit rating agency seeks to be registered (78o-7(a)(1)(C)(iii)).

100 See Section 15E(b)(1) of the Exchange Act, which requires an NRSRO to update certain information provided in its application for registration (15 U.S.C. 78o-7(b)(1)).

101 As explained below, Item 6 only would be used to provide information relating to the categories of credit ratings for which a credit rating agency was applying for registration. Therefore, unless the amendment is furnished to apply for registration in an additional category, Item 6 would not need to be completed or updated after registration. Item 7 requires information relating to current credit ratings, including information that could

exhibit. For example, if the NRSRO materially changed its procedures for preventing the misuse of material non-public information, the NRSRO would be required to furnish the Commission with an amendment on Form NRSRO and include the new procedures as an update to Exhibit 3.[102] It would not need to update the other public exhibits if the information in them remained materially accurate.

Finally, an NRSRO would use Form NRSRO to furnish the annual certification required by Section 15E(b)(2) of the Exchange Act.[103] This section requires the NRSRO to certify on an annual calendar-year basis that the information and documents provided in its application continue to be materially accurate (other than the QIB certifications).[104] It also requires the NRSRO to identify any material change to the information or documents that occurred during the previous calendar year.[105] In addition, Section 15E(b)(1) of the Exchange Act provides that the performance statistics about the NRSRO's credit ratings need only be updated on a yearly basis with the annual certification.[106]

The proposed Form NRSRO is designed to meet these statutory requirements. First, the certification on the facing page would include the representations needed for the annual certification; namely, that the NRSRO's application on Form NRSRO, as

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change relatively often such as the number of credit ratings currently issued. Therefore, this item would not need to be updated when information in the item materially changed. Instead, an NRSRO would be required to update it when furnishing a Form NRSRO for another reason.

102 As discussed below, Exhibit 3 requires policies and procedures implemented by the NRSRO to prevent the misuse of material non-public information.

103 15 U.S.C. 78o-7(b)(2).

104 Section 15E(b)(2)(A) of the Exchange Act (15 U.S.C. 78o-7(b)(2)(A)).

105 Section 15E(b)(2)(B) of the Exchange Act (15 U.S.C. 78o-7(b)(2)(B)).

106 15 U.S.C. 78o-7(b)(1)(A).

amended, continues to be accurate.[107] Second, Exhibit 1 would require information on credit rating performance statistics. The instructions would require this information to be provided in the initial application and, thereafter, updated with the annual certification (as opposed to the other public exhibits that would need to be updated promptly whenever they become materially inaccurate). The instructions also would require the NRSRO to include with the annual certification a list of each material change made during the previous calendar year.[108]

2. Items on the Form

Checkboxes indicating nature of submission. The first entry an applicant or NRSRO would make on Form NRSRO would be to indicate, by checking the appropriate box, the reason the form is being furnished: initial application, amendment, or annual certification. If an amendment, the NRSRO also would need to briefly describe the amendment on lines under the amendment check box. For example, if an NRSRO was filing the amendment because its address and organizational structure changed, the description of the amendments should be as brief as "Item 1C (address change)" and "Exhibit 4 (new organizational structure)."

Item 1 (Identifying information). Item 1 of proposed Form NRSRO would elicit the name and address of the credit rating agency, and the name and address of the contact person for the credit rating agency. The instructions for proposed Form NRSRO would provide that the individual listed as the contact person must be authorized to receive all communications and papers from the Commission and would be responsible for their dissemination within the credit rating agency.

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107 See Section 15E(b)(2)(A) of the Exchange Act (15 U.S.C. 78o-7(b)(2)(A).

108 See Section 15E(b)(2)(B) of the Exchange Act (15 U.S.C. 78o-7(b)(2)(B).

Item 2 (Legal status, place of formation, fiscal year end). Item 2 of proposed Form NRSRO would elicit the legal status of the credit rating agency (for example, corporation or partnership), the place and date of formation of the entity, and the fiscal year end of the credit rating agency. The information with respect to the fiscal year end of the applicant or NRSRO is relevant because Form NRSRO would require applicants to submit audited financial statements with the application. Proposed Rule 17g-3 would require NRSROs to annually furnish the Commission with audited financial statements covering the previous fiscal year.

Item 3 (Undertaking by non-resident NRSRO). Paragraph (f) of proposed Rule 17g-2 would require an NRSRO that does not reside in the United States to execute a written undertaking, in substantially the form provided in the proposed rule, to promptly provide books and records to the Commission in a form requested by the Commission, including translation into English. The proposed undertaking is designed to provide a means for the Commission to promptly obtain records subject to its examination authority located outside the U.S. without requiring that Commission staff travel to the location. In addition, because some non-resident NRSROs may maintain original records in a language other than English, the proposed undertaking would require a translation if the Commission requested it.

Item 3 of proposed Form NRSRO would require a non-resident applicant to attach the required undertaking to its initial application. If the application is granted, the undertaking would be in place when the applicant becomes an NRSRO and is subject to the proposed recordkeeping requirements. The prescribed form of the undertaking would make it applicable only to books and records a credit rating agency is required to

make, keep current, retain, or produce to the Commission pursuant to any provision of the Exchange Act[109] or any regulation under the Exchange Act.[110] An applicant becomes subject to these recordkeeping requirements only after registration is granted and the applicant becomes an NRSRO.

Item 4 (Compliance officer). Section 15E(j) of the Exchange Act requires every NRSRO to designate an individual responsible for administering the policies and procedures of the credit rating agency to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws.[111] Item 4 of proposed Form NRSRO would elicit the name of and contact information for this person.

Item 5 (Method of making form and public exhibits readily accessible). Section 15E(a)(3) of the Exchange Act provides that the Commission shall, by rule, require an NRSRO, upon the granting of registration, to make the non-confidential information and documents submitted to the Commission in the initial application, amendments, or annual certifications publicly available on the NRSRO's Web site or through another comparable, readily accessible means.[112] Item 5 of proposed Form NRSRO would elicit information on how the applicant would make the public information readily accessible. Providing this information on proposed Form NRSRO would assist the Commission in verifying that the NRSRO is complying with this requirement and assist the public in locating the information to assess the credibility and integrity of the NRSRO.

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109 15 U.S.C. 78a et seq.

110 This would include the records required to be retained in proposed Rule 17g-2.

111 15 U.S.C. 78o-7(j).

112 15 U.S.C. 78o-7(a)(3). Paragraph (d) of proposed Rule 17g-1 (discussed above) would implement this rulemaking authority.

Item 6 (Categories of credit ratings for which registration is sought and QIB certifications). Item 6 of proposed Form NRSRO would only need to be completed when a credit rating agency was furnishing an initial application to be registered as an NRSRO and when an NRSRO was applying to expand the scope of its registration by adding an additional class of credit ratings. This item would elicit information about the categories of credit ratings for which the applicant was applying for registration. It also would require the applicant to attach the QIB certifications to the application (unless the applicant was exempt from this requirement under Section 15E(a)(1)(D) of the Exchange Act).[113]

Section 15E(a)(1)(B)(vii) of the Exchange Act requires an applicant for NRSRO registration to provide information with respect to the categories of credit ratings for which it is applying to be registered.[114] Item 6 of proposed Form NRSRO would require a credit rating agency applying for registration, and an NRSRO applying to add a category of credit ratings to its registration, to indicate the categories of credit ratings for which registration was being sought.

Item 6 also would elicit the approximate number of credit ratings issued in each category as of the date of the application, and the number of consecutive years preceding the date of the application that the credit rating agency has issued credit ratings with respect to each category indicated. This information would be used by the Commission in verifying that the credit rating agency meets the definitional thresholds for registration

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113 15 U.S.C. 78o-7(a)(1)(D).

114 15 U.S.C. 78o-7(a)(1)(B)(vii).

as NRSRO, including that the entity has been in business as a credit rating agency for the three consecutive years preceding the date of its application.[115]

Item 6 also would elicit a brief description of how the credit rating agency makes its credit ratings readily accessible. The Commission would use this information to verify that the applicant meets another definitional threshold for registration eligibility; namely, that the applicant issues credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee.[116] The Act does not define "readily accessible" other than to specify that the method must be comparable to the Internet in terms of accessibility.[117] Moreover, as discussed above, the Act does not define "reasonable fee." However, the Commission believes the "fee" contemplated by the statute is the fee charged to access or receive the credit ratings of the credit rating agency (i.e., not the fees charged for other services). This information elicited in Item 6 (and after registration in Item 7) would assist the Commission in monitoring the cost to regulatory users of credit ratings of accessing or obtaining NRSRO credit ratings.

Finally, Item 6 would require the applicant to provide QIB certifications. Section 15E(a)(1)(B)(ix) of the Exchange Act requires an applicant to submit a minimum of ten QIB certifications with the application.[118] Sections 15E(a)(1)(C)(i), (ii), and (iii) further provide, respectively, that: (1) the certifying QIB must not be affiliated with the applicant; (2) the certification may address more than one of the categories of credit

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115 As discussed above, the definitions of "credit rating," "credit rating agency," and NRSRO in, respectively, Sections 3(a)(60), (61) and (62) of the Exchange Act prescribe the type of entity that is eligible for registration as an NRSRO (15 U.S.C. 78c(a)(60), (61) and (62)).

116 Section 3(a)(61)(A) of the Exchange Act (15 U.S.C. 78c(a)(61)(A)).

117 Id.

118 15 U.S.C. 78o-7(a)(1)(B)(ix).

ratings for which the applicant is seeking registration; and (3) at least two of the certifications must address each category of credit ratings for which the applicant is seeking registration.[119] Section 15E(a)(1)(C)(iv) provides that the QIB must state in the certification that it meets the definition of a "QIB" in Section 3(a)(64) of the Exchange Act[120] and that the QIB has used the credit ratings of the applicant for at least three years immediately preceding the date of the application in the subject category or categories of subscribers.[121] The Senate Report explained that the term "used" was intended to mean the QIB "seriously considered the ratings in some of [its] investment decisions."[122]

The proposed instructions to Item 6 would prescribe the form of the QIB certification. For example, consistent with Section 15E(a)(1)(C)(i)(I) of the Exchange Act[123] and the Senate Report explaining that section, the QIB certification would be required to include a representation that the QIB "has seriously considered the credit ratings of [the credit rating agency] in the course of making investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings."[124] The QIB certification also would be required to be executed by a person duly authorized by the QIB to make the certification on behalf of the QIB.[125]

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119 See 15 U.S.C. 78o-7(a)(1)(C)(i), (ii) and (iii), respectively.

120 15 U.S.C. 78c(a)(64).

121 15 U.S.C. 78o-7(a)(1)(C)(iv).

122 The Senate Report further explained that "a QIB whose analysts regularly read and consider [a credit rating agency's] ratings in the course of making investment decisions would have 'used' them under the meaning of the bill. A QIB whose employees subscribe to or regularly receive the ratings but do not read them or, if they read them, rarely or never consider them in making their investment decisions would not be deemed to have 'used' the ratings."

123 15 U.S.C. 78o-7(a)(1)(C)(i)(I).

124 Instructions to Item 6D of proposed Form NRSRO.

125 Id.

This is designed to ensure that the certification is that of the QIB and not an employee of the QIB who may have an interest (distinct from that of the QIB) in providing the certification to the applicant. In addition, as a measure designed to ensure the impartiality of the QIB's assessment, the QIB would need to certify that it had not received compensation for providing the certification.

Item 6 of proposed Form NRSRO also would require the applicant to indicate whether it was submitting the QIB certifications and, if so, how many certifications were being submitted or that the applicant was exempt from the requirement to provide the certifications. Under Section 15E(a)(1)(D) of the Exchange Act, a credit rating agency is not required to submit the QIB certifications if it was identified as an NRSRO in a Commission staff no-action letter issued before August 2, 2006.[126]

The Commission requests comment on whether there should be a requirement for an NRSRO to notify the Commission if a QIB withdraws its certification.

Item 7 (Categories of credit ratings covered by current registration). Item 7 would solicit information about the categories of credit ratings for which the NRSRO was currently registered, the approximate number of credit ratings currently outstanding in each category, and the number of years the NRSRO has issued credit ratings in that category. It also would elicit information about how the NRSRO makes its credit ratings readily accessible to users of credit ratings.

Because some of the information in Item 7 may change fairly regularly, this Item would need to be updated if it became materially inaccurate only when the NRSRO furnishes the next Form NRSRO either as an amendment or as an annual certification.

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126 15 U.S.C. 78o-7(a)(1)(D).

Thus, if the information in Item 7 became materially inaccurate, it would be updated on an annual basis at a minimum.

The information requested in Item 7 would allow users of credit ratings to assess the NRSRO with respect to the number of credit ratings it has issued and the number of years it has issued credit ratings in each category for which it is registered.[127]

Item 8 (Potential statutory disqualifications). Section 15E(a)(2)(C)(ii)(II) of the Exchange Act[128] directs the Commission to deny a credit rating agency's application for registration as an NRSRO if the Commission finds that the applicant, if granted registration, would be subject to suspension or revocation of its registration under Section 15E(d) of the Exchange Act.[129] Section 15E(d) of the Exchange Act[130] provides that the Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding 12 months, or revoke the registration of an NRSRO, if the Commission finds that the NRSRO or a person associated with the NRSRO has committed certain acts described in Sections 15(b)(4)(A), (D), (E), (G), or (H) of the Exchange Act,[131] been convicted of certain

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127 Because Item 7 would not have been filled out when the NRSRO applied for registration, it would remain blank for a period of time between the granting of an initial registration and the time when the NRSRO furnishes a new Form NRSRO either as an amendment or annual certification. Item 6, however, would have been filled out as part of the application for registration. This item requires the same information as Item 7. Therefore, users of credit ratings would have the access to the information through Item 6 until the NRSRO furnished a new Form NRSRO. Thereafter, the information would be located in Item 7.

128 15 U.S.C. 78o-7(a)(2)(C)(ii)(II).

129 15 U.S.C. 78o-7(d).

130 15 U.S.C. 78o-7(d).

131 15 U.S.C. 78o-7(b)(4)(A), (D), (E), (G) and (H).

offenses described in Section 15(b)(4)(B) of the Exchange Act,[132] been convicted of certain other offenses, or if a person associated with the NRSRO is subject to a Commission order suspending or barring the person from being associated with an NRSRO. Item 8 of proposed Form NRSRO would ask whether the acts, convictions or orders described in Section 15E(d) of the Exchange Act[133] applied to the credit rating agency or any person associated with the credit rating agency.

If a question in Item 8 was answered "yes," the credit rating agency would be required to provide additional information on a Disclosure Reporting Page (DRP) NRSRO as set forth in the instructions for Form NRSRO. The Commission would then need to evaluate whether an applicant's registration could be granted in light of the disclosure. After registration, an NRSRO would need to update the information in Item 8 if there was a change. The Commission would then evaluate whether it would be appropriate to issue an order censuring, placing limitations on the activities, functions, or operations of, suspending for a period not exceeding 12 months, or revoking the registration of the NRSRO as provided for under Section 15E(d) of the Exchange Act.[134]

Certification. Proposed Form NRSRO would require the signature of an authorized person of the credit rating agency representing that the information and statements contained in the form are current, accurate, and complete or, if the NRSRO is submitting an annual certification, that the application, as amended, is current, accurate, and complete.

3. Exhibits to the Form

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132 15 U.S.C. 78o(b)(4).

133 15 U.S.C. 78o-7(d).

134 15 U.S.C. 78o-7(d).

Proposed Form NRSRO would have 13 exhibits. Sections 15E(a)(1)(B)(i), (ii), (iii), (iv), (v), (vi), and (viii) of the Exchange Act require the furnishing of some of this information.[135] The Commission is proposing to require the furnishing of the remainder of the information pursuant to its authority under Section 15E(a)(1)(B)(x) of the Exchange Act.[136] The proposed exhibits are an important part of the program for NRSRO oversight. Therefore, the information and documents proposed to be provided in the exhibits must be sufficiently detailed to allow the Commission to evaluate and verify the information and, with respect to the public exhibits, assist users of credit ratings in understanding how the NRSRO manages its activities.

Exhibits 1 through 9 would be public exhibits that the NRSRO would be required to keep current through furnishing updated information and make readily accessible to the public. The information in these public exhibits would be useful to the users of credit ratings in assessing the ratings quality of the NRSRO and in comparing the NRSRO to other NRSROs.

Exhibits 10 through 13 would be accorded confidential treatment by the Commission, to the extent permitted by law, under provisions of Section 15E of the Exchange Act[137] in conjunction with proposed Rule 17g-1.[138] The information in the public and confidential exhibits would be used by the Commission to make the determination whether the credit rating agency has adequate financial and managerial

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135 15 U.S.C. 78o-7(a)(1)(B)(i), (ii), (iii), (iv), (v), (vi), and (viii).

136 15 U.S.C. 78o-7(a)(1)(B)(x).

137 See Sections 15E(a)(1)(B)(viii), (a)(1)(B)(ix), and (k) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(viii), (a)(1)(B)(ix), and (k).

138 See also Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b-2, 17 CFR 200.80 and 17 CFR 200.83.

resources to consistently produce credit ratings with integrity and to materially comply with the methodologies, policies, and procedures it discloses in the public exhibits.[139]

The information in Exhibits 10 through 13 would not need to be updated by furnishing amendments on proposed Form NRSRO after registration is granted. Instead, this information would be updated through the proposed financial reporting rule (proposed Rule 17g-3). Section 15E(b)(1) of the Exchange Act[140] provides that information submitted with an application must be updated promptly when the information becomes materially inaccurate, except information submitted under Sections 15E(a)(1)(B)(i) and (ix) of the Exchange Act (respectively, the performance statistics, which must be updated annually, and the QIB certifications, which need not be updated).[141] Thus, under the statute, the information provided in Exhibits 10 through 13 would need to be updated promptly if it became materially inaccurate. However, the Commission is not proposing that an NRSRO update these exhibits by furnishing the information to the Commission in Form NRSRO amendments. Rather, the Commission is proposing that the NRSRO would update this information as part of the financial statements that would be required to be furnished under proposed Rule 17g-3.

Exhibit 1 (Public). Section 15E(a)(1)(B)(i) of the Exchange Act requires that an application for registration as an NRSRO contain credit ratings performance measurement statistics over short-term, mid-term, and long-term periods (as applicable).[142] This information would be required as Exhibit 1 to proposed Form

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139 See Sections 15E(a)(2)(C) and (d) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C) and (d)).

140 15 U.S.C. 78o-7(b)(1).

141 15 U.S.C. 78o-7(a)(1)(B)(i) and (ix).

142 15 U.S.C. 78o-7(a)(1)(B)(i).

NRSRO. The Exchange Act does not otherwise define or identify the particular credit rating performance statistics to be provided with the application. The Commission believes credit rating agencies typically generate statistical reports showing historical default and downgrade rates within each credit rating notch or grade.[143] Further, the Commission believes these types of statistics are important indicators of the performance of a credit rating agency in terms of its ability to assess the creditworthiness of issuers and obligors and, consequently, would be useful to users of credit ratings in evaluating an NRSRO.

In addition to historical default and downgrade rates, the instructions to proposed Form NRSRO also would provide that an applicant or NRSRO include in the exhibit definitions of the credit ratings (i.e., an explanation of each grade or notch) and explanations of the performance measurement statistics, including the metrics used to derive the statistics. The Commission believes that requiring this information would be necessary or appropriate in the public interest or for the protection of investors because it would assist users of credit ratings in understanding how the measurements were derived and in making comparisons with the measurement statistics of other NRSROs.[144]

The definitions of the notches and grades also would assist the Commission in assessing whether the NRSRO's ratings, as a practical matter, can be used for certain

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143 The credit rating notches or grades of a credit rating agency generally are represented by symbols, numbers or other designations that are used to distinguish the creditworthiness of the obligors, securities and money market instruments the credit rating agency rates. For example, some credit rating agencies use symbols such as AAA, AA, A, BBB, BB, B, CCC, and CC to distinguish the creditworthiness of corporate debt securities. AAA would be the highest rating and CC would be the lowest rating above the default or regulatory supervision of the issuer.

144 Section 15E(a)(1)(B)(x) of the Exchange Act provides that the Commission can require additional information that it finds is necessary or appropriate in the public interest or for the protection of investors (15 U.S.C. 78o-7(a)(1)(B)(x)).

Commission rules. For example, paragraph(c)(2)(vi)(F) of Commission Rule 15c3-1 specifies lower haircuts for debt securities that are rated in one of the "four highest rating categories" (i.e., notches) of at least two NRSROs.[145] The current NRSROs generally have at least eight notches for their debt securities with the top four commonly referred to as "investment grade." If an NRSRO decided to use less than eight notches, the Commission would need to evaluate whether, based on the NRSRO's definitions, securities that would be included in the top four notches would be suitable for the lower haircuts specified in paragraph(c)(2)(vi)(F) of Rule 15c3-1.[146]

The Commission generally requests comment on Exhibit 1. The Commission also requests comment on whether the performance measurement statistics should use standardized inputs, time horizons and metrics to allow for greater comparability. Commenters are requested to provide specific details as to how these statistical measures could be standardized. The Commission further requests comment on whether credit rating agencies or other persons currently use other performance measurement statistics or whether other performance measurement statistics would be appropriate as an alternative, or in addition, to historical default and downgrade rates. For example, the Commission requests comment on whether Exhibit 1 should require measurement of the performance of a given credit rating by comparing or mapping it to the market value of the rated security or to extreme declines in the market value of the security after the rating. The Commission additionally requests comment on whether the requirement to include definitions and explanations in Exhibit 1 would achieve its stated purpose.

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145 17 CFR 240.15c3-1(c)(2)(vi)(F).

146 Id.

Exhibit 2 (Public). Section 15E(a)(1)(B)(ii) of the Exchange Act requires that an application for registration as an NRSRO contain information regarding the procedures and methodologies used by the credit rating agency to determine credit ratings.[147] This information would be required as Exhibit 2 to proposed Form NRSRO. The Exchange Act does not otherwise define or identify the procedures and methodologies that must be provided under this section.[148] However, the definition of "credit rating agency" in Section 3(a)(61) of the Exchange Act provides that a "credit rating agency" is an entity that, among other things, "employ[s] either a quantitative or qualitative model, or both, to determine credit ratings."[149]

The Commission believes that entities meeting the definition of "credit rating agency" in Section 3(a)(61) of the Exchange Act[150] generally establish procedures and methodologies for determining credit ratings in the following areas: the determination of whether to initiate a credit rating; the use of public and non-public sources of information to perform credit rating analysis, including information and analysis provided by third-party vendors; the use of quantitative and qualitative models and metrics to determine credit ratings; the interaction with the management of a rated obligor or issuer of rated securities; the establishment of the structure and voting process of committees that review or approve credit ratings; the notification of rated obligors or issuers of rated securities about credit rating decisions and for appeals of final or pending

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147 15 U.S.C. 78o-7(a)(1)(B)(ii).

148 See 15 U.S.C. 78a et seq.

149 See particularly, Section 3(a)(61)(B) of the Exchange Act (15 U.S.C. 78c(a)(61)(B)).

150 15 U.S.C. 78c(a)(61).

credit rating decisions; monitoring, reviewing, and updating of credit ratings; and the withdrawal, or suspension of the maintenance, of a credit rating.

This list identifies areas where a credit rating agency could establish procedures and methodologies for determining credit ratings. The applicability of certain areas to a particular credit rating agency may depend on whether it uses subjective qualitative analysis, purely quantitative models or a combination of both.[151] Consequently, an applicant and NRSRO may not establish a procedure or methodology in a given area because doing so would not be relevant to how the credit rating agency determines credit ratings.

In addition, credit rating agencies that issue "unsolicited" credit ratings may establish procedures and methodologies in the areas described above that are unique to such ratings. An "unsolicited" credit rating is one the credit rating agency decides to initiate without being requested to do so by an issuer, obligor, underwriter, or other interested party. Credit rating agencies that use a subscription fee based business model may only issue unsolicited ratings because that business model does not rely on fees from issuers, obligors, and underwriters to determine specific credit ratings (issuers, obligors, and underwriters, however, may subscribe to receive the credit ratings of such credit rating agencies). The procedures and methodologies these credit rating agencies employ, in some respects, may be unique to this business model.

Credit rating agencies that are paid by issuers, obligors, and underwriters to determine specific credit ratings sometimes also issue unsolicited ratings. As discussed below with regard to proposed Rule 17g-6, this practice has led to concerns that

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[151] See Section 3(a)(61) of the Exchange Act defining the term "credit rating agency" (15 U.S.C. 78c(a)(61)).

unsolicited ratings may be used to coerce issuers and obligors into ultimately paying the credit rating agency to determine and maintain the credit rating. Consequently, the Commission believes that credit rating agencies that rely on fees from issuers, obligors, and underwriters to determine specific credit ratings, but also issue unsolicited ratings, often have established procedures and methodologies for determining unsolicited credit ratings that are designed to address this concern and the fact that the issuer or obligor may not have participated in the determination of the credit rating (as is frequently the case with a solicited credit rating).

The Commission believes that information regarding the procedures and methodologies established by an NRSRO in the areas described above, including those with respect to unsolicited credit ratings, as applicable, would be useful to users of credit ratings. The information would provide an understanding of the nature of the credit rating agency (i.e., a user of quantitative models, qualitative analysis, or a combination of both) and how the credit rating agency produces credit ratings. This would provide a basis for comparing NRSROs. The disclosure also would provide the Commission with an understanding of the managerial and financial resources required to produce the credit ratings. This would assist the Commission in evaluating whether an applicant or NRSRO has adequate financial and managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies.[152]

The Commission generally requests comment on Exhibit 2, as proposed. The Commission also requests comment on whether the areas identified above are the areas where credit rating agencies establish procedures and methodologies for determining

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152 See Sections 15E(a)(2)(C) and 15E(d) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C) and (d)).

credit ratings. A commenter that believes one or more of the areas identified above is not one where any type of credit rating agency establishes procedures and methodologies should identify each area and explain the reason for such conclusion. The Commission also requests comment on whether there are additional areas where credit rating agencies establish procedures and methodologies for determining credit ratings and, if so, requests that commenters identify them.

Exhibit 3 (Public). Section 15E(a)(1)(B)(iii) of the Exchange Act[153] requires that an application for registration as an NRSRO contain information regarding policies or procedures adopted and implemented by the credit rating agency to prevent the misuse, in violation of Exchange Act[154] provisions and rules, of material, non-public information. Exhibit 3 would require an applicant and NRSRO to furnish its policies and procedures to prevent the misuse of material, nonpublic information established under Section 15E(g) of the Exchange Act[155] and proposed Rule 17g-4.

Section 15E(g)(1) of the Exchange Act[156] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[157] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[158] As discussed below, proposed Rule 17g-4 would implement this

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153 15 U.S.C. 78o-7(a)(1)(B)(iii).

154 15 U.S.C. 78a et seq.

155 15 U.S.C. 78o-7(g).

156 15 U.S.C. 78o-7(g)(1).

157 15 U.S.C. 78a et seq.

158 15 U.S.C. 78o-7(g)(2).

statutory provision by requiring an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[159] to include certain specific types of procedures.

The Commission generally requests comment on Exhibit 3, as proposed.

Exhibit 4 (Public). Section 15E(a)(1)(B)(iv) of the Exchange Act requires that an application for registration as an NRSRO contain information regarding the organizational structure of the applicant.[160] This information would be required as Exhibit 4 to proposed Form NRSRO. The Exchange Act does not otherwise define or identify the specific type of organizational information that should be provided under Section 15E(a)(1)(B)(iv) of the Exchange Act.[161] The Commission believes that companies typically create, as applicable, an organizational chart showing ultimate and sub-holding companies, subsidiaries, and material affiliates; an organizational chart showing divisions, departments, and business units within the entity; and an organizational chart showing the management structure and senior management reporting lines within the entity.

The Commission believes that, if a credit rating agency is part of a holding company structure, users of credit ratings and the Commission would benefit from an organizational chart showing the entity's ultimate and sub-holding companies, subsidiaries, and material affiliates. This chart would provide an understanding of where potential conflicts of interest relating to the business activities of related companies might arise. Also, the fact that a credit rating agency has a holding company that

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159 15 U.S.C. 78o-7(g)(1).

160 15 U.S.C. 78o-7(a)(1)(B)(iv).

161 Id, see also,15 U.S.C. 78a et seq.

potentially could provide financial support would be relevant to the Commission's evaluation of whether an applicant or NRSRO has adequate financial resources as required under the Exchange Act.[162]

The Commission further believes that, if a credit rating agency engages in business activities in addition to determining credit ratings, users of credit ratings and the Commission would benefit from an organizational chart showing the entity's divisions, departments, and business units. This chart would provide an understanding of where potential conflicts of interest relating to ancillary business activities might arise.

Finally, the Commission believes that users of credit ratings and the Commission would benefit from an organizational chart showing an NRSRO's management structure and senior management reporting lines. This chart would assist the Commission in evaluating whether an applicant and NRSRO has adequate managerial resources as required under the Exchange Act.[163] Users of credit ratings also would be able to use this information to compare the managerial resources of different NRSROs.

Additionally, the instructions to proposed Form NRSRO would provide that this managerial chart include the compliance officer designated by the NRSRO pursuant to Section 15E(j) of the Exchange Act.[164] The Commission believes that including the compliance officer in the chart would be necessary or appropriate in the public interest or for the protection of investors because it would assist the Commission and users of credit ratings in understanding the degree of the compliance officer's independence from

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162 See Sections 15E(a)(2)(C) and 15E(d) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C) and (d)).

163 See Sections 15E(a)(2)(C) and 15E(d) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C) and (d)).

164 15 U.S.C. 78o-7(j).

the business managers.[165] The Commission believes users of credit ratings would find the compliance officer's reporting lines relevant in assessing the integrity of the credit rating process of a particular NRSRO, since the officer is responsible for administering the credit rating agency's policies and procedures required by Sections 15E(g) and (h) of the Exchange Act[166] and for ensuring the NRSRO's compliance with the securities laws and rules and regulations thereunder.[167] In carrying out these responsibilities, a compliance officer would need to review activities overseen by senior business managers. The ability of the compliance officer to objectively review an area could be impacted by whether the officer reported to the senior manager responsible for the area. Thus, the relative independence of the compliance officer would be relevant to assessing the NRSRO's ability to ensure compliance with its policies and procedures.

For these reasons, Exhibit 4 would provide that the information about the organizational structure of the applicant or NRSRO required to be furnished and made public under Section 15E(a)(1)(B)(iv) of the Exchange Act[168] consist of charts showing the managerial structure and senior management reporting lines, and, if applicable, the ultimate and sub-holding companies, subsidiaries, and material affiliates of the entity, and the divisions, departments, and business units within the entity. The exhibit also would require that the management chart include the designated compliance officer.

The Commission generally requests comment on Exhibit 4, as proposed. The Commission specifically also requests comment on whether including the compliance

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165 See Section 15E(a)(1)(B)(x) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(x)).

166 15 U.S.C. 78o-7(g) and (h).

167 Section 15E(j) of the Exchange Act (15 U.S.C. 78o-7(j)).

168 Id.

officer in the chart would achieve the stated purpose of the requirement. The Commission further requests comment on whether other organizational information should be provided, or whether some of the information proposed to be required should be eliminated or modified. Commenters who believe that other information should be provided are asked to describe the information and explain why it would be appropriate under Section 15E of the Exchange Act.[169]

Exhibit 5 (Public). Section 15E(a)(1)(B)(v) of the Exchange Act requires that an application for registration as an NRSRO contain information regarding whether the applicant has a code of ethics in effect or an explanation of why the applicant has not established a code of ethics.[170] Exhibit 5 to proposed Form NRSRO would elicit this information by requiring an applicant and NRSRO to attach its code of ethics or an explanation of why it does not have a code of ethics. The Exchange Act does not otherwise define or identify the "code of ethics" that should be provided under Section 15E(a)(1)(B)(v).[171] The Commission believes credit rating agencies should have the flexibility to establish a code of ethics appropriate for their business model and organizational structure and, consequently, is not proposing any specific elements that should be in the code of ethics, if any, furnished in this exhibit.

The Commission generally requests comment on Exhibit 5, as proposed. The Commission also requests comment on whether it should propose specific elements to be included in the code of ethics provided in Exhibit 5. Commenters who believe the Commission should propose specific elements are asked to describe them. The

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169 15 U.S.C. 78o-7.

170 15 U.S.C. 78o-7(a)(1)(B)(v).

171 Id.

Commission further seeks comment on whether it should require in Exhibit 5 that NRSROs disclose whether they comply with international principles and codes of conduct related to credit rating agencies.

Exhibit 6 (Public). Section 15E(a)(1)(B)(vi) of the Exchange Act requires that an application for registration as an NRSRO contain information regarding any conflict of interest relating to the issuance of credit ratings by the applicant and NRSRO.[172] Exhibit 6 to proposed Form NRSRO would require an applicant and NRSRO to identify, in general terms, the types of conflicts of interest that arise from its business as a credit rating agency.

The Exchange Act does not otherwise define or identify the types of conflicts of interest that should be disclosed under Section 15E(a)(1)(B)(vi) of the Exchange Act.[173] The Commission believes that credit rating agencies that rely on fees from issuers, obligors and underwriters to determine specific credit ratings are exposed to a unique set of conflicts, as are credit rating agencies that operate under a subscriber fee based business model. Moreover, certain conflicts, such as those arising from owning securities of a rated entity, can arise under either business model.

The Commission believes that the types of conflicts of interest arising from the activities of credit rating agencies include, as applicable: receiving compensation from rated obligors, issuers of rated securities and money market instruments, and underwriters of rated securities and money market instruments to determine or maintain a credit rating and for other services; owning securities of, or having any other form of ownership interest in, a rated obligor, issuer of rated securities and money market

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172 15 U.S.C. 78o-7(a)(1)(B)(vi).

173 Id, see also 15 U.S.C. 78a et seq.

instruments, or underwriter of rated securities and money market instruments; receiving compensation for any service from subscribers that use credit ratings for regulatory purposes; owning securities of, or having any other form of ownership interest in, a subscriber that uses credit ratings for regulatory purposes; and having another material business relationship (e.g., a loan) or affiliation (e.g., being an officer or director) with a rated obligor, issuer of rated securities and money market instruments, underwriter of a rated securities and money market instruments, or entity that uses credit ratings for regulatory purposes.

The Commission believes the above list covers the range of general conflicts of interest that arise from the activities of credit rating agencies.[174] However, as noted, based on a particular credit rating agency's business model, some of these conflicts would not be evident. The Commission further believes that an applicant and NRSRO subject to any of these types of conflicts would need to disclose that fact in a general manner in order to comply with Section 15E(a)(1)(B)(vi) of the Exchange Act.[175] Furthermore, the disclosure would assist the Commission in evaluating whether an applicant has sufficient financial and managerial resources to comply with the procedures for managing conflicts of interest required under Section 15E(h) of the Exchange Act,[176] given the conflicts of interest identified by the applicant.[177] The information also would be useful to users of credit ratings in assessing an NRSRO by,

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174 The section below describing proposed Rule 17g-5 provides a further discussion of conflicts of interest generally and how the types of activities described in this list can give rise to conflicts of interest.

175 15 U.S.C. 78o-7(a)(1)(B)(vi).

176 15 U.S.C. 78o-7(h).

177 See Section 15E(a)(2)(C) Exchange Act (15 U.S.C. 78o-7(a)(2)(C)).

for example, comparing the types of conflicts disclosed by the entity in Exhibit 6 with the procedures for managing conflicts of interest disclosed by the entity in Exhibit 7 (discussed next). As noted above, the disclosure of the type of conflict only would need to be general in nature. For example, an NRSRO that receives compensation from issuers for rating their securities would only need to disclose that fact. It would not need to disclose separately each time it was compensated by an issuer or the identity of each such issuer.

The instructions to Form NRSRO also would provide that an applicant and NRSRO include in Exhibit 6 the identity of any affiliated entity that acts as an underwriter or uses credit ratings for regulatory purposes.[178] The Commission believes that requiring a credit rating agency to disclose this information would be necessary or appropriate in the public interest or for the protection of investors because it would apprise users of credit ratings to a potential conflict of interest arising from the fact that the affiliate could exercise undue influence on the credit rating agency to issue a credit rating that assists in the marketing of the security or that provides a regulatory benefit.[179] Users of credit ratings would able to review the NRSRO's procedures made public in Exhibit 7 to understand how the credit rating agency addresses these potential conflicts.

The Commission generally requests comment on Exhibit 6, as proposed. The Commission also requests comment on whether there are conflicts of interest that should be disclosed in addition to those identified above, or whether some of the information proposed to be required should be eliminated or modified. Commenters who believe that

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178 As discussed below, proposed Rule 17g-5 would prohibit an NRSRO from having a conflict with respect to issuing or maintaining a credit rating with respect to an affiliate. Thus, this type of conflict would need to be avoided rather than disclosed and managed.

179 See Section 15E(a)(1)(B)(x) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(x)).

other conflicts exist should describe how they arise from the business of credit rating agencies. The Commission further requests specific comment on whether requiring the identification of affiliates that are underwriters and regulatory users of credit ratings would achieve the stated purpose of the requirement.

Exhibit 7 (Public). Section 15E(h) of the Exchange Act requires an NRSRO to establish, maintain, and enforce written policies and procedures to address and manage conflicts of interest.[180] These policies and procedures would be required as Exhibit 7 to proposed Form NRSRO. The Commission believes that requiring these policies and procedures would be necessary or appropriate in the public interest or for the protection of investors.[181] First, their disclosure would assist the Commission in monitoring whether an NRSRO is complying with Section 15E(h) of the Exchange Act.[182] Second, the disclosure would assist the Commission in evaluating whether an applicant or NRSRO has sufficient financial and managerial resources to manage the conflicts of interest disclosed by the credit rating agency in Exhibit 6. Third, the disclosure would allow users of credit ratings to compare an NRSRO's policies and procedures for managing conflicts of interest with the types of conflicts disclosed in Exhibit 7.

The Commission requests general comment on Exhibit 7, as proposed, including on whether including this information would achieve the stated purpose of the requirement.

Exhibits 8 (Public). The ability of a credit rating agency to assess the credit worthiness of an issuer and obligor depends on the competence of the personnel

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180 15 U.S.C. 78o-7(h).

181 See Section 15E(a)(1)(B)(x) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(x)).

182 15 U.S.C. 78o-7(h).

responsible for determining the entity's credit ratings ("credit analysts"). This is true regardless of whether the credit rating agency uses quantitative models or qualitative analysis or a combination of both. A credit rating agency that solely uses quantitative models would be relying on credit analysts to understand the model inputs and metrics and back test the model's results to judge whether the model is producing credible credit ratings. A credit rating agency that uses qualitative analysis would be relying on credit analysts to understand and interpret relevant information about an obligor or issuer and use the information to render a credible assessment of the issuer or obligor's creditworthiness.

The Commission believes that requiring an applicant and NRSRO to disclose information about the responsibilities, experience and employment history of its credit analysts and supervisors would be necessary or appropriate in the public interest or for the protection of investors.[183] First, it would assist users of credit ratings in assessing the competence of an NRSRO's credit analysts and, thereby, provide a means for users to compare NRSROs. Second, this information would assist the Commission in evaluating whether the applicant has adequate managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies.[184]

The Commission requests comment on Exhibit 8, as proposed. Comment is specifically sought on whether the information would be helpful to users of credit ratings in comparing the NRSRO to other NRSROs. The Commission also requests comment on whether other information should be provided, or whether some of the information

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183 See Section 15E(a)(1)(B)(x) of the Exchange Act (15 U.S.C. 78o-7(a)(1)(B)(x)).

184 See Sections 15E(a)(2)(C) and (d) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C) and (d)).

proposed to be required should be eliminated or modified. For example, comment is sought on whether Exhibit 8 should be limited to eliciting information about the supervisors of the credit analysts. Commenters who believe other information should be provided should describe the information and explain why it would be appropriate.

Exhibit 9 (Public). As discussed above, Section 15E(j) of the Exchange Act requires every NRSRO to designate an individual responsible for administering the policies and procedures of the credit rating agency to prevent the misuse of nonpublic information, to manage conflicts of interest, and to ensure compliance with the securities laws and the rules and regulations under those laws.[185] The ability of the compliance officer to carry out these statutorily mandated responsibilities would depend, in part, on the officer's experience and qualifications. Additionally, based on the size of the credit rating agency, it may depend also on the experience and qualifications of persons who assist the designated compliance officer in these responsibilities.

The Commission believes that requiring information about the experience and employment history of the designated compliance officer and persons assisting the officer would be necessary or appropriate in the public interest or for the protection of investors. It would assist the Commission in evaluating whether the applicant has adequate managerial resources to consistently produce credit ratings with integrity and to materially comply with its procedures and methodologies.[186] It also would be useful to users of credit ratings because it would provide information regarding the resources an NRSRO devotes to ensuring, among other things, that credit ratings are determined in

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185 15 U.S.C. 78o-7(j).

186 See Sections 15E(a)(2)(C) and (d) of the Exchange Act (15 U.S.C. 78o-7(a)(2)(C) and (d)).

accordance with the procedures and methodologies the NRSRO makes public in Exhibit 1.

The Commission requests comment on Exhibit 9, as proposed. The Commission also requests comment on whether other information should be provided, or whether some of the information proposed to be required should be eliminated or modified. Commenters should describe the additional information and why it would be appropriate.

Exhibit 10 (Confidential). Section 15E(a)(1)(B)(viii) of the Exchange Act requires that an application for registration as an NRSRO include, on a confidential basis, a list of the 20 largest issuers and subscribers that use the credit rating services provided by the credit rating agency by amount of net revenue received by the credit rating agency in the fiscal year immediately preceding the date of submission of the application.[187] This information would be required as Exhibit 10 to proposed Form NRSRO. An NRSRO would not be required to make this information public (to the extent permitted by law) or update the exhibit after registration. However, an NRSRO would be required to update this information in the audited financial statements provided to the Commission under proposed Rule 17g-3.

The statute refers to the "20 largest issuers and subscribers." The instructions to Exhibit 10 would provide that an applicant add certain large obligors (i.e., persons who are rated as an entity as opposed to having their securities rated) and underwriters to the list. Specifically, these types of customers would need to be added to the list if they are determined to have provided at least as much net revenue as the 20th largest issuer or

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187 15 U.S.C. 78o-7(a)(1)(B)(viii).

subscriber. Consequently, a credit rating agency would be required to identify the 20 largest issuers and subscribers as required by Section 15E(a)(1)(B)(viii) of the Exchange Act[188] and add any obligor and underwriter customers that met the above criteria.

The Commission believes that adding large obligor and underwriter customers to the list of the 20 largest issuer and subscriber customers would be necessary or appropriate in the public interest or for the protection of investors.[189] The Commission views the list as a means to identify customers that could potentially have undue influence on an NRSRO given the amount of revenue the customer provides the NRSRO. Obligors and securities underwriters would have as much of an interest in potentially influencing a credit rating as issuers and subscribers.

Section 15E(a)(1)(B)(viii) of the Exchange Act limits the customers required to be included in the list to users of the "credit rating services" of the applicant and NRSRO.[190] The Exchange Act[191] does not define the term "credit rating services." The Commission would interpret this term to mean any of the following: rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings to a subscriber. The intent of this interpretation is to include – along with customers that pay for credit ratings and subscriptions – customers that are rated, or whose securities or money market instruments are rated, but that did not pay for the credit rating. Even

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188 Id.

189 15 U.S.C. 78o-7(a)(1)(B)(x).

190 See 15 U.S.C. 78o-7(a)(1)(B)(viii).

191 15 U.S.C. 78a et seq.

though these customers may not have paid for the credit rating, they potentially could have undue influence on the credit rating agency if they provide substantial net revenue for other services or products.

Section 15E(a)(1)(B)(viii) of the Exchange Act provides that the determination of the 20 largest issuers and subscribers is to be based on "net revenue" received from the issuer or subscriber.[192] The Exchange Act[193] does not define the term "net revenue." The Commission proposes to interpret the term "net revenue" for the purposes of Section 15E(a)(1)(B)(viii) of the Exchange Act[194] to mean all fees, sales proceeds, commissions, and other revenue received by the applicant and its affiliates for any type of service or product, regardless of whether related to credit ratings, and net of any fees, sales proceeds, rebates, commissions, and other monies paid to the customer by the credit rating agency and its affiliates. The risk is that a large customer may be in a position to influence the determination of the credit rating. Limiting the interpretation of net revenue to revenues relating to "credit rating services" may not capture the largest customers of the NRSRO or its affiliates as these customers may use credit rating services of the NRSRO and other services of the NRSRO and its affiliates. The instructions for proposed Form NRSRO would implement this proposed interpretation by providing that the calculation of net revenue should include all revenue received from the customer.

The Commission requests comment on Exhibit 10, as proposed. The Commission specifically requests comment on its proposal to include large obligor and

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192 15 U.S.C. 78o-7(a)(1)(B)(viii).

193 15 U.S.C. 78a et seq.

194 15 U.S.C. 78o-7(a)(1)(B)(viii).

underwriter customers in the list. The Commission further requests comment on the proposed interpretations of "credit rating services" and "net revenue." Specifically, the Commission requests comment on how these interpretations affect the determination of large customers. If a commenter believes they are not practicable, the commenter should provide alternative interpretations and explain how they would achieve the goal of identifying large customers that could potentially exercise undue influence on the NRSRO.

Exhibit 11 (Confidential). Exhibit 11 would require the applicant to furnish audited financial statements for the past three fiscal or calendar years immediately preceding the date of the application. An NRSRO would not need to make the information in Exhibit 11 public (to the extent permitted by law) or update the exhibit after registration. An NRSRO would, however, be required to provide audited financial statements to the Commission annually under proposed Rule 17g-3.

The Commission believes this financial information would be necessary or appropriate in the public interest or for the protection of investors because it would assist the Commission in making the finding required by Section 15E(a)(2)(C) of the Exchange Act.[195] This section directs the Commission to grant a credit rating agency's application for registration as an NRSRO unless, among other things, the Commission finds that the applicant does not have adequate financial and managerial resources to consistently issue ratings with integrity and to materially comply with its procedures and methodologies furnished in the public exhibits and with the requirements in Sections 15E(g), (h), (i) and

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195 See 15 U.S.C. 78o-7(a)(2)(C).

(j) of the Exchange Act.[196] The financial statements would provide the Commission with information as to the applicant's net worth and income, which would assist it in determining whether the applicant has sufficient financial resources. Financial statements for three years would provide information that would assist the Commission in verifying that the applicant has been in the business of issuing credit ratings for the three years immediately preceding the date of its application for registration. An applicant must have been in the business of issuing credit ratings for the three years preceding the application to be eligible for registration with the Commission as an NRSRO.[197] The information also would alert the Commission to a significant downward trend in the applicant's financial condition, which could be relevant to whether it has adequate financial resources.

The proposed requirement that the financial statements be audited would provide the Commission with an independent verification of the information in the statements. However, the Commission anticipates that some applicants may not have been audited in the past. In this case, the applicant would only need to provide an audited financial statement for the fiscal year immediately preceding the date of the application. The other years could be covered by unaudited statements. The applicant would need to attach to the unaudited financial statements a statement by a duly authorized person of the applicant that the financial statements present fairly, in all respects, the financial condition, results of operations, and the cash flows of the applicant. This would provide a level of assurance that the information in the financial statements had been reviewed and verified by the applicant.

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196 See 15 U.S.C. 78o-7(a)(2)(C)(ii)(I).

197 See Section 3(a)(62)(A) of the Exchange Act (15 U.S.C. 78c(a)(62)(A)).

In addition, the Commission also anticipates that some applicants would be subsidiaries of holding companies. In this case, the applicant would be able to provide consolidated and consolidating financial statements of the parent company. This would diminish the burden on applicants that have a holding company audit but not an audit of the subsidiary credit rating agency. Consolidated and consolidating financial statements would provide sufficient information about the subsidiary credit rating agency for the Commission to evaluate whether its financial resources meet the requirements of Section 15E(a)(2)(C)(ii)(I) of the Exchange Act.[198]

The Commission requests comment on whether the furnishing of audited financial statements would achieve the stated purposes of the requirement.

Exhibit 12 (Confidential). Exhibit 12 would require an applicant to provide information as to the amount of revenue generated from various credit rating services and a separate computation of total revenue from all other services. The information would be for the most recently completed fiscal or calendar year and would not have to be audited. An NRSRO would not need to make the information in Exhibit 12 public (to the extent permitted by law) or update the exhibit after registration. An NRSRO would, however, be required to update this information with the annual audited financial statements provided to the Commission under proposed Rule 17g-3.

As described in the instructions for proposed Form NRSRO, the specific revenue items would be, as applicable:

- Revenue from determining and maintaining credit ratings.
- Revenue from subscribers.

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198 Id.

- Revenue from granting licenses or rights to publish credit ratings.
- Revenue from determining credit ratings that are not made readily accessible (private ratings).
- Revenue from all other services and products offered by the rating organization (include descriptions of any major sources of revenue).

The Commission believes this revenue information would be necessary or appropriate in the public interest or for the protection of investors because it would assist the Commission in making the finding with respect to adequate financial resources required by Section 15E(a)(2)(C) of the Exchange Act.[199] This information would augment the financial statements that would be required under proposed Exhibit 11 in that it would provide detail as to the revenues generated by different types of services.

The Commission requests comment on whether the furnishing of this revenue information would achieve the stated purposes of the requirement, or whether any additions, deletions or modifications should be made. The Commission also requests comment on any difficulties a credit rating agency may confront in determining its revenues from these various sources. If a commenter believes it would not be practicable to do so, the commenter should explain why.

Exhibit 13 (Confidential). Exhibit 13 would require an applicant to provide the amount of total aggregate annual compensation paid to its credit analysts and the median compensation. The information would be for the most recently completed fiscal or calendar year and would not have to be audited. An NRSRO would not need to make the information in Exhibit 13 public (to the extent permitted by law) or update the exhibit after registration. An NRSRO would, however, be required to update this

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[199] See 15 U.S.C. 78o-7(a)(2)(C).

information with the annual audited financial statements provided to the Commission under proposed Rule 17g-3.

The Commission believes this compensation information would be necessary or appropriate in the public interest or for the protection of investors because it would assist the Commission in making the finding with respect to adequate financial resources required by Section 15E(a)(2)(C) of the Exchange Act.[200] Similar to the revenue information, this information would augment the financial statements that would be required under Exhibit 11 because it provides detail on the expenses necessary to retain the credit rating agency's credit analysts.

The Commission requests comment on Exhibit 13, as proposed. The Commission also requests comment on any difficulties a credit rating agency would have in determining these compensation amounts. If a commenter believes it would not be practicable to do so, the commenter should explain why.

Request for comment. In addition to the specific requests for comment above, the Commission requests comment on all aspects of proposed Form NRSRO and the proposed instructions to the form, including whether the proposals could be more narrowly tailored and still meet the stated goals. Further, the Commission solicits comment about whether other requirements should be added, or whether items and exhibits proposed should be eliminated or modified. Commenters are asked to explain their conclusions.

D. Proposed Rule 17g-2 – Recordkeeping

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200 See 15 U.S.C. 78o-7(a)(2)(C).

The Act amends Section 17(a)(1) of the Exchange Act to add NRSROs to the list of entities required to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act.[201] The inclusion of NRSROs on the list also provides the Commission with authority under Section 17(b)(1) of the Exchange Act to examine all the records of an NRSRO.[202]

Proposed Rule 17g-2, "Records to be made and retained by nationally recognized statistical rating organizations," would implement the Commission's recordkeeping rulemaking authority under Section 17(a) of the Exchange Act.[203] The proposed rule would require an NRSRO to make and retain certain records relating to its business and to retain certain other business records, if such records are made. The rule also would prescribe the time periods and manner in which all these records must be retained.

With respect to other regulated entities, the Commission has made clear that books and records rules are "integral to the Commission's investor protection function because the preserved records are the primary means of monitoring compliance with applicable securities laws."[204] Proposed Rule 17g-2 is designed to ensure that an

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201 See Section 5 of the Act and 15 U.S.C 78q(a)(1).

202 See 15 U.S.C 78q(b)(1).

203 15 U.S.C 78q.

204 See Electronic Storage of Broker-Dealer Records, Exchange Act Release No. 47806 (May 7, 2003), 68 FR 25281 (May 12, 2003); see also Commission order in Matter of Deutsche Bank Securities, Inc. et al, Exchange Act Release No. 46937 (December 3, 2002) ("The record keeping rules are 'a keystone of the surveillance of broker-dealers'") (citations omitted); Commission order in Matter of J.P. Morgan Securities Inc., Exchange Act Release No. 51200 (February 14, 2005); Electronic Recordkeeping by Investment Companies and Investment Advisers, Investment Company Act Release No. 24991 (May 24, 2001) ("The recordkeeping requirements are a key part of the

NRSRO makes and retains records that would assist the Commission in monitoring, through its examination authority, whether an NRSRO was complying with the provisions of Section 15E of the Exchange Act[205] and the rules thereunder. For example, examiners would use the records to monitor whether an NRSRO was following its disclosed procedures and methodologies for determining credit ratings, its disclosed policies and procedures for preventing the misuse of material non-public information, and managing conflicts of interest, and whether it was complying with proposed Rules 17g-4, 17g-5 and 17g-6 discussed below.

1. Paragraph (a): Records to be Made and Retained

Paragraph (a) of proposed Rule 17g-2 would require an NRSRO to make and retain certain books and records. Under the proposed rule, the records required in paragraph (a) must be complete and current. Consequently, it would be a violation of the proposed rule to falsify a record or fail to update a record when the information on the record becomes stale or incomplete. The Commission believes the records required to be made and retained under paragraph (a) of proposed Rule 17g-2 would be necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act because, as described below, they would assist the Commission in monitoring whether an NRSRO was complying with Section 15E of the Exchange Act and the rules thereunder.[206] The Commission does not intend that these provisions of proposed Rule 17g-2 require a specific form of record. An NRSRO would

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Commission's regulatory program for funds and advisers, as they allow [the Commission] to monitor fund and adviser operations, and to evaluate their compliance with federal securities laws.").

205 15 U.S.C. 78o-7.

206 See 15 U.S.C 78q(a)(1).

have the flexibility to implement a recordkeeping system that captured the following information in a manner that conformed to the NRSRO's internal processes.

Paragraph (a)(1). Paragraph (a)(1) of proposed Rule 17g-2 would require an NRSRO to make records of original entry into the rating organization's accounting system, and records reflecting entries to and balances in all general ledger accounts of the rating organization for each fiscal year. These are fundamental business records and necessary for the preparation of the audited financial statements and schedules that would need to be prepared under proposed Rule 17g-3.

Paragraph (a)(2). Paragraph (a)(2) of proposed Rule 17g-2 would require an NRSRO to make and retain the following records with respect to each of the NRSRO's current credit ratings, as applicable: the identity of any credit analyst(s) that determined the credit rating; the identity of the person(s) who approved the credit rating before it was issued; the procedures and methodologies used to determine the credit rating; the method by which the credit rating was made readily accessible; whether the credit rating was solicited or unsolicited; and the date the credit rating action was taken. As noted above, the NRSRO would not be required to make a single record containing all this information for each current credit rating. Rather, the NRSRO would have the flexibility to implement a recordkeeping system that captured this information in different records in a manner that conformed to the NRSRO's internal processes.

The information in these records about the identity of the credit analysts, the persons who approved the credit rating, the methodology used to determine the credit rating, and whether the credit rating was solicited or unsolicited, collectively would assist the Commission in monitoring whether the NRSRO was following its procedures

and methodologies for determining credit ratings. The information about the identity of the credit analysts, and the persons who approved the credit rating, also would assist the Commission in monitoring whether the NRSRO was complying with procedures designed to prevent the misuse of material nonpublic information.

Paragraph (a)(3). Paragraph (a)(3) of proposed Rule 17g-2 would require a record identifying each person that solicits the NRSRO to determine or maintain a credit rating (e.g., an obligor, issuer, or underwriter) and the credit ratings determined for the person. This information would assist the Commission in monitoring whether the NRSRO was complying with procedures for addressing and managing conflicts of interest as well as complying with the requirements in proposed Rule 17g-5 prohibiting certain conflicts of interest.

Paragraph (a)(4). Paragraph (a)(4) of proposed Rule 17g-2 would require a record for each person that subscribes to receive the credit ratings of the NRSRO. Similar to the records that would be required under paragraph (a)(3), this information would assist the Commission in monitoring whether the NRSRO was complying with procedures for addressing and managing conflicts of interest as well as complying with the requirements in proposed Rule 17g-5 prohibiting certain conflicts of interest.

Paragraph (a)(5). Paragraph (a)(5) of proposed Rule 17g-2 would require a record describing each type of service and product offered by the NRSRO. This record would provide the Commission with details of the ancillary business activities of the credit rating agency and, therefore, would be useful in identifying potential conflicts of interest that arise from such activities. Commission examiners would then be able to

review whether the NRSRO had implemented procedures to manage these potential conflicts.

Request for comment. The Commission requests comment on whether the records that would be required to be made and retained under paragraph (a) of proposed Rule 17g-2 would achieve the stated purposes of the requirements. Commenters should explain any conclusions they reach on this question with respect to each type of record. The Commission also requests comment on whether there are other types of records that should be required, or whether any of the proposed requirements should be modified or omitted. Commenters that believe additional records should be required are asked to describe the record and explain why the Commission should require that it be made and retained.

2. Records to Be Retained if Made

There are certain records an NRSRO may make or receive as a matter of business practice. The Commission does not believe an NRSRO should be required, by rule, to make these records. However, the Commission believes an NRSRO should be required to retain these records for a period of time because the records would assist the Commission's oversight of NRSROs. Accordingly, paragraph (b) of proposed Rule 17g-2 would require that an NRSRO retain certain records, if they are made or received by the NRSRO. Since these are not records that are required to be made, they would not need to be updated under the requirements of proposed Rule 17g-2. Rather, the rule would require that the NRSRO retain the original record in an unaltered form or a true copy of the original record for the prescribed retention period. The Commission notes,

however, that, under Section 15E(b)(1) of the Exchange Act,[207] an NRSRO must update, as provided in that section, the forms and exhibits (Form NRSRO) that would be required to be retained under paragraph (b)(9) of proposed Rule 17g-2 (discussed below).

The Commission believes the records required to be retained under paragraph (b) of proposed Rule 17g-2 would be necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act because, as described below, they would assist the Commission in monitoring whether an NRSRO was complying with Section 15E of the Exchange Act[208] and the rules thereunder.[209]

Paragraph (b)(1). Paragraph (b)(1) of proposed Rule 17g-2 would require an NRSRO to retain all significant records underlying the information included in the credit rating agency's annual audited financial statements and schedules required under proposed Rule 17g-3. This would require the NRSRO to retain records such as bank statements, bills payable and receivable, trial balances and records relating to the determination of the largest customers for the list required under paragraph (b)(iii) of proposed Rule 17g-3. These records would assist Commission examiners in understanding and verifying the basis for information provided in the audited financial statements and schedules the NRSRO would be required to annually furnish to the Commission. For example, examiners could use the records relating to the list of the largest customers to verify that the NRSRO had identified such customers in accordance with proposed Rule 17g-3.

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207 See 15 U.S.C. 78o-7(b)(1).

208 15 U.S.C. 78o-7.

209 See 15 U.S.C 78q(a)(1).

Paragraph (b)(2). Paragraph (b)(2) of proposed Rule 17g-2 would require an NRSRO to retain internal records, including non-public information and work papers, used to determine a credit rating. These records would include, for example, notes of conversations with the management of an issuer or obligor that was the subject of the credit rating and the inputs and raw results of a quantitative model used to determine the credit rating. The retention of this information, and other internal records used to determine a credit rating, would assist the Commission in verifying whether an NRSRO was complying with its procedures and methodologies for determining credit ratings and for preventing the misuse of material nonpublic information.

Paragraph (b)(3). Paragraph (b)(3) of proposed Rule 17g-2 would require an NRSRO to retain credit analysis reports, credit assessment reports, and private credit rating reports and internal records, including nonpublic information and work papers, used to form the basis for the opinions expressed in these reports. These reports – which credit rating agencies commonly create and sell as an ancillary service to the issuance of credit ratings – generally provide a detailed analysis of the information and assumptions underlying a credit rating. In developing these reports, the credit analyst may receive material nonpublic information about an issuer or obligor. For example, an issuer may request a private credit rating report to understand how a contemplated transaction would impact the current publicly available credit rating of its debt securities. Consequently, the retention of these reports and internal records used to form the basis of the reports would assist the Commission in monitoring whether the NRSRO was complying with its policies and procedures for preventing the misuse of material nonpublic information.

Paragraph (b)(4). Paragraph (b)(4) of proposed Rule 17g-2 would require an NRSRO to retain all compliance reports and exception reports relating to the business of operating as credit rating agency. The retention of these reports would identify activities of the NRSRO that its designated compliance officer had determined raised, or did not raise, compliance and control issues. Examiners would then be able to review how the NRSRO addressed the compliance issues. This could lead to more focused examinations, which also would decrease the burden on the NRSRO. The reports also would provide information as to whether the NRSRO was complying with its rating credit ratings methodologies, procedures, and policies.

Paragraph (b)(5). Paragraph (b)(5) of proposed Rule 17g-2 would require an NRSRO to retain all internal audit plans, internal audit reports, and documents relating to internal audit follow-up measures relating to the business of operating as credit rating agency and all records identified by the NRSRO's internal auditors as necessary to perform the audit of an activity relating to the business of operating as credit rating agency. Similar to the compliance reports, the retention of these records would identify activities of the NRSRO that its internal auditors determined raised, or did not raise, compliance or control issues. They also would assist the Commission in verifying whether the NRSRO was complying with its stated methods, procedures, and policies.

Paragraph (b)(6). Paragraph (b)(6) of proposed Rule 17g-2 would require an NRSRO to retain all marketing materials relating to the business of operating as credit rating agency. Section 15E(f) of the Exchange Act prohibits an NRSRO from representing that it has been designated, recommended, or approved, or that its abilities

or qualifications have been passed upon by any federal agency or officer.[210] The retention of marketing materials would assist the Commission in verifying that the NRSRO was complying with this statutory provision.

Paragraph (b)(7). Paragraph (b)(7) of proposed Rule 17g-2 would require an NRSRO to retain all external and internal written communications, including electronic communications, received and sent by the NRSRO and its employees relating to initiating, determining, maintaining, changing or withdrawing a credit rating. The retention of written communications has played an important role in assisting the Commission in identifying legal violations and compliance issues with respect to other regulated entities.[211]

Paragraph (b)(8). Paragraph (b)(8) of proposed Rule 17g-2 would require an NRSRO to retain the record that must be made under paragraph (b) of proposed Rule 17g-6 with respect to declining to determine or withdrawing a credit rating with respect to a structured product. The retention of this record would assist the Commission in understanding the reason behind an NRSRO's decision to take one of these actions and, therefore, to monitor its compliance with the prohibitions in proposed Rule 17g-6.

Paragraph (b)(9). Paragraph (b)(9) of proposed Rule 17g-2 would require an NRSRO to retain the forms and exhibits (Form NRSRO) furnished to the Commission under proposed Rule 17g-1. This would make the forms and exhibits subject to the retention and production requirements in proposed Rule 17g-2. For example, they would

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210 15 U.S.C. 78o-7(f).

211 See e.g., Commission complaint in Commission v. Citigroup Global Markets Inc., 03 CV 2945 (WHP) (S.D.N.Y.) (April 28, 2003); Commission complaint in Commission v. Merrill, Lynch, Pierce, Fenner & Smith, 03 CV 2941 (WHP) (S.D.N.Y) (April 28, 2003); Commission Order in Matter of Columbia Management Advisers, Inc. and Columbia Funds Distributor, Inc., Securities Act Release No. 8534 (February 9, 2005).

need to be retained in a manner that makes them easily accessible to the NRSRO's principal office. This would assist Commission examiners, particularly examiners in regional and district offices, in accessing the records on site during an examination.

Request for comment. The Commission requests comment on whether the retention of the records under paragraph (b) of proposed Rule 17g-2 would achieve the stated purposes of the requirements. Commenters should explain any conclusions they reach on this question with respect to each type of record. The Commission also requests comment on whether there are other standards or criteria that could be used to further tailor these requirements. The Commission further requests comment on whether there are other types of records that should be required to be retained, or whether any proposed requirements should be eliminated or modified. Commenters that believe additional records should be retained are asked to describe the record and explain why requiring its retention would be necessary.

3. Remaining Provisions

Proposed Rule 17g-2 has additional provisions that would prescribe how long the records in paragraphs (a) and (b) would need to be retained, the manner in which they would need to be retained and the manner in which they, and any other records subject to the Commission's examination authority, would need to be produced. The Commission believes the additional provisions of proposed Rule 17g-2 would be necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act because, as described below, they would assist the

Commission in monitoring whether an NRSRO was complying with Section 15E of the Exchange Act and the rules thereunder.[212]

Paragraph (c). Paragraph (c) of proposed Rule 17g-2 would prescribe how long the records identified in paragraphs (a) and (b) would need to be retained by an NRSRO. Specifically, the records required to be made pursuant to paragraph (a) would need to be retained for three years after the record is replaced with an updated record, except that the records with respect to customers would need to be retained for three years after the NRSRO's business relationship with the customer ended. The records required to be retained under paragraph (b) would need to be retained for three years after the record is made or received by the NRSRO. The three year retention periods are designed to ensure that the records are preserved for at least one internal audit or Commission exam cycle.

Paragraph (d). Paragraph (d) of proposed Rule 17g-2 would provide that records retained pursuant to paragraphs (a) and (b) must be retained in a manner that makes them easily accessible to the principal office and any other office that conducted activities causing the record to be made or received. This provision is designed to facilitate Commission examination of the NRSRO and to avoid delays in obtaining the records during an on-site examination. The proposed rule does not specify the format in which the records must be retained. NRSROs could retain them in, for example, paper form, on microfilm or microfiche, and electronically.

Paragraph (e). Paragraph (e) of proposed Rule 17g-2 would provide that records identified in paragraphs (a) and (b) could be made or retained by a third-party record

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212 See 15 U.S.C 78q(a)(1).

custodian, provided the NRSRO furnishes the Commission with a written undertaking of the custodian. The proposed form of the undertaking is designed to ensure that storing the records with a third-party does not make them less accessible than records stored at an NRSRO's offices. Thus, the third-party would undertake that the records are the exclusive property of the NRSRO, will be produced promptly to the NRSRO or the Commission and its representatives at the request of the NRSRO, and will be available for inspection by the Commission and its representatives. The proposed rule also would provide that an NRSRO would remain responsible for complying with the Commission's books and records rules, notwithstanding the fact that a third-party was making and/or storing the records.

Paragraph (f). Paragraph (f) of proposed Rule 17g-2 would provide that a non-resident NRSRO (defined in paragraph (h)) must undertake to send books and records to the Commission and its representatives upon request. The undertaking would need to be attached to an initial application for registration as an NRSRO (see Item 3 of proposed Form NRSRO). This proposed requirement is designed to provide a mechanism for the Commission examination staff to inspect records maintained overseas without having to travel to the location. In addition, because some non-resident NRSROs may maintain original records in a language other than English, the proposed undertaking would require a translation if the Commission requested it.

Paragraph (g). Paragraph (g) of proposed Rule 17g-2 would require an NRSRO to promptly furnish the Commission with copies of the records that it would have to retain under proposed Rule 17g-2 and any other records of the NRSRO that are subject

to examination by the Commission under Section 17(b) of the Exchange Act[213] that are requested by the Commission and its staff. Similar to the "easily accessible" requirement of paragraph (d), this proposed requirement is designed to facilitate Commission examinations of NRSROs by requiring an NRSRO to promptly produce requested records.

Paragraph (h). Paragraph (h) of proposed Rule 17g-2 would define the term non-resident rating organization to mean an NRSRO that is located or has its principal office in a location outside the U.S., its territories, or possessions. This definition is similar to definitions of non-resident entities in other Commission rules.[214]

Request for comment. The Commission requests comment on whether the additional provisions of proposed Rule 17g-2 would achieve the stated purposes of the requirements. Commenters should explain any conclusions they reach on this question with respect to a provision. The Commission also requests comment on whether there are other provisions that should be required, or whether any proposed requirements should be modified or omitted. Commenters that believe additional provisions would be appropriate are asked to describe the nature of the provision and explain why it should be required.

More broadly, the Commission requests comment on all aspects of proposed Rule 17g-2, including whether the proposals could be more narrowly tailored and still meet the stated goals, or whether items should be added, eliminated, or modified. Commenters are asked to explain their conclusions.

E. Proposed Rule 17g-3 – Annual Audit

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213 See 15 U.S.C 78q(b).

214 See e.g., 17 CFR 240.17a-7 and 17 CFR 275.0-2.

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[215] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[216] For the reasons discussed below, the Commission believes proposed Rule 17g-3 requiring annual financial statements and schedules would be necessary or appropriate in the public interest or for the protection of investors.[217]

First, Section 15E(d) of the Exchange Act provides that the Commission shall, by order, censure, place limitations on the activities, functions or operations of, suspend for a period not exceeding 12 months, or revoke the registration of an NRSRO if, among other things, the NRSRO fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity.[218] The audited financial statements and schedules required to be furnished by an NRSRO on an annual basis under proposed Rule 17g-3 would assist the Commission in monitoring the NRSRO's financial resources and whether the resources were at a level that would necessitate the Commission taking action under Section 15(d) of the Exchange Act.[219]

Second, Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration, as prescribed in that section, if any information or

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215 15 U.S.C. 78o-7(k).

216 Id.

217 See 15 U.S.C. 78o-7(k).

218 15 U.S.C. 78o-7(d).

219 Id.

document provided in the application becomes materially inaccurate.[220] As discussed above, the application (proposed Form NRSRO) would require the following financial information: a list of large customers in terms of net revenues, audited financial statements, information about revenues, and information about credit analyst compensation. This information would need to be as of, or for, the previous fiscal year. Accordingly, information only would become materially inaccurate and, therefore, need to be updated on an annual basis. In addition, the information would be furnished in the application on a confidential basis and, to the extent permitted by law, would not need to be made public. Therefore, because the information only would be disclosed to the Commission, it would be more appropriate to update this information by furnishing an annual financial statement and schedules than by furnishing an amended Form NRSRO.

Paragraph (a). Paragraph (a) of proposed Rule 17g-3 would require an NRSRO to furnish the audited financial statements to the Commission annually, as of the fiscal year end indicated on the NRSRO's current Form NRSRO, within 90 calendar days after the end of such fiscal year. The financial statements would include the schedules discussed below. The requirement that the financial statements be audited, therefore, would provide the Commission with an independent verification that the information in the financial statements is presented fairly, in all material respects, and that the schedules are presented fairly, in all material respects, based on the financial statements taken as a whole. The 90 day time period would be consistent with the time period for furnishing the annual certification with respect to NRSROs whose fiscal year-end is the end of the

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220 15 U.S.C. 78o-7(b)(1).

calendar year. These NRSROs could furnish both the annual audited financial statements and the annual certification to the Commission at the same time.

Paragraph (a) also would provide that the financial statements be prepared according to generally accepted accounting principles and comply with applicable provisions of the Commission's Regulation S-X.[221] These requirements are designed to ensure that the financial statements comport with accounting standards and Commission rules.

Paragraph (b). Paragraph (b) of proposed Rule 17g-3 would require an NRSRO to include three supporting schedules in the audited financial statements. These schedules would be the mechanism by which an NRSRO would update the list of large customers, information about revenues, and information about total aggregate credit analyst compensation and median compensation originally furnished in the NRSRO's initial application for registration.

As discussed above with respect to Exhibit 10, the list of the largest customers would assist the Commission in identifying customers of an NRSRO that could potentially have undue influence on the NRSRO given the amount of revenue they provide the credit rating agency. The largest customers would be determined using the same definitions of "net revenues" and "credit rating services" discussed with respect to Exhibit 10. In addition, just as with Exhibit 10, obligor and underwriter customers would be added to the list to the extent they were as large as, or larger than, the 20th largest issuer or subscriber customer.

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221 17 CFR 210.1-01 et seq.

The information on revenue sources and analyst compensation that would be required in the schedule would be the same as the information that would be required in Exhibits 12 and 13, respectively. The information on revenue sources and credit analyst compensation would augment the financial statements by providing detail as to the revenues generated specifically from credit rating services and the expenses necessary to retain the credit rating agency's credit analysts. This information collectively would assist the Commission in monitoring whether an NRSRO maintains adequate financial resources to consistently produce credit ratings with integrity.[222]

Paragraph (c). Paragraph (c)(1) of proposed Rule 17g-3 would require that the financial statements be certified by an independent public accountant in accordance with the provisions the Commission's Regulation S-X. These provisions are designed to ensure that auditors are independent of their audit clients.[223]

Paragraph (c)(2) of proposed Rule 17g-3 would require that the NRSRO attach to the financial statements a statement by a duly authorized person of the NRSRO that the financial statements present fairly, in all respects, the financial condition, results of operations, and the cash flows of the NRSRO. This would provide a level of assurance that the information in the financial statements had been reviewed and verified by the NRSRO. This proposed requirement parallels Commission Rule 17a-5(e)(2), which requires a duly authorized officer of a broker-dealer (or, in the case of a general

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222 15 U.S.C. 78o-7(d).

223 See Final Rule: Strengthening the Commission's Rules Regarding Auditor Independence, Securities Act Release No. 8183 (January 28, 2003), 68 FR 6005 (February 5, 2003).

partnership, the general partner) to attach an oath or affirmation stating the financial statements and schedules required under that rule are true and correct.[224]

Finally, Paragraph (d) of proposed Rule 17g-3 would provide that the Commission may grant an extension of time from any requirements in the proposed rule either unconditionally or on specified terms and conditions on the written request of an NRSRO, if the Commission finds that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors. The Commission believes the 90-day period after the end of the fiscal year to prepare and furnish the financial statements and schedules required under proposed Rule 17g-3 would be a sufficient amount of time to fulfill these requirements. However, there may be situations where an NRSRO would require more time. In such cases, the NRSRO would be required to request an extension in writing and the Commission could grant it unconditionally or subject to certain specified terms and conditions.

Request for comment. The Commission requests comment on all aspects of proposed Rule 17g-3, including whether the proposed requirements could be more narrowly tailored and still meet the stated goals. Further, the Commission solicits comment on whether any additional requirements should be added, or whether any of the proposed requirements should be omitted or modified. The Commission also requests comment on the 90-day time period to provide the audited financial statements and, in particular, whether that time frame is too long or too short. The Commission further requests comment on whether the requirement that the schedules to the financial statements be audited is practicable, given the information to be included in them.

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224 17 CFR 240.17a-5(e)(2).

Commenters that believe it would not be practicable should explain the reasons for their conclusion.

F. Proposed Rule 17g-4 – Procedures to Prevent the Misuse of Material Non-Public Information

Section 15E(g)(1) of the Exchange Act[225] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[226] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[227] Proposed Rule 17g-4 would implement this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[228] include three specific types of procedures.

First, paragraph (a) of proposed Rule 17g-4 would require procedures designed to prevent the inappropriate dissemination within and outside the NRSRO of material nonpublic information obtained for the purpose of developing a credit rating. Some credit rating agencies, as part of their analysis, contact senior management of the obligors and issuers subject to their credit ratings. In the course of these contacts, an issuer or obligor may provide the credit rating agency with nonpublic information including contemplated business transactions or estimated financial projections.[229] Credit rating agencies have commented that this confidential information greatly assists

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225 15 U.S.C. 78o-7(g)(1).

226 15 U.S.C. 78a et seq.

227 15 U.S.C. 78o-7(g)(2).

228 15 U.S.C. 78o-7(g)(1).

229 See Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization, Securities Act Release No. 8570 (April 22, 2005), 70 FR 21306 (April 25, 2005).

them in issuing credible and reliable ratings.[230] In fact, the Commission's Regulation FD, which governs the disclosure of material non-public information by issuers, contains an exception that permits issuers to intentionally disclose material non-public information to a credit rating agency without making a simultaneous public disclosure of the information.[231] The selective disclosure to the credit rating agency, however, must be solely for the purpose of developing a publicly available credit rating.[232]

Under paragraph (a) of proposed Rule 17g-4, a credit rating agency that permits its credit analysts to contact an issuer or obligor in the process of determining or maintaining a credit rating would be required to, for example, have procedures reasonably designed to prevent material, non-public information obtained by the credit analyst from being shared with or made readily accessible to any person outside the NRSRO or to persons employed by the NRSRO who do not need to know the information because they are not involved in determining or approving the credit rating. One concern that has been raised in the past is that subscribers to a credit rating agency's more detailed credit reports also may be granted direct access to the credit analysts.[233] If the credit analyst is in possession of material non-public information, there is a risk the

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230 See Id.

231 See 17 CFR 243.100.

232 17 CFR 243.100(b)(2)(iii).

233 See Commission 2003 CRA Report and Commission 2003 Concept Release, Securities Act Release No. 8236 (June 4, 2003), 68 FR 35258 (June 12, 2003), noting the concern raised by some that subscribers may have preferential access to credit analysts and, as a result, may inappropriately learn material non-public information in the possession of a credit analyst.

information may be inappropriately disclosed to the subscriber during the course of communications with the credit analyst.[234]

The Commission believes NRSROs should have flexibility to develop procedures tailored to their specific organizational structures and business models and, consequently, is not proposing to prescribe specific procedures. Nonetheless, as applicable to the business model of the NRSRO, an NRSRO could have procedures requiring credit analysts to receive training in the laws governing the misuse of material non-public information; defining the persons within the NRSRO with whom the credit analyst can share the information; prohibiting the credit analyst from disclosing the information to any other persons; and requiring the credit analyst to take steps to safeguard documents containing the information. An NRSRO that does not use management contacts as part of its methodology for determining credit ratings could prohibit credit analysts from contacting rated issuers or obligors.

Paragraph (b) of proposed Rule 17g-4 would require an NRSRO to implement specific procedures designed to prevent an associated person or member of an associated person's household from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person possesses or has access to material nonpublic information obtained for the purpose of developing a credit rating. This proposed rule recognizes the risk that individuals in possession of, or with access to, material nonpublic information about an issuer or obligor may trade securities or money market instruments on the information.[235] Again, the Commission does not

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234 Id.

235 See e.g., Commission complaint in Commission v. Rick A. Marano, William Marano and Carl Loizzi, 04 CV 5828 (Judge Kimba Wood) (S.D.N.Y.); see also Commission

intend to prescribe exact procedures. However, as applicable to the business model of the NRSRO, an NRSRO could have policies prohibiting associated persons from purchasing or selling a security or money market instrument that is subject to a pending rating action; requiring associated persons to obtain pre-approval before purchasing or selling a security or money market instrument; and requiring associated persons to be notified of securities or money market instruments that are on a "do not trade" list.

Paragraph (c) of proposed Rule 17g-4 would require an NRSRO to implement specific procedures designed to prevent the inappropriate dissemination within and outside the NRSRO of a credit rating action prior to making the action readily accessible. This provision recognizes that a credit rating action of an NRSRO that is not yet public may be material, non-public information. Consequently, an NRSRO should have policies designed to ensure that its pending credit rating actions are not disclosed in a manner that allows a person to trade on the information before the action is widely disseminated to the market. Once again, the Commission does not intend to prescribe specific procedures. However, as applicable to the business model of the NRSRO, these policies could include procedures designed to ensure that a credit rating action is issued in a way that makes it readily accessible to the market place, such as posting the credit rating or an announcement of the credit rating action on the NRSRO's Web site or through a news or information service used by market participants. The policies also could include procedures prohibiting credit analysts from selectively disclosing the pending action to persons outside the NRSRO and to persons inside the NRSRO who do not need to know of the pending action.

Litigation Release No. 18799 (July 27, 2004).

At the same time, the Commission understands that some credit rating agencies, as part of their methodologies for determining credit ratings, will discuss a proposed credit rating action with the management of the issuer or obligor being rated to solicit their views or provide an opportunity to appeal the decision. NRSROs engaging in this practice should have procedures designed to ensure that the discussions with the issuer or obligor do not lead to the selective disclosure of the information to persons other than those persons within the issuer or obligor who are authorized to receive the information.

The Commission requests comment on all aspects of this proposed rule, including whether the proposals could be more narrowly tailored and still meet the stated goals. The Commission also requests comment on whether other types of specific procedures should be required, or whether any of the proposed requirements should be omitted or modified.

G. Proposed Rule 17g-5 – Management of Conflicts of Interest

Section 15E(h)(1) of the Act requires an NRSRO to establish, maintain, and enforce policies and procedures reasonably designed, taking into consideration the nature of its business, to address and manage conflicts of interest.[236] Section 15E(h)(2) of the Act requires the Commission to adopt rules to prohibit or require the management and disclosure of conflicts of interest relating to the issuance of credit ratings.[237] Proposed Rule 17g-5 would implement this statutory provision by requiring an NRSRO to disclose and manage certain conflicts of interest and prohibiting other conflicts of interest.

Paragraph (a) of proposed Rule 17g-5 would make it unlawful for an NRSRO to have a conflict of interest relating to the issuance of a credit rating that is identified in

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236 15 U.S.C. 78o-7(h)(1).

237 15 U.S.C. 78o-7(h)(2).

paragraph (b) of the proposed rule unless the NRSRO has publicly disclosed the type of conflict of interest in compliance with Rule 17g-1 and has implemented policies and procedures to address and manage such conflict of interest in accordance with Section 15E(h)(1) of the Exchange Act. As discussed, Rule 17g-1 would require an NRSRO to apply for registration and update its registration using Form NRSRO. Exhibit 6 to proposed Form NRSRO would require the NRSRO to identify and publicly disclose the types of conflicts of interest that arise from its business activities as required by Section 15E(a)(1)(B)(vi) of the Exchange Act.[238] As mentioned above, Section 15E(h)(1) of the Exchange Act requires an NRSRO to establish, maintain, and enforce written policies and procedures to address conflicts of interest.[239] Accordingly, under proposed Rule 17g-5, it would be unlawful for an NRSRO to have a conflict of interest identified in paragraph (b) of the rule if it had not complied with its regulatory and statutory requirements with respect to disclosing and managing types of conflicts of interest. The Commission believes that these requirements in proposed Rule 17g-5 would be appropriate in the public interest and for the protection of investors because they are designed to ensure that users of credit ratings are made aware of the potential conflicts of interest that arise from an NRSRO's business activities and that an NRSRO establishes policies and procedures for managing the specific conflicts.

The types of conflicts identified in paragraph (b) of proposed Rule 17g-5 are those that a credit rating agency commonly faces, depending on its business model. Consequently, prohibiting them outright could adversely impact the ability of an NRSRO to operate as a credit rating agency. Nonetheless, the conflicts should be

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238 15 U.S.C. 78o-7(a)(1)(B)(vi).

239 Id.

managed through policies and procedures and disclosed so that users of the credit ratings can assess whether the conflict impacts the NRSRO's judgment.

The first type of conflict identified in paragraph (b) of proposed Rule 17g-5 involves receiving compensation from a rated person for a service or product of the NRSRO or its affiliates.[240] This type of conflict arises from a common business model in the credit rating industry; namely, charging issuers and obligors to determine and maintain a credit rating of the issuer or obligor. A related conflict may arise when the credit rating agency offers other services and products of its own and its affiliates to rated issuers and obligors, including credit assessment and risk management consulting.[241] Furthermore, an NRSRO could potentially issue a credit rating that the rated issuer or obligor uses for regulatory purposes. For example, an issuer may rely on the credit rating to qualify for Form S-3 – the Commission's "short-form" registration statement.[242]

The second type of conflict identified in paragraph (b) of proposed rule 17g-5 involves having an ownership interest (securities or otherwise) in an issuer or obligor subject to a credit rating of the NRSRO.[243] As discussed below, this conflict would be

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240 Paragraph (b)(1) of proposed Rule 17g-5. See 15 U.S.C. 78o-7(h)(2)(A).

241 See Commission 2003 CRA Report noting concerns of some that conflicts in this area could become much greater if these ancillary services were to become a substantial portion of an NRSRO's business. See also Commission 2003 CRA Concept Release, Securities Act Release No. 8236 (June 4, 2003), 68 FR 35258 (June 12, 2003), noting concerns of some that greater concerns about conflicts of interest that arise when a credit rating agency offers consulting or other advisory services to issuers it rates.

242 Form S-3 (17 CFR § 239.13).

243 Paragraph (b)(2) of proposed Rule 17g-5. See 15 U.S.C. 78o-7(h)(1)(C); see also Proposed Rule: Definition of Nationally Recognized Statistical Rating Organization, Securities Act Release No. 8570 (April 22, 2005), 70 FR 21306 (April 25, 2005), which noted that conflicts may arise when a person associated with a credit rating agency also is associated with, or has an interest in, an issuer that is being rated.

prohibited under paragraph (c) of proposed Rule 17g-5 if the NRSRO, credit analyst, or an associated person approving the credit rating had the ownership interest.[244] However, it may be appropriate for an NRSRO to permit employees that have no involvement in determining or approving the credit rating of an obligor or issuer to own securities of the entity.[245] For example, a prohibition for all employees could be a particular hardship if the NRSRO issued credit ratings with respect to most public companies.

The third type of conflict identified in paragraph (b) of proposed rule 17g-5 involves receiving compensation from subscribers that use the credit ratings of the NRSRO for regulatory purposes.[246] As discussed in section I, numerous federal and state statutes and regulations use the term "NRSRO." A subscriber potentially could be subject to one or more of these statutes and regulations and, consequently, benefit depending on how the NRSRO rates securities held by the subscriber. For example, a broker-dealer subscriber holding debt securities would be able to apply lower haircuts when computing its net capital under Exchange Act Rule 15c3-1, if the securities are rated investment grade by two NRSROs.[247] Regulatory users of credit ratings such as broker-dealers likely also would be subscribers to an NRSRO's credit ratings or credit

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244 Several commenters to the 2005 proposing release recommended prohibiting a credit rating agency and its analysts from owning securities in the companies they rate. Letters from Charles D. Brown, General Counsel, Fitch, Inc., dated June 9, 2005; Marjorie E. Gross, Senior Vice President and Regulatory Counsel, The Bond Market Association and Frank A. Fernandez, Senior Vice President and Chief Economist, Securities Industry Association, dated June 9, 2005; and Larry G. Mayewski, Executive Vice President & Chief Rating Officer, A.M. Best Company, Inc., dated June 9, 2005.

245 Cf. 17 CFR 275.204A-1(e)(1) (defining "access person" for purposes of requiring investment advisers to establish procedures requiring access persons to report their personal securities holdings).

246 Paragraph (b)(3) of proposed Rule 17g-5.

247 See, 17 CFR 240.15c3-1(c)(2)(vi)(E), (F), and (H).

analysis. Therefore, prohibiting this conflict could be impractical, particularly for NRSROs that rely solely on a subscription-based business model.

The fourth type of conflict identified in paragraph (b) of proposed rule 17g-5 involves having an ownership interest in a subscriber that uses the NRSRO's credit ratings for regulatory purposes.[248] This potentially could create an incentive for the credit rating agency or an associated person to issue a credit rating that allows the subscriber to take advantage of a benefit in a statute or regulation using the NRSRO concept.

The fifth type of conflict identified in paragraph (b) of proposed rule 17g-5 involves having a business or personal relationship or affiliation with a rated issuer or obligor, underwriter of a rated issuer's securities, or a subscriber that uses the credit ratings for regulatory purposes.[249] An example of this conflict would include a person associated with the NRSRO having a relative or spouse who worked for a rated issuer, obligor, or underwriter of a rated issuer's securities. It also would include a person associated with the NRSRO having a business relationship with one of these types of entities, for example, receiving a loan from a bank that is rated.[250] The Commission believes, however, that prohibiting these types of relationships outright may be unnecessary or could prove impractical. However, an NRSRO should have robust policies and procedures to manage conflicts arising from these relationships. Moreover, paragraph (c) of proposed Rule 17g-5 would not prohibit a credit analyst or associated person approving the credit rating from having these types of relationships with the rated

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248 Paragraph (b)(4) of proposed Rule 17g-5.

249 Paragraph (b)(5) of proposed Rule 17g-5.

250 See 15 U.S.C. 78o-7(h)(2)(C).

issuer or obligor or underwriter of the rated issuer's securities.[251] However, there may be circumstances where an NRSRO, as part of its policies and procedures, should prohibit the conflict. One potential example would be if the credit analyst's spouse or close family member works for the rated issuer or obligor.

The sixth type of conflict identified in paragraph (b) of proposed rule 17g-5 involves being an officer or director of a rated issuer or obligor, underwriter of a rated issuer's securities, or subscriber that uses the NRSRO's credit ratings for regulatory purposes.[252] As discussed below, this type of conflict would be prohibited under paragraph (c) of proposed Rule 17g-5 if the credit analyst or associated person responsible for approving the credit rating was an officer or director of one of these entities. However, it may be appropriate, subject to adequate policies and procedures, for other employees of the NRSRO and its affiliates to serve in these roles, since they would have no direct role in determining the credit rating.

The seventh type of conflict identified in paragraph (b) of proposed rule 17g-5 would be any other type of conflict that the NRSRO identifies on proposed Form NRSRO in compliance with Section 15E(a)(1)(B)(vi) of the Exchange Act[253] and proposed Rule 17g-1. This catchall provision would capture conflict types not specifically listed in paragraph (b) of Rule 17g-5 that the NRSRO has identified on Exhibit 6 to proposed Form NRSRO as arising from its business activities.[254]

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251 See 15 U.S.C. 78o-7(h)(2)(D).

252 Paragraph (b)(5) of proposed Rule 17g-5.

253 15 U.S.C. 78o-7(a)(1)(B)(vi).

254 See 15 U.S.C. 78o-7(h)(2)(E).

Paragraph (c) of proposed Rule 17g-5 would specifically prohibit four types of conflicts of interest. The Commission preliminarily believes that prohibiting such conflicts of interest would be appropriate in the public interest and for the protection of investors.

The first proposed prohibition would make it unlawful for an NRSRO to have a conflict relating to the issuance of a credit rating where the person soliciting the credit rating was the source of 10% or more of the total net revenue of the NRSRO and its affiliates in the most recently ended fiscal year.[255] Such a person would be in a position to exercise substantial influence on the NRSRO.[256] It would be difficult for the NRSRO to remain impartial, given the impact on the NRSRO's income if the issuer, obligor or underwriter withdrew its business. Given our understanding that fees from a single entity generally compose a very small percentage of the revenues of entities currently identified as NRSROs, the Commission preliminarily believes that a 10% threshold is a reasonable benchmark for registered NRSROs.[257]

The second proposed prohibition would make it unlawful for an NRSRO to have a conflict relating to the issuance of a credit rating where the NRSRO, a credit analyst responsible for the credit rating, or a person associated with the NRSRO responsible for approving the credit rating, owns securities of, or has any other ownership interest in the

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255 Paragraph (c)(1) of proposed Rule 17g-5. The determination of "net revenue" would be same as the determination of net revenue for purposes of Form NRSRO and proposed Rule 17g-3.

256 As noted in the Commission 2003 CRA Report, some participants in the Commission 2002 CRA Hearings expressed concern that ancillary services could become much greater in the future and suggestions were made that their percentage contribution to total revenue be capped.

257 As noted in the Commission 2003 CRA Report, fees from any single issuer typically comprise a very small percentage – less than 1% -- of a credit rating agency's total revenue.

rated person, or is a borrower or lender with respect to the rated person.[258] The Commission preliminarily believes that the NRSRO, credit analyst responsible for determining the credit rating, and person responsible for approving the credit rating should not have a direct financial interest in the rated issuer or obligor. The Commission preliminarily believes an NRSRO or associated person having such a financial interest could not remain impartial and issue an objective credit rating in these circumstances.[259]

The third proposed prohibition would make it unlawful for an NRSRO to have a conflict relating to the issuance of a credit rating where the rated entity is a person associated with the NRSRO.[260] The Commission preliminary believes an NRSRO would not be able to maintain an appropriate level of impartiality when issuing a credit rating with respect to an affiliated entity.

The fourth proposed prohibition would make it unlawful for an NRSRO to have a conflict relating to the issuance of a credit rating where the credit analyst responsible for the credit rating, or a person associated with the NRSRO responsible for approving the credit rating, also is an officer or director of the person that is the subject of the credit rating.[261] Again the Commission preliminarily believes that an NRSRO or person associated with the NRSRO having such a position could not issue an objective credit rating in these circumstances.

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258 Paragraph (c)(2) of proposed Rule 17g-5.

259 The Senate Report notes that rating agencies argue that although the pay-for-rating business model presents inherent conflicts of interest, the conflict is effectively managed inasmuch as credit analysts do not benefit financially from any of their ratings decisions. The Senate Report further notes that credit analysts are not permitted to own any of the securities they follow.

260 Paragraph (c)(3) of proposed Rule 17g-5.

261 Paragraph (c)(4) of proposed Rule 17g-5. Cf. Rule 2711 of the National Association of Securities Dealers, Inc. ("NASD") allowing a securities research analyst to be an officer or director of a subject company if proper disclosure is made.

The Commission requests comment on all aspects of proposed Rule 17g-5, including whether the proposals could be more narrowly tailored and still meet the stated goals. The Commission also requests comment on whether paragraph (b) of proposed Rule 17g-5 captures all the types of conflicts that arise from the activities of a credit rating agency. Comment also is sought on whether proposed Rule 17g-5 should contain materiality thresholds insomuch as some conflicts may be inconsequential. The Commission seeks comment on whether the focus of the proposal on the "type" of conflict of interest would appropriately capture the conflicts that arise from the business of a credit rating agency. In addition, the Commission requests comment on the prohibited conflicts and whether these conflicts should be permitted if a credit rating agency discloses them and has procedures in place to manage such conflicts. If so, what specific disclosures should be required? Alternatively, should the rule prohibit other types of conflicts of interest, or should some of the proposed requirements be eliminated or modified? The Commission further requests comment on whether there should be specific exceptions to the proposed prohibitions. For example, should the prohibition against ownership of securities in a rated company apply to indirect ownership of securities such as through a mutual fund. The Commission also requests comment on whether the 10% net revenue threshold in proposed Rule 17g-5(c)(1) is appropriate, or should a higher or lower threshold be applied.

H. Proposed Rule 17g-6 – Prohibited Unfair, Coercive, or Abusive Practices

Section 15E(i)(1) of the Exchange Act[262] provides that the Commission shall adopt rules prohibiting any act or practice by an NRSRO that the Commission

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262 15 U.S.C. 78o-7(i)(1).

determines is unfair, abusive, or coercive, including certain acts and practices set forth in paragraphs (i)(1)(A)-(C) of Section 15E of the Exchange Act.[263] In explaining this statutory provision, the Senate Report stated that "the Commission, as a threshold consideration, must determine that the practices subject to prohibition under this section are unfair, coercive or abusive before adopting rules prohibiting such practices." The Commission has made a preliminary determination that the acts and practices described in paragraphs (i)(1)(A)-(C) of Section 15E of the Exchange Act[264] would be unfair, coercive, or abusive. Consequently, the Commission is proposing to prohibit them in proposed Rule 17g-6, with one conditional exception. Further, the Commission also has made a preliminary determination that an additional act and practice relating to unsolicited credit ratings (as noted above, these are credit ratings that are not initiated at the request of the issuer, obligor or underwriter) would be unfair, coercive, or abusive and, consequently, is proposing to use its authority under Section 15E(i)(1) of the Exchange Act[265] to prohibit such act and practice.[266]

Section 15E(i)(1)(A) of the Exchange Act provides that the Commission shall prohibit the following practice if the Commission determines it is unfair, coercive, or abusive:

> Conditioning or threatening to condition the issuance of a credit rating on the purchase by the obligor or an affiliate thereof of other

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263 15 U.S.C. 78o-7(i)(1)(A), (B) and (C).

264 Id.

265 15 U.S.C. 78o-7(i)(1).

266 See Commission 2003 CRA Report, which noted that some participants in the Commission 2002 CRA Hearings questioned the appropriateness of unsolicited credit ratings because they could used to engage in "strong-arm" tactics to induce payment for a credit rating an issuer did not request.

services or products, including pre-credit rating assessment products of the nationally recognized statistical rating organization or any person associated with such nationally recognized statistical rating organization[.][267]

The Commission has preliminarily determined that this practice would be unfair, coercive, or abusive and proposes to prohibit it. Paragraph (a)(1) of Proposed Rule 17g-6 would prohibit an NRSRO from conditioning or threatening to condition the issuance of a credit rating on the purchase of other products or services, including pre-credit rating assessment products.[268]

Credit ratings play an important role in financial markets. Market participants use them in making financial decisions whether to buy or sell debt securities and extend credit to rated entities. Moreover, credit ratings of NRSROs are used in federal and state laws and regulations to establish limits or confer exemptions or privileges. Consequently, an entity may benefit from having an NRSRO credit rating because it makes its securities more marketable or the rating would qualify the entity for an exemption or privilege in one of these rules or statutes or make holding the entity's debt securities or transacting with the entity more attractive to other regulated entities. An NRSRO could abuse this incentive by using it to coerce an issuer or obligor to purchase services from the NRSRO or its affiliates. Accordingly, the Commission is proposing to prohibit this potential practice.

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267 15 U.S.C. 78o-7(i)(1)(A).

268 See Commission 2003 CRA Report, which noted that some participants in the Commission's 2002 CRA Hearings worried that issuers could be unduly pressured to purchase advisory services, particularly in cases where they were solicited by the credit rating analyst.

An NRSRO would be allowed to condition the issuance and maintenance of a credit rating on the issuer or obligor paying for the service of determining and monitoring the credit rating. As noted above, this is a longstanding business model in the credit rating industry.[269] However, as discussed, the NRSRO could not condition the issuance of the credit rating on the purchase of any other service or product offered by the NRSRO and its affiliates. This practice would violate paragraph (a)(1) of proposed Rule 17g-6 even if the NRSRO agreed to issue or did issue a credit rating that otherwise was determined in accordance with its methodologies for issuing credit ratings.

Section 15E(i)(1)(C) of the Exchange Act provides that the Commission shall prohibit the following practices if the Commissions determines they are unfair, coercive, or abusive:

> Modifying or threatening to modify a credit rating or otherwise departing from systematic procedures and methodologies in determining credit ratings, based on whether the obligor, or an affiliate of the obligor, purchases or will purchase the credit rating or any other service or product of the nationally recognized statistical rating organization or any person associated with such organization.[270]

The Commission has preliminarily determined that these practices would be unfair, coercive, or abusive and, consequently, proposes to prohibit them through paragraphs

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269 See Commission 2003 CRA Report, which noted that by the mid-1970s credit rating agencies began charging issuers for ratings, due to difficulties in limiting access to their credit ratings to subscribers, as well as to respond to the demand for more comprehensive and resource-intensive analysis of issuers.

270 15 U.S.C. 78o-7(i)(1)(C).

(a)(2) and (a)(3) of proposed Rule 17g-6. Paragraph (a)(2) would prohibit an NRSRO from issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the NRSRO's established procedures for determining credit ratings based on whether the rated person purchases or will purchase the credit rating or another product or service.[271] Thus, an NRSRO would be prohibited from issuing or threatening to issue a credit rating that is lower than would result from using its methodology for determining credit ratings based on whether the issuer or obligor pays for the credit rating or any other service or product of the NRSRO and its affiliates. The NRSRO also would be prohibited from issuing or promising to issue a higher credit rating in these circumstances.[272]

The practice proposed to be prohibited in this paragraph is distinguishable from the practice proposed to be prohibited in Paragraph (a)(1). Paragraph (a)(1) addresses the situation where an NRSRO conditions the issuance of a credit rating on the purchase of another service or product. Paragraph (a)(2) addresses the situation where an NRSRO conditions the conclusion reached in the credit rating on the purchase of the credit rating or another service.[273] Thus, unlike paragraph (a)(1), an NRSRO would violate paragraph (a)(2) if it conditioned the issuance of the credit rating on the obligor or issuer paying for the credit rating. This is because the NRSRO would not be agreeing to determine a credit

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271 Paragraph (a)(2) of proposed Rule 17g-6.

272 Presumably, an issuer or obligor would not agree to compensate an NRSRO for a credit rating that was lower than would result from applying the NRSRO's methodologies. Nonetheless, if an NRSRO agreed to issue a lower than warranted credit rating in return for compensation, the NRSRO would violate paragraph (a)(2) as well.

273 See Commission 2003 CRA Report, which noted that some participants in the Commission 2002 CRA Hearings believed that, even if the purchase of ancillary services did not impact the credit rating decision, issuers may be pressured into using the services out of fear that their failure to do so may adversely impact their credit rating.

rating that reflected the NRSRO's assessment of the creditworthiness of the issuer or obligor as determined by its methodologies (including, as applicable, quantitative and qualitative models). Rather, the NRSRO would be agreeing to skew the rating higher based on the issuer or obligor agreeing to pay for it.

Paragraph (a)(3) of proposed Rule 17g-6 would prohibit an NRSRO from modifying, or offering or threatening to modify, a credit rating in a manner contrary to its procedures for modifying a credit rating based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the NRSRO and its affiliates. The prohibition in paragraph (a)(2) of proposed Rule 17g-6, as discussed, would apply to threats or promises with respect to the issuance of a credit rating. Paragraph (a)(3) would extend this prohibition to threats or promises with respect to changing an existing credit rating.

The potential for an NRSRO to use the threat of a lower or the promise of a higher credit rating to obtain business arises from the fact that an entity's cost of credit and, in some cases, ability to obtain credit, generally depends on its credit rating. Entities with lower credit ratings must pay higher interest rates to borrow funds or issue debt. In some cases, a low credit rating could block an entity's access to credit. Thus, it is in a borrower's economic interest to have a high credit rating. This creates the potential for an NRSRO to have inappropriate leverage over an issuer or obligor. The NRSRO could use this leverage to obtain business by threatening to issue or modify a credit rating in a manner that results in a lower rating than would have resulted from using its established methodologies. The NRSRO also could issue a lower rating or lower an existing rating to punish an issuer or obligor for not purchasing the credit rating

or another service or product of the NRSRO and its affiliates. Conversely, the NRSRO could promise to issue or modify a credit rating in a manner that results in a higher rating than would have resulted from using its established methodologies as a reward for purchasing the credit rating or other services or products. Proposed Rule 17g-6 would provide a check on the potential inappropriate influence an NRSRO may have over issuers and obligors by prohibiting an NRSRO from using this leverage to coerce an issuer or obligor into purchasing a credit rating or other services and products of the NRSRO and its affiliates.

A second reason to prohibit these practices is that they would lead to credit ratings that could mislead the marketplace and undermine the regulatory use of NRSRO credit ratings. An NRSRO that follows through on a threat to issue a low credit rating or promise to issue a high credit rating would be issuing a credit rating that does not accurately reflect the credit rating agency's true assessment of the creditworthiness of the issuer or obligor. The credibility and reliability of an NRSRO and its credit ratings depends on the NRSRO developing and implementing sound methodologies for determining credit ratings and following those methodologies. The fact that an issuer or obligor agrees or refuses to purchase a credit rating or other service or product from the NRSRO and its affiliates should have no bearing on the NRSRO's credit assessment of the issuer or obligor.[274]

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[274] The Commission is mindful of the limitation in Section 15E(c)(2) of the Exchange Act that the rules the Commission adopts under the Exchange Act not regulate the substance of credit ratings (15 U.S.C. 78o-7(c)(2)). The Commission does not believe that this prohibition would interfere with the process by which an NRSRO assesses the creditworthiness of a security, money market instrument or obligor. An issuer's or obligor's agreement or refusal to pay the NRSRO or its affiliate for a service or product is not, necessarily of itself, relevant to a credit assessment of the issuer or obligor. Moreover, this is a practice that Congress specifically identified in Section 15E(i)(1)(C)

Section 15E(i)(1)(B) of the Exchange Act provides that the Commission by rule shall prohibit the following practices if the Commission determines they are unfair, coercive, or abusive:

> Lowering or threatening to lower a credit rating on, or refusing to rate, securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, unless a portion of the assets within such pool or part of such transaction, as applicable, also is rated by the nationally recognized statistical rating organization[.][275]

In explaining this statutory provision, the Senate Report stated that "there may be instances when a rating agency may refuse to rate securities or money market instruments for reasons that are not intended to be anti-competitive." The Senate Report further stated that "the Commission . . . should prohibit only those ratings refusals that occur as part of unfair, coercive or abusive conduct."

This provision in the statute is seeking to address a practice, sometimes referred to as "notching," where a credit rating agency refuses to rate securities or money market instruments issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction (collectively, a "structured product") or discounts the rating for a structured product because it has not rated all of the underlying assets. Critics of this practice argue that it forces issuers of structured products to obtain credit ratings from

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of the Exchange Act as potentially unfair, coercive, or abusive (15 U.S.C. 78o-7(i)(1)(C)).

275 15 U.S.C. 78o-7(i)(1)(A).

the same credit rating agencies that rated the underlying assets.[276] They argue this makes it difficult for other credit rating agencies to develop a market in rating structured products. On the other hand, credit rating agencies that rate structured products argue that their rating of the structured product necessarily must involve assessments of the creditworthiness of the underlying assets. They do not believe it would be appropriate to rely on credit ratings of the underlying assets issued by another credit rating agency because those ratings may have been determined using different methodologies and may reflect different assessments of the creditworthiness of the asset.[277]

The Commission preliminarily determines that it would be unfair, coercive, or abusive for an NRSRO to issue or threaten to issue a lower credit rating, lower or threaten to lower an existing credit rating, refuse to issue a credit rating, or to withdraw a credit rating with respect to a structured product unless a portion of the assets underlying the structured product also are rated by the NRSRO. Consequently, the Commission proposes to prohibit these practices in paragraph (a)(4) of Proposed Rule 17g-6.

At the same time, the Commission believes there could be legitimate reasons for an NRSRO to refuse to rate a structured product where the NRSRO has not rated the underlying assets. Therefore, the Commission is proposing that an NRSRO could refuse to initiate a rating or withdraw an existing rating in certain circumstances. This exception only would apply to the prohibition in paragraph (a)(4) against refusing to rate

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276 See Commission 2003 CRA Report, which noted that one credit rating agency that participated in the Commission 2002 CRA Hearings complained that other credit rating agencies were attempting to squeeze it out of certain structured finance markets by engaging in the practice of "notching."

277 The Commission 2003 CRA Report noted that the credit rating agency that raised the concern about "notching" in Commission 2002 Hearings suggested, as a possible solution, that NRSROs be required to recognize the credit ratings of other NRSROs as their own for purposes of rating these asset pools.

the security or withdrawing a rating. It would not apply to issuing or threatening to issue a lower credit rating or lowering or threatening to lower an existing credit rating.

Under the exception to the prohibition, an NRSRO could refuse to issue the rating or withdraw the rating if the NRSRO has rated less than 85% of the market value of the assets underlying the structured product. This is designed to address the concern that an NRSRO when assessing the credit worthiness of the structured product would be forced to issue a rating either when a portion of the underlying assets are not rated or when the underlying assets have been rated by another credit rating agency. If the underlying assets were unrated, the NRSRO may not have sufficient information for issuing a rating on the structured product. In case where the underlying assets were rated by another credit rating agency, the other credit rating agency may have used different methodologies to assess the creditworthiness of the asset and may have determined a credit rating that is different than the credit rating the NRSRO would issue, if it had rated the asset. The Commission preliminarily does not believe it would be appropriate to require the NRSRO to issue or maintain a rating when the NRSRO has rated less than 85% of the market value of the underlying assets.[278]

Finally, the Commission is proposing to prohibit a practice that is not specifically identified in the Section 15E(i)(1) of the Exchange Act[279] but is related to the practices described in the statute. Specifically, the Commission has preliminarily determined that it would be unfair, coercive or abusive to issue an unsolicited credit rating and

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278 Anecdotally, the Commission understands that several of the credit rating agencies currently subject to a staff no-action letter have procedures under which they will undertake to issue a credit rating for a structured product where they have rated approximately 80% to 90% of the market value of the underlying assets.

279 15 U.S.C. 78o-7(i)(1).

communicate with the rated person to induce or attempt to induce the rated person to pay for the rating or another product or service of the NRSRO or its affiliates. Consequently, paragraph (a)(5) of proposed Rule 17g-6 would prohibit this practice.

It may be appropriate for an NRSRO that operates under a business model where issuers or obligors pay for the credit ratings to issue a credit rating that the issuer or obligor has not requested. For example, an NRSRO may want to have an active credit rating for every major issuer in a given industry.

It would not be appropriate, however, to determine an unsolicited credit rating and then to contact the issuer or obligor to solicit them to pay for the rating.[280] As discussed, an NRSRO may yield a degree of influence on issuers and obligors, given the impact a credit rating can have on the issuer's or obligor's access to credit and cost of credit. Thus, an issuer or obligor may agree to pay for an unsolicited credit rating to placate the NRSRO, rather than because they want to be rated. For example, the issuer or obligor may already be paying other credit rating agencies for a credit rating and, therefore, would derive no additional benefit from having an additional credit rating.

The Commission requests comment on all aspects of proposed Rule 17g-6, particularly on whether the proposed rule's requirements that prohibit certain acts and practices could be more narrowly tailored and still meet the stated goals. The Commission also requests comment on whether there are any other unfair, coercive, or abusive practices which should be prohibited under the proposed rules, or whether any of

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280 As discussed above, some participants in the Commission 2002 CRA Hearings questioned the appropriateness of unsolicited credit ratings because they could be used to engage in "strong-arm" tactics to induce payment for a credit rating an issuer did not request. Potential tactics identified included sending a bill for an unsolicited rating or sending a fee schedule and encouraging payment. See Commission 2003 CRA Report.

the practices proposed to be prohibited should not be subject to prohibition. The Commission further requests comment on whether any of the proposed prohibitions should be modified. With respect to the exception to the prohibition in paragraph (a)(4) of the Rule 17g-6, the Commission requests comment on whether the proposed exception permitting an NRSRO to refuse to issue a credit rating or withdraw a credit rating of structured product when it has not rated all the under lying assets should be modified or deleted and whether the 85% threshold in that exception should be higher or lower.

IV. PAPERWORK REDUCTION ACT

Certain provisions of the proposed rules contain a "collection of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[281] The Commission has submitted the proposed rules to the Office of Management and Budget ("OMB") for review in accordance with the PRA. An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid control number. The titles for the collections of information are:

(1) Rule 17g-1, Application for registration as a nationally recognized statistical rating agency; Form NRSRO and the Instructions for Form NRSRO;

(2) Rule 17g-2, Records to be made and retained by national recognized statistical rating organizations;

(3) Rule 17g-3, Annual audited financial statements to be furnished by nationally recognized statistical rating organizations;

(4) Rule 17g-4, Prevention of Misuse of Material Nonpublic Information; and

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281 44 U.S.C. 3501 et seq.; 5 CFR 1320.11.

(5) Rule 17g-6, Prohibited Acts and Practices.

A. Collections of Information Under the Proposed Amendments

The Commission is proposing for comment rules to implement registration, recordkeeping, financial reporting, and oversight rules under the Credit Rating Agency Reform Act of 2006 (the "Act").[282] The proposed rules contain recordkeeping and disclosure requirements that are subject to the PRA. The collection of information obligations imposed by the proposed rules would be mandatory. The proposed rules, however, would apply only to credit rating agencies that are registered with the Commission as NRSROs and registration is voluntary.[283]

In summary, the proposed rules would require an NRSRO to (1) complete an initial application for registration on Form NRSRO;[284] (2) provide written notice to the Commission if information submitted on the application is materially inaccurate, as well as furnishing an updated Form NRSRO to the Commission, prior to final action by the Commission;[285] (3) if applicable, provide a written notice of withdrawal of the application prior to final action by the Commission;[286] (4) make the current Form NRSRO, including non-confidential exhibits, publicly available on its Web site or through another comparable, readily accessible means;[287] (5) if applicable, apply to be

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282 Pub. L. No. 109-291 (2006).

283 See Section 15E of the Exchange Act (15 U.S.C. 78o-7)).

284 Section 15E(a)(1) of the Exchange Act (15 U.S.C. 78o-7(a)(1)) and proposed Rule 17g-1(a).

285 Proposed Rule 17g-1(c); see also Section 15E(a)(1) of the Exchange Act (15 U.S.C. 78o-7(a)(1)).

286 Proposed Rule 17g-1(b)(2); see also Section 15E(a)(1) of the Exchange Act (15 U.S.C. 78o-7(a)(1)).

287 Section 15E(a)(3) of the Exchange Act (15 U.S.C. 78o-7(a)(3)) and proposed Rule 17g-

registered for an additional category of credit ratings by furnishing an amended Form NRSRO;[288] (6) update its Form NRSRO after registration with the Commission;[289] (7) furnish an annual certification to the Commission with respect to Form NRSRO;[290] (8) if applicable, provide a written notice of withdrawal of registration;[291] (9) make, keep and preserve certain records;[292] (10) if applicable, furnish the Commission with an undertaking from a third-party custodian;[293] (11) if applicable, provide an undertaking with respect to producing records to the Commission;[294] (12) furnish the Commission with annual audited financial statements;[295] (13) develop procedures to prevent the misuse of material nonpublic information;[296] and (14) if applicable, document, in writing, the reason for refusing to initiate a rating, or withdrawing an existing rating,

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1(d).

288 Proposed Rule 17g-1(e).

289 Section 15E(b)(1) of the Exchange Act (15 U.S.C. 78o-7(b)(1)) and proposed Rule 17g-1(f).

290 Section 15E(b)(2) of the Exchange Act (15 U.S.C. 78o-7(b)(2)) and proposed Rule 17g-1(g).

291 Section 15E(e)(1) of the Exchange Act (15 U.S.C. 78o-7(e)(1)) and proposed Rule 17g-1(h).

292 Proposed Rule 17g-2 under authority in Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

293 Proposed Rule 17g-2(e) under authority in Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

294 Proposed Rule 17g-2(f) under authority in Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

295 Section 15E(k) of the Exchange Act (15 U.S.C. 78o-7(k)) and Proposed Rule 17g-3.

296 Section 15E(g) of the Exchange Act (15 U.S.C. 78o-7(g)) and proposed Rule 17g-4.

with respect to an asset-backed or mortgaged-backed security.[297] Many of these requirements are prescribed in Section 15E of the Exchange Act.[298]

B. Proposed Use of Information

Proposed Rules 17g-1 through 17g-6, Form NRSRO, and the Instructions for Form NRSRO, would create a framework for Commission oversight of NRSROs. The collections of information in the proposed rules are designed to allow the Commission to determine whether an entity should be registered as an NRSRO. Further, they would assist the Commission in effectively monitoring, through its examination function, whether an NRSRO is conducting its activities in accordance with Section 15E of the Exchange Act[299] and the rules thereunder. These proposed rules also are designed to assist users of credit ratings by requiring the disclosure of information with respect to an NRSRO that could be used to compare the credit ratings quality of different NRSROs. The information would include methods for determining credit ratings, organizational structure, policies for managing material, non-public information, information regarding conflicts of interest, policies for managing conflicts of interest, credit analyst experience, and management experience. As noted in the Senate Report accompanying the Act, the information that NRSROs would have to make public "will facilitate informed decisions by giving investors the opportunity to compare ratings quality of different firms."[300]

C. Respondents

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297 See Proposed Rule 17g-6(b)(2) under authority in Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

298 See 15 U.S.C. 78o-7.

299 15 U.S.C. 78o-7.

300 See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006) ("Senate Report").

The number of respondents that would be subject to the proposed rules would depend, in part, on the number of entities that meet the statutory requirements to be eligible for registration. The Act, by adding definitions to Section 3 of the Exchange Act,[301] identifies the types of entities that may apply for registration with the Commission as an NRSRO.[302] First, it defines an "NRSRO" as a "credit rating agency" that, in pertinent part, has been in business as a credit rating agency for at least three consecutive years immediately preceding the date of its application for registration; issues credit ratings certified by 10 QIBs (unless exempted from that requirement) with respect to financial institutions, brokers, dealers, insurance companies, corporate issuers, issuers of asset-backed securities (as that term defined in 17 CFR 229.1101(c)), issuers of government securities, issuers of municipal securities, or issuers of foreign government securities; and is registered with the Commission.[303]

Section 3 of the Exchange Act also defines the term "credit rating agency" as, in pertinent part, any person engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee; employing either a quantitative or qualitative model, or both, to determine credit ratings; and receiving fees from either issuers, investors, or other market participants, or a combination of these persons.[304] The definition specifically excludes a commercial

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301 15 U.S.C. 78c.

302 See Section 3 of the Act.

303 Section 3(a)(62) of the Exchange Act (15 U.S.C. 78c(a)(62)). Section 3(a)(64) of the Exchange Act defines the "qualified institutional buyer" ("QIB") as having the "meaning given such term in [17 CFR 230.144A(a)] or any successor thereto." 15 U.S.C. 78c(a)(62).

304 Section 3(a)(61) of the Exchange Act (15 U.S.C. 78c(a)(61)).

credit reporting company.[305] Finally, Section 3 of the Exchange Act defines the term "credit rating" to mean "an assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments."[306]

These definitions create threshold eligibility requirements with respect to the entities that would be eligible to apply for registration as an NRSRO. Because NRSROs have not previously been supervised as such, and because credit rating agencies include publicly and privately held companies located throughout the world, it is difficult to estimate the number of entities that would be eligible to register as NRSROs.

In 2000, a working group of the Basel Committee on Banking Supervision[307] issued a report on credit rating agencies that was based, in part, on surveys of 28 credit rating agencies located around the world, including the five credit rating agencies currently identified as NRSROs through the Commission's no-action letter process.[308] In its report, the working group estimated that there were approximately 150 credit rating agencies located world-wide.[309] The working group also noted that there was a wide disparity in size among credit rating agencies in terms of number of employees and

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305 Section 3(a)(61)(A) of the Exchange Act (15 U.S.C. 78c(a)(61)(A)).

306 Section 3(a)(60) of the Exchange Act (15 U.S.C. 78c(a)(60)).

307 The Basel Committee on Banking Supervision is comprised of members from Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom and the United States. Countries are represented by their central bank and also by the authority with formal responsibility for the prudential supervision of banking business where this is not the central bank. More information about the Basel Committee for Banking Supervision can be found at: http://www.bis.org/.

308 Credit Ratings and Complementary Sources of Credit Quality Information, Working group of the Basel Committee on Banking Supervision, No. 3 – August 2000 ("Basel Report").

309 Id.

credit ratings issued.[310] In addition, the working group noted that some credit rating agencies focus exclusively on issuers in the countries where they are located.[311] More recently, the Web site www.DefaultRisk.com has tracked the number of credit rating agencies. This site identifies 57 credit rating agencies as of February 2006 and indicates that this count reflects a decrease from a previous count of 74.[312] The Web site attributed the decrease to smaller firms either being consolidated into larger firms or ceasing operations.[313]

The Commission believes the estimates in the 2000 Basel Report and by DefaultRisk.Com provide some basis upon which to estimate the number of entities engaging in the business of issuing credit ratings. The Commission, however, cannot determine whether the entities included in these estimates would meet the statutory requirements to apply for, and be registered as, an NRSRO.

In addition, the Commission cannot estimate with certitude how many credit rating agencies ultimately would opt to be registered as NRSROs. Section 15E(a)(1) of the Exchange Act makes registration voluntary.[314] Some credit rating agencies may decide not to seek registration because, for example, they do not believe that being an NRSRO would benefit them based on their business model. The Commission staff's experience with the current no-action letter process of identifying NRSROs provides some support for the conclusion that a substantial number of credit rating agencies may not apply for registration. Specifically, assuming the number of credit rating agencies

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310 Id.

311 Id.

312 See http://www.defaultrisk.com ("DefaultRisk.com").

313 Id.

314 15 U.S.C. 78o-7(a)(1).

has fluctuated over the years from between approximately 150 as of 2000 (Basel Report) and 57 as of February 2006 (DefaultRisk.com), then a large majority of these firms have not applied to the Commission to be identified as NRSROs under the current no-action letter process. It is possible that certain firms that did not seek NRSRO status previously would seek it under Section 15E of the Exchange Act[315] and any rules adopted thereunder. In addition, the use of QIB certifications as a prerequisite to registration (as opposed to the no-action letter process which evaluated national recognition) also may increase the number of credit rating agencies that would be eligible for registration as an NRSRO.

For all these reasons, the Commission estimates that the number of credit rating agencies applying for registration would be larger than the sum of the number of credit rating agencies currently identified as NRSROs plus the handful of entities with pending requests for no-action letters. At the same time, the Commission does not believe that all of the 57 credit rating agencies identified by DefaultRisk.Com would apply for, or be granted, registration. Consequently, the Commission estimates that approximately 30 credit rating agencies would be registered as NRSROs under Section 15E of the Exchange Act.[316]

The Commission requests comment on this estimate and whether more or fewer credit rating agencies would be registered as NRSROs. The Commission also requests comment on whether the sources of industry information used in arriving at the estimate (the Basel Report and the DefaultRisk.Com Web site) provide a reasonable basis for arriving at the estimate of 30 NRSROs. The Commission further requests comment on

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315 15 U.S.C. 78o-7.

316 15 U.S.C. 78o-7.

whether there are other industry sources that could provide credible statistics that could be used to determine the number of credit rating agencies that would be registered as NRSROs. Commenters should identify any such sources and explain how a given source would be used to either support the Commission's estimate of 30 NRSROs or arrive at a different estimate.

D. Total Annual Recordkeeping and Reporting Burden

As discussed in further detail below, the Commission estimates the total recordkeeping burden resulting from these proposed rules would be approximately 16,021 hours[330] on an annual basis and 21,825 hours[331] on a one-time basis.

The total annual and one-time hour burden estimates described below are averages across all types of expected NRSROs. The size and complexity of NRSROs would range from small entities to entities that are part of complex global organizations employing thousands of credit analysts. The Commission believes that larger NRSROs generally would have established written policies and procedures and recordkeeping systems that would comply with a substantial portion of the requirements in the proposed rules. For example, many of the requirements in the proposed rules are consistent with the IOSCO Code, which a number of credit rating agencies have adopted. These firms might only be required to augment or modify existing policies and procedures and recordkeeping systems to comply with the proposed rules.

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330 This total is derived from the total annual hours set forth in the order that the totals appear in the text: 1 + 1,500 + 300 + 300 + 7,620 + 6,000 + 300 = 16,021 hours.

331 This total is derived from the total one-time hours set forth in the order that the totals appear in the text: 9,000 + 125 + 900 + 9,000 + 100 + 1,500 = 21,825 hours.

Some smaller entities also would have implemented the policies, procedures, and recordkeeping systems necessary to comply with the proposed rules. Moreover, given their smaller size and simpler structure, smaller entities would require significantly fewer hours to comply with a substantial portion of the requirements in the proposed rules. Consequently, the burden hour estimates represent the average time across all NRSROs (regardless of size) and taking into account that many firms would only need to augment existing policies, procedures, and recordkeeping systems and processes to comply with the proposed rules. The Commission further notes that, given the significant variance in size between the largest credit rating agencies and the smaller firms, the burden estimates, as averages across all NRSROs, are skewed higher by the largest firms. Furthermore, because the Commission is proposing to require additional information in Form NRSRO beyond that prescribed in Section 15E(1)(B) of the Exchange Act,[317] the burden estimates for proposed Rule 17g-1 include estimates that arise from requirements imposed by Section 15E of the Exchange Act.[318] The intent is to quantify the incremental burden of complying with these statutory requirements as a result of the additional information that would be required under proposed Rule 17g-1. Thus, the estimates do not seek to capture paperwork burden that would be solely attributable to requirements in Section 15E of the Exchange Act.[319]

The Commission seeks comment on whether these factors have been reasonably incorporated into the burden estimates.

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317 15 U.S.C. 78o-7(a)(1)(B).

318 15 U.S.C. 78o-7.

319 Id.

1. Proposed Rule 17g-1, Form NRSRO and Instructions for Form NRSRO

Section 15E(a)(1) of the Exchange Act requires a credit rating agency applying for registration with the Commission to furnish an application containing certain specified information and such other information as the Commission prescribes as necessary or appropriate in the public interest or for the protection of investors.[320] Proposed Rule 17g-1 would implement this statutory provision by requiring a credit rating agency to furnish an initial application on Form NRSRO to the Commission to apply to be registered under Section 15E of the Exchange Act.[321] The Commission estimates that the average time necessary to complete the initial Form NRSRO, and compile the various attachments, would be approximately 300 hours per applicant. This estimate is based on staff experience with the current NRSRO no-action letter process.[322] The Commission, therefore, estimates that the total one-time burden to the industry as a result of this requirement would be approximately 9,000 hours.[323]

The Commission also anticipates that an NRSRO likely would engage outside counsel to assist it in the process of completing and submitting a Form NRSRO. The amount of time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. Therefore, the Commission estimates that, on average,

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320 15 U.S.C. 78a-7(a)(1).

321 15 U.S.C. 78o-7.

322 As a comparison, the Commission notes that Form ADV, the registration form for investment advisers, is estimated to take approximately 22.25 hours to complete. See Investment Advisor Act of 1940 Release No. 2266 (July 20, 2004). The Commission estimates that the hour burden under Rule 17g-1 would be greater, given the substantially larger amount of information that would be required in proposed Form NRSRO.

323 300 hours x 30 entities = 9,000 hours.

an outside counsel would spend approximately 40 hours assisting an NRSRO in preparing its application for registration for a one-time aggregate burden to the industry of 1,200 hours. The Commission further estimates that this work would be split between a partner and associate, with an associate performing a majority of the work. Therefore, the Commission estimates that the average hourly cost for an outside counsel would be approximately $400 per hour. For reasons, the Commission estimates that the average one-time cost to an NRSRO would be $16,000[324] and the one-time cost to the industry would be $480,000.[325]

As noted, proposed Rule 17g-1 would require a credit rating agency to provide the Commission with a written notice if it intends to withdraw its application prior to final Commission action. Based on staff experience, the Commission estimates that one credit rating agency per year would withdraw a Form NRSRO prior to final Commission action on the application and, consequently, would furnish a notice of its intent to withdraw the application. Based on the Commission's current estimates for a broker-dealer to file a notice with the Commission under Rule 17a-11, the Commission estimates the average burden to an NRSRO to furnish the notice of withdrawal would be one hour.[326] Thus, the Commission estimates that the aggregate annual burden to the industry of providing a notice of withdrawal prior to final Commission action would be one hour per year.[327]

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324 $400 per hour x 40 hours = $16,000.

325 $16,000 x 30 NRSROs = $480,000.

326 See Exchange Act Release No. 49830 (June 8, 2004), at note 89; see also 17 CFR 240.17a-11.

327 (1 hour x 1 entity) = 1 hour.

Proposed Rule 17g-1 also would require that an NRSRO registered for fewer than the five categories of credit ratings listed in Section 3(a)(62)(B) of the Exchange Act would apply to be registered for an additional category by furnishing an amendment on Form NRSRO.[328] The Commission estimates that it would take an NRSRO substantially less time to update the Form NRSRO for this purpose than to prepare the initial application. For example, much of the information on the form and many of the exhibits would still be current and not have to be updated. Based on the Commission's estimate of the burden to complete a Form ADV, the Commission estimates that filing an amended Form NRSRO for this purpose would take an average of approximately 25 hours per NRSRO.[329]

The Commission further estimates based on staff experience that approximately five of the 30 credit rating agencies expected to register with the Commission would apply to register for additional categories of credit ratings within the first year. The Commission believes that almost all NRSROs would initially apply to register for the first three categories of credit ratings identified in the definition of NRSRO: (1) financial institutions, brokers, or dealers; (2) insurance companies; and (3) corporate issuers.[330] The Commission believes these are the most common types of credit ratings issued, particularly since some credit rating agencies limit their credit ratings to domestic companies. The Commission believes that, after these three categories, the next largest category of credit ratings for which most NRSROs would be registered would be for

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328 See proposed Rule 17g-1(e).

329 As noted above, the Commission's burden estimate for Form ADV is approximately 22.25 hours to complete. See Investment Advisor Act of 1940 Release No. 2266 (July 20, 2004).

330 Section 3(a)(62)(B) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)).

credit ratings with respect to issuers of government securities, municipal securities, and foreign government securities.[331] These types of credit ratings take additional expertise. Finally, the Commission believes the category of credit ratings for which the least number of NRSROs would be registered would be credit ratings of issuers of asset-backed securities (as that term defined in 17 CFR 229.1101(c)).[332] This assumption is based on the fact that determining a credit rating for an asset-backed security takes specialized expertise beyond that for determining credit ratings of corporate issuers and obligors. For example, it requires analysis of complex legal structures.

For these reasons, the Commission anticipates that a number of NRSROs may register for less than all five categories of credit ratings. Moreover, some of these NRSROs , in time, may develop their businesses to include issuing credit ratings of a category for which they are not initially registered. Based on staff experience, the Commission estimates that approximately five of the estimated 30 NRSROs would apply to add another category of credit ratings to their registration within the first year. Therefore, given the 25 hour per NRSRO average burden estimate, the total aggregate one-time burden to the industry for filing the amended Form NRSRO to change the scope of registration would be approximately 125 hours.[333]

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if any information or document provided in the application becomes materially inaccurate.[334] Proposed Rule 17g-1 would require an NRSRO to

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331 Section 3(a)(62)(B)(v) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)(v)).

332 Section 3(a)(62)(B)(iv) of the Exchange Act (15 U.S.C. 78c(a)(62)(B)(iv)).

333 25 hours x 5 NRSROs = 125 hours.

334 15 U.S.C. 78o-7(b)(1).

comply with this statutory requirement by furnishing the amendment on Form NRSRO. Based on staff experience, the Commission estimates that an NRSRO would file two amendments of its Form NRSRO per year on average. Furthermore, for the reasons discussed above, the Commission estimates that it would take an average of approximately 25 hours to prepare and furnish an amendment on Form NRSRO.[335] Therefore, the Commission estimates that the total aggregate annual burden to the industry to update Form NRSRO would be approximately 1,500 hours each year.[336]

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish an annual certification.[337] Proposed Rule 17g-1 would require an NRSRO to furnish the annual certification on Form NRSRO.[338] The Commission estimates that the annual certification, generally, would take less time than an amendment to Form NRSRO because it would be done on a regular basis (albeit yearly) and, therefore, become more a matter of routine over time. Consequently, the Commission estimates that the burden would be similar to that of broker-dealers filing the quarterly reports required under Rules 17h-1T and 17h-2T, which is approximately 10 hours per year for each respondent.[339] Therefore, the Commission estimates it would take an NRSRO approximately 10 hours to complete the annual certification for a total aggregate annual hour burden to the industry of 300 hours.[340]

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335 This estimate also is based on the estimates for the collection of information on Rule 17i-2 of the Exchange Act. See 17 CFR 240.17i-2.

336 25 hours per amendment x 2 amendments x 30 NRSROs = 1,500 hours.

337 15 U.S.C. 78o-7(b)(2).

338 See proposed Rule 17g-1(g).

339 See 17 CFR 240.17h-1T and 2T.

340 10 hour x 30 NRSROs = 300 hours.

Finally, section 15E(a)(3) of the Exchange Act requires an NRSRO to make the information and documents submitted in its application publicly available on its Web site or through another comparable readily accessible means.[341] Proposed Rule 17g-1 would require that this be done within five business days of the granting of an NRSRO's registration or the furnishing of an amendment to the form or annual certification.[342] The Commission assumes that each NRSRO already would have a Web site and would choose to use their Web site to comply with Section 15E(a)(3) of the Exchange Act (15 U.S.C. 78o-7(a)(3)). Therefore, based on staff experience, the Commission estimates that, on average, an NRSRO would spend 30 hours to disclose the information in its initial application on its Web site and, thereafter, 10 hours per year to disclose updated information. Accordingly, the total aggregate one-time burden to the industry to make Form NRSRO publicly available would be 900 hours[343] and the total aggregate annual burden would be 300 hours.[344]

2. Proposed Rule 17g-2

Section 17(a)(1) of the Exchange Act (as amended by the Act)[345] provides the Commission with authority to require an NRSRO to make and maintain such records as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act.[346] Proposed Rule 17g-2 would implement this rulemaking authority by requiring an NRSRO to make

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341 15 U.S.C. 78o-7(a)(3).

342 See proposed Rule 17g-1(d).

343 30 hours x 30 NRSROs.

344 10 hours x 30 NRSROs.

345 See Section 5 of the Act.

346 See Section 5 of the Act and 15 U.S.C 78q(a)(1).

and keep current certain records relating to its business. It addition, the proposed rule would require an NRSRO to preserve those and other records for certain prescribed time periods. This proposed rule is designed to assist the Commission monitor, through its examination function, whether NRSROs are complying with the requirements of Section 15E of the Exchange Act[347] and the regulations thereunder. The Commission estimates that the average one-time burden of implementing a recordkeeping system to comply with this proposed rule would be approximately 300 hours. This estimates is based on the Commission's experience with, and burden estimates for, certain recordkeeping requirements of consolidated supervised entities ("CSEs") subject to Commission supervision.[348]

The Commission also estimates that an NRSRO may need to purchase recordkeeping system software to establish a recordkeeping system in conformance with the proposed rule. The Commission estimates that the cost of the software would vary based on the size and complexity of the NRSRO. Also, the Commission estimates that some NRSRO's would not need such software because they already have adequate recordkeeping systems or, given their small size, such software would not be necessary. Based on these estimates, the Commission estimates that the average cost for recordkeeping software across all NRSROs would be approximately $1000 per firm. Therefore, the one-time cost to the industry would be $30,000.

Additionally, the Commission estimates that the average annual amount of time that an NRSRO would spend to make and maintain these records would be approximately 254 hours per year. The estimate for annual hours is based on the

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347 15 U.S.C. 78o-7.

348 See 17 CFR 15c3-1g.

Commission's present estimate the amount of time it would take a broker-dealer to comply with the recordkeeping rule, Rule 17a-4.[349] Therefore, the Commission estimates that the one-time hour burden for making and preserving the records under proposed Rule 17g-2 would be approximately 9,000 hours[350] and the total annual hour burden would be approximately 7,620 hours per year.[351]

Proposed Rule 17g-2 also would require that an NRSRO that uses a third-party record custodian furnish the Commission with an undertaking from the custodian. Based on staff experience, the Commission estimates that approximately five NRSROs would file this undertaking on a one-time basis. Proposed Rule 17g-2 also would require that a non-resident NRSRO provide an undertaking to the Commission. The Commission estimates, based on staff experience, approximately five non-resident NRSROs would provide this undertaking to the Commission. The Commission estimates, based on staff experience, it would take an NRSRO approximately 10 hours to complete an undertaking prior to furnishing it to the Commission.[352] Therefore, the Commission estimates the total one-time hour burden for these undertakings would be 100 hours.[353]

3. Proposed Rule 17g-3

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349 See 17 CFR 240.17a-4 (recordkeeping requirements for broker-dealers). This rule has previously has been subject to notice and comment and has been approved by OMB. The Commission notes that proposed Rule 17g-2 is based, in part, on Exchange Act Rules 17a-3 (17 CFR 240.17a-3) and 17a-4. The annual hour burden estimate for the proposed rule, however, is based only on the PRA estimate for Rule 17a-4. The proposed rule would require substantially less records to be made and maintained than Rules 17a-3 and 17a-4. Therefore, the Commission is basing its estimate that the burden estimate for only Rule 17a-4 (as opposed to Rules 17a-3 and 17a-4 combined).

350 300 hours x 30 NRSROs = 9,000 hours.

351 254 hours x 30 NRSROs = 7,620 hours.

352 The estimated 10 hours includes drafting, legal review and receiving corporate authorization to file the undertaking with the Commission.

353 (10 hours x 5 NRSROs) + (10 hours x 5 NRSROs) = 100 hours.

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[354] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[355]

Proposed Rule 17g-3 would implement this statutory provision by requiring an NRSRO to furnish audited annual financial statements to the Commission, including certain specified schedules.[356] The Commission estimates that, on average, it would take an NRSRO approximately 200 hours to prepare for and file the annual audit. This estimate is based on the current PRA estimates used for CSEs under Appendix G to Exchange Act Rule 15c3-1, as well the PRA estimates for supervised investment bank holding companies under Rule 17i-5.[357] Therefore, the Commission estimates that the total annual hour burden to prepare and furnish annual audited financial statements with the Commission would be approximately 6,000 hours.[358]

To comply with proposed Rule 17g-3, an NRSRO would need to engage the services of independent public accountant. The cost of hiring an accountant would vary substantially based on the size and complexity of the NRSRO. For example, the Commission notes, based on staff experience, that the annual audit costs of a small

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354 15 U.S.C. 78o-7(k).

355 Id.

356 See proposed Rule 17g-3.

357 See 17 CFR 240.15c3-1g and 17i-5.

358 200 hours x 30 NRSROs = 6,000 hours.

broker-dealer generally range from $3,000 to $5,000 a year. The Commission estimates that the annual audit costs for a small NRSRO would be comparable. The costs for a large NRSRO would be much greater. However, many of these firms already are audited by a public accountant for other regulatory purposes. These firms, however, may incur some incremental costs, given the schedules in proposed Rule 17g-3. For these reasons, the Commission estimates that the average annual cost across all NRSROs to engage the services of an independent public accountant would be approximately $15,000. Therefore, the annual cost to the industry would be $450,000.[359]

4. Proposed Rule 17g-4

Section 15E(g)(1) of the Exchange Act[360] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[361] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[362] Proposed Rule 17g-4 would implement this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[363] include three specific types of procedures.[364]

The Commission expects that most credit rating agencies already have procedures in place to address the specific misuses of material nonpublic information

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359 $15,000 x 30 NRSROs = $450,000.

360 15 U.S.C. 78o-7(g)(1).

361 15 U.S.C. 78a et seq.

362 15 U.S.C. 78o-7(g)(2).

363 15 U.S.C. 78o-7(g)(1).

364 See proposed Rule 17g-4.

identified in proposed Rule 17g-4.[365] Nonetheless, the Commission anticipates that some NRSROs may need to modify their procedures to comply with the specific procedures that would be required by the proposed rule. Based on staff experience, the Commission estimates that it would take approximately 50 hours for an NRSRO to establish procedures in conformance with the proposed rule for a total one-time burden of 1,500 hours.[366]

5. Proposed Rule 17g-6(b)

Proposed Rule 17g-6(b) would require an NRSRO using the exception in the rule to document in writing the reasons for refusing to issue a credit rating or withdrawing a credit rating in connection with a mortgaged-backed or asset-backed security. Based on staff experience, the Commission estimates that each NRSRO would need to document approximately five refusals per year and it that would take approximately two hours to create the record. The two hour estimate is based on staff experience and on the current one-hour estimate for a broker-dealer to file the notice under Rule 17a-11. The Commission has adjusted this estimate upwards to two hours because the Commission believes that an NRSRO would take longer to explain the applicability of the safe harbor than to explain the reasons for the notices required under Rule 17a-11. For these reasons, the Commission estimates that the total annual hour burden of for this proposed rule would be 300 hours per year.[367]

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365 For example, the IOSCO Code requires credit rating agencies to develop such procedures.

366 50 hours x 30 NRSROs = 1,500 hours.

367 (2 hours x 5 refusals) x 30 NRSROs = 300 hours.

E. Collection of Information Is Mandatory

These recordkeeping and notice requirements are mandatory, where applicable.

F. Confidentiality

Pursuant to section 15E(a)(1)(B) of the Exchange Act, certain information collected in Form NRSRO required under Rule 17g-1(a) would not be confidential. However, other information would be confidential under section 15E(a)(1)(B) of the Exchange Act and proposed Rule 17g-1(b). The Commission would keep this information confidential to the extent permitted by law. The books and records information collected under proposed Rules 17g-2, 17g-4, and 17g-6 would be stored by the NRSRO and made available to the Commission and its representatives as required in connection with examinations, investigations, and enforcement proceedings.

The information collected under Rule 17g-3 (the annual audited financial statements) would be generated from the internal records of the NRSRO. Pursuant to Section 15E(k) of the Exchange Act, the annual audit would be furnished to the Commission on a confidential basis, to the extent permitted by law.[368]

G. Record Retention Period

Paragraph (c) of proposed Rule 17g-2 would require an NRSRO to retain the records for at least three years, except records relating to customers would need to be retained until three years after the business relationship with the customer ended.[369]

H. Request for Comment

The Commission requests comment on the proposed collections of information in order to: (1) evaluate whether the proposed collection of information is necessary for the

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368 15 U.S.C. 78o-7(k).

369 See proposed Rule 17g-2(c).

proper performance of the functions of the Commission, including whether the information would have practical utility; (2) evaluate the accuracy of the Commission's estimate of the burden of the proposed collection of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; (4) evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and (5) evaluate whether the proposed rules would have any effects on any other collection of information not previously identified in this section.

Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, and refer to File No. S7-04-07. OMB is required to make a decision concerning the collections of information between 30 and 60 days after publication of this document in the Federal Register; therefore, comments to OMB are best assured of having full effect if OMB receives them within 30 days of this publication. The Commission has submitted the proposed collections of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-04-07, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549.

V. COSTS AND BENEFITS OF THE PROPOSED RULES

The Commission is sensitive to the costs and benefits that result from its rules. The Commission has identified certain costs and benefits of the proposed rules and requests comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis.[370] The Commission seeks comment and data on the value of the benefits identified. The Commission also welcomes comments on the accuracy of its cost estimates in each section of this cost-benefit analysis, and requests those commenters to provide data so the Commission can improve the cost estimates, including identification of industry statistics relied on by commenters to reach conclusions on cost estimates. The Commission also seeks comment on the extent to which costs are attributable to requirements set forth in Section 15E of the Exchange Act,[371] rather than the proposed rules. Finally, the Commission seeks estimates and views regarding these costs and benefits for particular types of

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370 For the purposes of this cost/benefit analysis, the Commission is using salary data from the SIA Report on Management and Professional Earnings in the Securities Industry 2005 ("SIA Management Report 2005"), which provides base salary and bonus information for middle-management and professional positions within the securities industry. The positions in the report are divided into the following categories: Accounting, Administration & Finance, Compliance, Customer Service, Floor/Trading, Human Resources Management, Internal Audit, Legal, Marketing/Corporate Communications, New Business Development, Operations, Research, Systems/Technology, Wealth Management, and Business Continuity Planning. The Commission believes that the salaries for these securities industry positions would be comparable to the salaries of similar positions in the credit rating industry. The Commission also notes that it is using salaries for New York-based employees, which tend to be higher than the salaries for comparable positions located outside of New York. This conservative approach is intended to capture unforeseen costs. Finally, the salary costs derived from the SIA Management Report 2005 and referenced in this cost benefit section, are modified to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead.

371 15 U.S.C. 78o-7.

market participants, as well as any other costs or benefits that may result from the adoption of these proposed rules.

A. Benefits

The purposes of the Credit Rating Agency Reform Act of 2006 (the "Act")[372] are to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.[373] As the Senate Report states, the Act establishes "fundamental reform and improvement of the designation process," and "eliminating the artificial barrier to entry will enhance competition and provide investors with more choices, higher quality ratings, and lower costs."[374]

To these ends, the Act establishes – through statutory provisions and the grant of Commission rulemaking authority – a regulatory program for credit rating agencies opting to have their credit ratings qualify for purposes of laws and rules using the term "NRSRO." Specifically, the Act sets out a voluntary mechanism for credit rating agencies to register with the Commission as an NRSRO.[375] It requires an NRSRO to make public certain information to help users of credit ratings assess the NRSRO's credibility and compare the NRSRO with other NRSROs.[376] The Act also requires an NRSRO to furnish the Commission with periodic financial reports.[377] Further, the Act

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372 Pub. L. No. 109-291 (2006).

373 See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006) ("Senate Report").

374 Id.

375 Section 15E of the Exchange Act (15 U.S.C. 78o-7).

376 Sections 15E(a)(1) and (b)(1) of the Exchange Act (15 U.S.C. 78o-7(a)(1) and (b)(1)).

377 Section 15E(k) of the Exchange Act (15 U.S.C. 78o-7(k)).

requires an NRSRO to implement policies to manage the handling of material non-public information and conflicts of interest.[378] Pursuant to authority under the Act, the Commission would prohibit certain acts and practices the Commission determines to be unfair, coercive, or abusive.[379]

The rules proposed by the Commission under the Act would be issued pursuant to specific grants of rulemaking authority in the Act. They are designed to further the goals of the Act. A primary purpose of the Act is to foster "competition in the credit rating agency business."[380] The practice of identifying NRSROs through staff no-action letters has been criticized as a process that lacks transparency and creates a barrier for credit rating agencies seeking wider recognition and market share. The Commission believes that these proposed rules further the Act's goal of increasing competition because they would provide credit rating agencies with a transparent process to apply for registration as an NRSRO that does not favor a particular business model or larger, established firms. This would make it easier for more credit rating agencies to apply for registration. Increased competition in the credit ratings business could lower the cost to issuers, obligors, and underwriters of obtaining credit ratings.

In addition, the Act requires NRSROs to make their credit ratings and information about themselves available to the public. Part of the definition of "credit rating agency" in the Act is that the entity must be in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a

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378 Sections 15E(g) and (h) of the Exchange Act (15 U.S.C. 78o-7(g) and (h)).

379 Section 15E(i) of the Exchange Act (15 U.S.C. 78o-7(i)).

380 See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006) ("Senate Report").

reasonable fee.[381] Under the Act and the rules proposed to be adopted thereunder, an NRSRO would need to disclose important information such as its credit ratings performance statistics, its methods for determining credit ratings, its organizational structure, its procedures to prevent the misuse of material non-public information, the conflicts of interest that arise from its business activities, its code of ethics, and the qualifications of its credit analysts, credit analyst supervisors and compliance personnel. The Commission believes that these disclosures under the proposed rules would allow users of the credit ratings to compare the ratings quality of different NRSROs. Although the information an NRSRO would provide on its Form NRSRO and to comply with the proposed rules cannot substitute for an investor's due diligence in evaluating a credit rating, it would aid investors by providing a publicly accessible foundation of basic information about an NRSRO.

In addition, the proposed rules implement provisions of the Act that are designed to improve the integrity of NRSROs. For example, the registration of a credit rating agency as an NRSRO would allow the Commission to conduct regular examinations of the credit rating agency to evaluate compliance with the regulatory scheme set forth in Section 15E of the Exchange Act[382] and the proposed rules and would subject an NRSRO to disclosure, recordkeeping, and annual audit requirements, as well as requirements regarding the prevention of misuse of material, nonpublic information, the management of conflicts of interest, and certain prohibited acts and practices. Increased confidence in the integrity of NRSROs and the credit ratings they issue could promote participation in the securities markets. Better quality ratings could also reduce the

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381 Section 3(a)(61) of the Exchange Act (15 U.S.C. 78c(a)(61)).

382 15 U.S.C. 78o-7.

likelihood of an unexpected collapse of a rated issuer or obligor, reducing risks to individual investors and to the financial markets. In addition to improving the quality of credit ratings, increased oversight of NRSROs could increase the accountability of an NRSRO to its subscribers, investors, and other persons who rely on the credibility and objectivity of credit ratings in making an investment decision.

Proposed Rule 17g-1 prescribes a process for a credit rating agency to register with the Commission as an NRSRO.[383] This proposed rule would require a credit rating agency apply for registration using Form NRSRO. Proposed Form NRSRO would require that a credit rating agency provide information required under Section 15E(a)(1)(B) of the Exchange Act and certain additional information.[384] The additional information would assist the Commission in making the assessment regarding financial and managerial resources required under Section 15E(a)(2)(C)(ii)(I) of the Exchange Act.[385] This section directs the Commission to grant a credit rating agency's application for registration as an NRSRO unless, among other things, the Commission finds that the applicant does not have adequate financial and managerial resources to consistently issue ratings with integrity and to materially comply with its procedures and methodologies disclosed under Sections 15E(a)(1)(B) of the Exchange Act[386] and with the requirements in Sections 15E(g), (h), (i) and (j) of the Exchange Act.[387] Certain other additional

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383 See proposed Rule 17g-1.

384 See Section 15E(a)(1)(B) of the Exchange Act. 15 U.S.C. 78o-7(a)(1)(B). See Section III.C.2. (discussing the items included in Form NRSRO).

385 See 15 U.S.C. 78o-7(a)(2)(C)(ii)(I).

386 15 U.S.C. 78o-7(a)(1)(B).

387 15 U.S.C. 78o-7(g), (h), (i) and (j).

information that would need to be made public would assist users of credit ratings in assessing the credibility of the NRSRO and to compare the NRSRO with other NRSROs.

Proposed Rule 17g-2 would implement the Commission's recordkeeping and rulemaking authority under Section 17(a) of the Exchange Act[388] by requiring an NRSRO to make and retain certain records related to its business as a credit rating agency.[389] The proposed recordkeeping rule would assist the Commission in monitoring whether an NRSRO is complying with provisions of Section 15E of the Exchange Act and the rules thereunder. This would include monitoring whether it is operating consistently with the methodologies and procedures it establishes (and discloses) to determine credit ratings and its policies and procedures designed to ensure the impartiality of its credit ratings.

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[390] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[391] Proposed Rule 17g-3 would require an NRSRO to furnish annual audited financial statements to the Commission.[392] This proposed rule would enhance Commission oversight of an NRSRO. Specifically, it would aid the Commission in

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388 15 U.S.C. 78q(a)(1).

389 See proposed Rule 17g-2.

390 15 U.S.C. 78o-7(k).

391 Id.

392 See proposed Rule 17g-3.

monitoring whether the initiation of a proceeding under Section 15E(d) of the Exchange Act would be appropriate because the NRSRO "fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity."[393] In addition, the audited financial statements also would assist the Commission in monitoring potential conflicts of interests of a financial nature which may arise in the operation of an NRSRO.[394]

Section 15E(g)(1) of the Exchange Act[395] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[396] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[397] Proposed Rule 17g-4 would implement this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[398] include three specific types of procedures.[399] These specific procedures would establish a baseline for the type of procedures an NRSRO must implement to meet the statutory requirement in Section 15E(g) of the Exchange

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393 15 U.S.C. 78o-7(d).

394 See e.g., proposed Rule 17g-5(c)(1) prohibiting an NRSRO from issuing or maintaining a credit rating for a person that, in the most recently ended fiscal year, provided the NRSRO with net revenue equaling or exceeding 10% of the NRSRO's total revenue for the year.

395 15 U.S.C. 78o-7(g)(1).

396 15 U.S.C. 78a et seq.

397 15 U.S.C. 78o-7(g)(2).

398 15 U.S.C. 78o-7(g)(1).

399 See proposed Rule 17g-4.

Act.[400] In this way, the proposed rule is designed to ensure that an NRSRO establishes adequate procedures and controls to protect material nonpublic information.

Proposed Rule 17g-5 would implement Section 15E(h)(2) of the Exchange Act[401] by requiring an NRSRO to disclose and manage certain conflicts of interest, as well as specifically prohibiting other conflicts of interest.[402] The proposed rule would promote the disclosure and management of conflicts of interest required by Sections 15E(a)(1)(B)(vi) and 15E(h) of the Exchange Act and mitigate potential undue influences on an NRSRO's credit rating process.[403]

Proposed Rule 17g-6 would prohibit an NRSRO from engaging in certain unfair, abusive, or coercive acts or practices, including practices with respect to unsolicited ratings.[404] These proposed prohibitions are designed to enhance the integrity of NRSROs, promote competition and fulfill a statutory mandate.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify, including the identification of sources of empirical data that could be used for such metrics.

B. Costs

The Act requires that the rules and regulations that the Commission may prescribe under the Act "shall be narrowly tailored" to meet its requirements.[405] The

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400 15 U.S.C. 78o-7(g).

401 15 U.S.C. 78o-7(h)(2).

402 See proposed Rule 17g-5.

403 15 U.S.C. 78o-7(a)(1)(B)(vi) and (h).

404 See proposed Rule 17g-6.

405 15 U.S.C. 78o-7(c)(2).

rules proposed by the Commission are designed to adhere to this statutory mandate and, thereby, keep compliance costs as low as possible.

The cost of compliance to a given NRSRO would depend on its size and the complexity of its business activities. As discussed above, the size and complexity of credit rating agencies varies significantly. Therefore, it is difficult to quantify a cost per NRSRO. Instead, the Commission is providing estimates of the average cost per NRSRO taking into consideration the range in size and complexity of NRSROs and the fact that many already may have established policies, procedures and recordkeeping systems and processes that would comply substantially with the proposed requirements.

The Commission believes that larger NRSROs generally would already have established written policies and procedures and recordkeeping systems that would comply with a substantial portion of the requirements in the proposed rules. Many of the requirements in the proposed rules are consistent with the IOSCO Code, which a number of credit rating agencies (including the largest) have adopted. These firms would need to augment or modify existing policies and procedures and recordkeeping systems to comply with the proposed rules (rather than establish new ones). Some smaller credit rating agencies also have implemented the policies, procedures, and recordkeeping systems necessary to comply with the proposed rules. Moreover, given their smaller size and simpler structure, smaller entities would require less effort and incur less cost to comply with a substantial portion of the requirements in these proposed rules.

For these reasons, the cost estimates represent the average cost across all NRSROs (regardless of size) and take into account that many firms would only need to augment existing policies, procedures and recordkeeping systems and processes to come

into compliance with the proposed rules. Furthermore, as discussed with respect to the Paperwork Reduction Act of 1995 ("PRA"),[406] the Commission is proposing to require additional information in Form NRSRO beyond that prescribed in Section 15E(1)(B) of the Exchange Act.[407] Therefore, the cost estimates for proposed Rule 17g-1 include estimates that arise from requirements imposed by Section 15E of the Exchange Act.[408] The intent is to quantify the incremental burden of complying with these statutory requirements as a result of the additional information that would be required under the proposed Rule 17g-1. Thus, those estimates do not seek to capture costs that would be solely attributable to requirements in Section 15E of the Exchange Act.[409] The Commission requests commenters to provide data for the costs that would be solely attributable to the requirements of Section 15E of the Exchange Act.

Given the estimates set forth below, the Commission estimates that the total one-time estimated cost to NRSROs resulting from these rule proposals would be approximately $4,936,325[410] and the total estimated annual cost to NRSROs resulting from these rule proposals would be approximately $3,955,500 per year.[411]

1. Proposed Rule 17g-1, Form NRSRO and Instructions to Form NRSRO

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406 44 U.S.C. 3501 et seq.; 5 CFR 1320.11.

407 15 U.S.C. 78o-7(a)(1)(B).

408 15 U.S.C. 78o-7.

409 Id.

410 This total is derived from the total one-time costs set forth in the order that they appear in the text: $2,007,000 + $480,000 + $25,625 + $30,000 + $241,200 + $1,845,000 + $307,500 = $4,936,325.

411 This total is derived from the total annual costs set forth in the order that they appear in the text: $307,500 + $61,500 + $80,400 + $1,562,100 + $1,494,000 + $450,000 = $3,505,500.

Section 15E(a)(1) of the Exchange Act requires a credit rating agency applying for registration with the Commission to furnish an application containing certain specified information and such other information as the Commission prescribes as necessary or appropriate in the public interest or for the protection of investors.[412] Proposed Rule 17g-1 would implement this statutory provision by requiring a credit rating agency to furnish an initial application on Form NRSRO to apply to be registered under section 15E of the Exchange Act.[413]

NRSROs would incur costs to register under Section 15E of the Exchange Act and proposed Rule 17g-1 thereunder.[414] As discussed above with respect to PRA, the Commission estimates that an NRSRO would spend approximately 300 hours to complete and furnish an initial Form NRSRO. Also, as discussed with respect to the PRA, the Commission estimates there would be 30 NRSROs. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be $66,900[415] and the total aggregate one-time cost to the industry would be $2,007,000.[416]

Also, as discussed with respect to the PRA, the Commission also anticipates that an NRSRO likely would engage outside counsel to assist it in the process of completing and submitting a Form NRSRO. The amount of time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. Therefore, the

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412 15 U.S.C. 78o-7(a)(1).

413 15 U.S.C. 78o-7.

414 There is no filing fee for a Form NRSRO.

415 The Commission estimates that a credit rating agency would have a senior compliance examiner perform these responsibilities. The SIA Management Report 2005 (Senior Compliance Examiner) indicates that the average hourly cost for a senior compliance examiner is $223. Therefore, the average one-time cost per NRSRO would be approximately $66,900 [(300 hours) x ($223 per/hour)].

416 30 NRSROs x $66,900 = $2,007,000.

Commission estimates that, on average, an outside counsel would spend approximately 40 hours assisting an NRSRO in preparing its application for registration. The Commission further estimates that this work would be split between a partner and associate, with an associate performing a majority of the work. Therefore, the Commission estimates that the average hourly cost for an outside counsel would be approximately $400 per hour. For reasons, the Commission estimates that the average one-time cost to an NRSRO would be $16,000[417] and the one-time cost to the industry would be $480,000.[418]

Under proposed Rule 17g-1, an NRSRO applying to be registered for an additional category of credit ratings would need to file an amended Form NRSRO with the Commission. As discussed with respect to the PRA, the Commission estimates, on average, an NRSRO would spend 25 hours completing and furnishing a Form NRSRO for this purpose. The Commission also estimates with respect to the PRA that five of the 30 NRSROs would apply to register for an additional category of credit ratings. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be $5,125[419] and the total aggregate one-time cost to the industry would be $25,625.[420]

Furthermore, as discussed above with respect to the PRA, the Commission also estimates that an NRSRO may need to purchase recordkeeping system software to

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417 $400 per hour x 40 hours = $16,000.

418 $16,000 x 30 NRSROs = $480,000.

419 The Commission estimates an NRSRO would have a senior compliance person perform these responsibilities. The SIA Management Report 2005 (Compliance Officer) indicates that the average hourly cost for a compliance manager is $205. Therefore, the average cost to an NRSRO would be $5,125 [(25 hours for one year) x ($205)].

420 5 NRSROs x $5,125 = $25,625

establish a recordkeeping system in conformance with the proposed rule. The Commission estimates that the cost of the software would vary based on the size and complexity of the NRSRO. Also, the Commission estimates that some NRSRO's would not need such software because they already have adequate recordkeeping systems or, given their small size, such software would not be necessary. Based on these estimates, the Commission estimates that the average cost for recordkeeping software across all NRSROs would be approximately $1000 per firm. Therefore, the one-time cost to the industry would be $30,000.[421]

Section 15E(b)(1) of the Exchange Act requires an NRSRO to promptly amend its application for registration if any information or document provided in the application becomes materially inaccurate.[422] Proposed Rule 17g-1 would require an NRSRO to comply with this statutory requirement by furnishing the amendment on Form NRSRO. As discussed with respect to the PRA, the Commission estimates that an NRSRO would furnish two amendments on Form NRSRO per year on average. The Commission also estimates with respect to the PRA that it would take approximately 25 hours to prepare and furnish an amendment and that there would be 30 NRSROs. For these reasons, the

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421 $1,000 x 30 NRSROs = $30,000.

422 15 U.S.C. 78o-7(b)(1).

Commission estimates that the average annual cost to an NRSRO would be $10,250[423] and the total aggregate annual cost to the industry would be $307,500.[424]

Section 15E(b)(2) of the Exchange Act requires an NRSRO to furnish an annual certification.[425] Proposed Rule 17g-1 would require an NRSRO to furnish the annual certification on Form NRSRO.[426] As discussed with respect to the PRA, the Commission estimates an NRSRO would spend approximately 10 hours per year completing and furnishing the annual certification and that there would be 30 NRSROs. For these reasons, the Commission estimates that the average annual cost to an NRSRO would be $2,050[427] and the total aggregate annual cost to the industry would be $61,500.[428]

Section 15E(a)(3) of the Exchange Act requires an NRSRO to make certain information and documents submitted in its application publicly available on its Web site or through another comparable readily accessible means.[429] Proposed Rule 17g-1 would require that this be done within five business days of the granting of an NRSRO's

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423 Based on the PRA estimates, an NRSRO would spend approximately 50 hours each year updating its application on Form NRSRO (25 hours per amendment x two amendments). The Commission estimates an NRSRO would have a senior compliance person perform these responsibilities. The SIA Management Report 2005 (Compliance Officer) indicates that the average hourly cost for a compliance manager is $205. Therefore, the total average annual cost to an NRSRO to update its registration on Form NRSRO would be $10,250 [(50 hours per year) x ($205 per hour)].

424 $10,250 x 30 NRSROs = $307,500.

425 15 U.S.C. 78o-7(b)(2).

426 See proposed Rule 17g-1(g).

427 The Commission estimates an NRSRO would have a senior compliance person perform these responsibilities. The SIA Management Report 2005 (Compliance Officer) indicates that the average hourly cost for a compliance manager is $205. Therefore, the average annual cost would be $2,050 [(10 hours per year) x ($205 per hour)].

428 $2,050 x 30 NRSROs = $61,500.

429 15 U.S.C. 78o-7(a)(3).

registration or the furnishing of an amendment to the form or annual certification.[430] As discussed with respect to the PRA, the Commission estimates that the average hour burden for an NRSRO to disclose this information on its Web site would be approximately 30 hours on a one-time basis and 10 hours per year. Furthermore, as discussed with respect to the PRA, the Commission estimates that there would be 30 NRSROs. For these reasons, the Commission estimates that an NRSRO would incur an average one-time cost of $8,040 and an average annual cost of $2,680.[431] Consequently, the total aggregate one-time cost to the industry would be $241,200[432] and total aggregate annual cost to the industry would be $80,400 per year.[433]

The Commission believes the requirements in proposed Rule 17g-1 to provide notices when a credit rating agency withdraws its application or an NRSRO withdraws its registration would result in de minimis costs.

As noted above, we request comment on these proposed cost estimates. We also request comment on whether there would be costs in addition to those identified above, such as costs arising from systems changes. We also request comment on whether these proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who

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430 See proposed Rule 17g-1(d).

431 The Commission estimates that an NRSRO would have a Senior Programmer perform this work. The SIA Management Report 2005 (Senior Programmer) indicates that the average hourly cost for a senior programmer is $268. Therefore, the average one-time cost would be $8,040 [(30 hours) x ($268 per hour)] and the average annual cost would be $2,680 [(10 hours per year) x ($268 per hour)].

432 $8,040 x 30 NRSROs = $241,200.

433 $2,680 x 30 NRSROs = $80,400.

purchase services and products from NRSROs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

2. Proposed Rule 17g-2

Section 17(a)(1) of the Exchange Act[434] provides the Commission with authority to require an NRSRO to make and maintain such records as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act.[435] Proposed Rule 17g-2 would implement this rulemaking authority by requiring an NRSRO to make and preserve specified records related to its credit rating business.

As discussed with respect to the PRA, the Commission estimates that an NRSRO, on average, would spend approximately 300 hours on a one-time basis to establish a recordkeeping system and 254 hours each year updating its books and records. For these reasons, the Commission estimates that an NRSRO would incur an average one-time cost of $61,500 and an average annual cost of $52,070.[436] Consequently, the total aggregate one-time cost to the industry would be $1,845,000,[437] and the total aggregate annual cost to the industry would be $1,562,100 per year.[438]

As noted above, we request comment on these proposed cost estimates. We also request comment on whether there would be costs in addition to those identified above,

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434 See Section 5 of the Act.

435 See Section 5 of the Act and 15 U.S.C 78q(a)(1).

436 The Commission estimates that an NRSRO would have a compliance manager perform these responsibilities. The SIA Management Report 2005 indicates that the average hourly cost for a compliance manager is $205. Therefore, the average one-time cost would be $61,500 [(300 hours) x ($205 per hour)] and the average annual cost would be $52,070 [(254 hours per year) x ($205 per hour)].

437 $61,500 x 30 NRSROs = $1,845,000.

438 $52,070 x 30 NRSROs = $1,562,100.

such as costs arising from restructuring business practices. We also request comment on whether these proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

3. Proposed Rule 17g-3

Section 15E(k) of the Exchange Act requires an NRSRO to furnish to the Commission, on a confidential basis and at intervals determined by the Commission, such financial statements and information concerning its financial condition that the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[439] The section also provides that the Commission may, by rule, require that the financial statements be certified by an independent public accountant.[440]

Proposed Rule 17g-3 would implement this statutory provision by requiring an NRSRO to furnish audited annual financial statements to the Commission, including certain specified schedules.[441] As discussed above with respect to the PRA, the Commission estimates that NRSRO, on average, would spend approximately 200 hours per year preparing for and furnishing the annual audit. For these reasons, the Commission estimates that the average annual cost to an NRSRO would be $49,800[442] and the total aggregate annual cost to the industry would be $1,494,000.[443]

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439 15 U.S.C. 78o-7(k).

440 Id.

441 See proposed Rule 17g-3.

442 The Commission estimates that a senior internal auditor would perform these responsibilities. The SIA Management Report 2005 (Senior Internal Auditor) indicates

As noted above, the average one-time and annual costs to NRSROs would vary widely depending on the size and complexity of the NRSRO. Moreover, some large credit rating agencies already prepare audited financial statements in accordance with other regulatory requirements. Nonetheless, these credit rating agencies, if they become NRSROs, may need to make changes to their accounting systems to comply with proposed annual audit requirements in Rule 17g-3. The Commission believes these costs would vary, depending on the size and complexity of the NRSRO, and seeks comment on the costs that would be incurred to make changes to their accounting systems.

Furthermore, as discussed above with respect to the PRA, an NRSRO would need to engage the services of independent public accountant to comply with proposed Rule 17g-3. The cost of hiring an account would vary substantially based on the size and complexity of the NRSRO. As the noted above, based on staff experience, the annual audit costs of a small broker-dealer generally range from $3,000 to $5,000 a year. As the Commission estimated above, the annual audit costs for a small NRSRO would likely be comparable to the costs incurred by a small broker-dealer. The costs for a large NRSRO would be much greater. However, many of these firms already are audited by a public accountant for other regulatory purposes. These firms, however, may incur some incremental costs, given the schedules in proposed Rule 17g-3. For these reasons, the Commission estimates that the average annual cost across all NRSROs to engage the services of an independent public account would be approximately $15,000. Therefore,

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that the average hourly cost for a senior internal auditor is $249. Therefore, the average annual cost would be $49,800 [(200 hours per year) x ($249 per hour)].

[443] $49,800 x 30 NRSROs = $1,494,000.

the annual cost to the industry would be $450,000.[444]

As noted above, we request comment on these proposed cost estimates. We also request comment on whether there would be costs in addition to those identified above, such as costs arising from systems changes. We also request comment on whether these proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

4. Proposed Rule 17g-4

Section 15E(g)(1) of the Exchange Act[445] requires an NRSRO to establish, maintain, and enforce written policies and procedures to prevent the misuse of material, nonpublic information in violation of the Exchange Act.[446] Section 15E(g)(2) of the Exchange Act provides that the Commission shall adopt rules requiring an NRSRO to establish specific policies and procedures to prevent the misuse of material, non-public information.[447] Proposed Rule 17g-4 would implement this statutory provision by requiring that an NRSRO's policies and procedures established pursuant to Section 15E(g)(1) of the Exchange Act[448] include three specific types of procedures.[449]

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444 $15,000 x 30 NRSROs = $450,000.

445 15 U.S.C. 78o-7(g)(1).

446 15 U.S.C. 78a et seq.

447 15 U.S.C. 78o-7(g)(2).

448 15 U.S.C. 78o-7(g)(1).

449 See proposed Rule 17g-4.

As discussed above with respect to PRA, the Commission estimates that it would take approximately 50 hours for an NRSRO to establish procedures in conformance with the proposed rule and that there would be 30 NRSROs. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be $10,250[450] and the total aggregate one-time cost to the industry would be $307,500.[451]

As noted above, we request comment on these proposed cost estimates. We also request comment on whether there would be costs in addition to those identified above, such as costs arising from systems changes and restructuring business practices. We also request comment on whether these proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

5. Proposed Rules 17g-5 and 17g-6

Proposed Rules 17g-5 and 17g-6 are conduct rules that would require NRSROs respectively to avoid certain conflicts of interest and unfair, abusive or coercive acts and practices and, consequently, do not require an NRSRO to make records or reports or create recordkeeping or accounting systems.[452] Moreover, 15E(1)(B)(vi) of the

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450 The Commission estimates an NRSRO would have a senior compliance person perform these responsibilities. The SIA Management Report 2005 (Compliance Officer) indicates that the average hourly cost for a compliance manager is $205. Therefore, the average one-time cost to an NRSRO would be $10,250 [(50 hours) x ($205)].

451 30 NRSROs x $10,250 = $307,500.

452 Paragraph (b) of Rule 17g-6 does require a record to be made in certain situations. However, the Commission estimates that this requirement would impose de minimis costs.

Exchange Act requires an NRSRO to disclose any conflicts of interest. Additionally, Section 15E(h) of the Exchange Act requires an NRSRO establish, maintain, and enforce written policies and procedures reasonable designed to address and manage any conflicts of interest that can arise from its business. Therefore, the Commission does not anticipate that proposed Rule 17g-5 would result in any significant incremental costs.

Proposed Rules 17g-5 and 17g-6 do prohibit respectively certain conflicts of interest and unfair, coercive and abusive acts and practices. The Commission believes that most entities that would become NRSROs do not engage in these types of conflicts, acts and practices. Therefore, the Commission estimates that these proposed rules generally would impose de minimis costs. However, the Commission recognizes that an NRSRO may incur costs related to training employees about the requirements in these proposed rules. It also is possible that the proposed rules could require some NRSROs to restructure their business models or activities. The Commission, therefore, requests comment on such training and restructuring costs. The Commission also request comment on whether there are any other costs associated with these proposed rules.

VI. CONSIDERATION OF BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Under Section 3(f) of the Exchange Act,[453] the Commission must, when engaging in rulemaking that requires the Commission to consider or determine if an action is necessary or appropriate in the public interest, consider whether the action will promote efficiency, competition, and capital formation. Section 23(a)(2) of the Exchange Act[454] requires the Commission to consider the anticompetitive effects of any rules the

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453 15 U.S.C. 78c(f).

454 15 U.S.C. 78w(a)(2).

Commission adopts under the Exchange Act. Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.

The Commission's preliminary view is that the proposed rules should promote efficiency, competition, and capital formation. As discussed above with respect to the costs and benefits of the proposed rules, the primary purpose of the Credit Rating Agency Reform Act of 2006 (the "Act")[455] is to foster "competition in the credit rating agency business."[456] The practice of identifying NRSROs through staff no-action letters has been criticized as a process that lacks transparency and creates a barrier for credit rating agencies seeking wider recognition and market share. The Commission believes that these proposed rules implementing provisions of the Act further the Act's goal of increasing competition because they would provide credit rating agencies with a transparent process to apply for registration as an NRSRO that does not favor a particular business model or larger, established firms. This would make it easier for more credit rating agencies to apply for registration. Increased competition in the credit ratings business could lower the cost to issuers, obligors, and underwriters of obtaining credit ratings.

In addition, the Act requires NRSROs to make their credit ratings and information about themselves available to the public. Part of the definition of "credit rating agency" in the Act is that the entity must be in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a

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455 Pub. L. No. 109-291 (2006).

456 See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006) ("Senate Report").

reasonable fee.[457] Under the Act and the rules proposed to be adopted thereunder, an NRSRO would need to disclose important information such as its credit ratings performance statistics, its methods for determining credit ratings, its organizational structure, its procedures to prevent the misuse of material non-public information, the conflicts of interest that arise from its business activities, its code of ethics, and the qualifications of its credit analysts, credit analyst supervisors and compliance personnel. The Commission believes that these disclosures under the proposed rules would allow users of the credit ratings to compare the ratings quality of different NRSROs. Although the information an NRSRO would provide on its Form NRSRO and to comply with the proposed rules cannot substitute for an investor's due diligence in evaluating a credit rating, it would aid investors by providing a publicly accessible foundation of basic information about an NRSRO.

In addition, the proposed rules implement provisions of the Act that are designed to improve the integrity of NRSROs. For example, the registration of a credit rating agency as an NRSRO would allow the Commission to conduct regular examinations of the credit rating agency to evaluate compliance with the regulatory scheme set forth in Section 15E of the Exchange Act and the proposed rules and would subject an NRSRO to disclosure, recordkeeping, and annual audit requirements, as well as requirements regarding the prevention of misuse of material, nonpublic information, the management of conflicts of interest, and certain prohibited acts and practices. Increased confidence in the integrity of NRSROs and the credit ratings they issue could promote participation in the securities markets. Better quality ratings could also reduce the likelihood of an

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457 Section 3(a)(61) of the Exchange Act (15 U.S.C. 78c(a)(61)).

unexpected collapse of a rated issuer or obligor, reducing risks to individual investors and to the financial markets. In addition to improving the quality of credit ratings, increased oversight of NRSROs could increase the accountability of an NRSRO to its subscribers, investors, and other persons who rely on the credibility and objectivity of credit ratings in making an investment decision.

The Commission solicits comment on these matters with respect to the proposed rules. In particular, the Commission solicits comment on whether the proposed rules would have an adverse effect on competition that is neither necessary nor appropriate in furtherance of the purposes of the Exchange Act. In addition, comment is sought on whether the proposed rules, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

VII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[458] the Commission must advise OMB whether a proposed regulation constitutes a major rule. Under SBREFA, a rule is "major" if it has resulted in, or is likely to result in:

- an annual effect on the economy of $100 million or more
- a major increase in costs or prices for consumers or individual industries; or
- a significant adverse effect on competition, investment, or innovation.

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458 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C., 15 U.S.C. and as a note to 5 U.S.C. 601).

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. The Commission requests comment on the potential impact of each of the proposed rules on the economy on an annual basis. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

VIII. INITIAL REGULATORY FLEXIBILITY ANALYSIS

The Commission has prepared the following Initial Regulatory Flexibility Analysis (IRFA), in accordance with the provisions of the Regulatory Flexibility Act,[459] regarding proposed rules 17g-1, 17g-2, 17g-3, 17g-4, 17g-5, and 17g-6 and proposed Form NRSRO under the Exchange Act.

The Commission encourages comments with respect to any aspect of this IRFA, including comments with respect to the number of small entities that may be affected by the proposed rules. Comments should specify the costs of compliance with the proposed rules and suggest alternatives that would accomplish the goals of the rules. Comments will be considered in determining whether a Final Regulatory Flexibility Analysis is required and will be placed in the same public file as comments on the proposed rules. Comments should be submitted to the Commission at the addresses previously indicated.

A. Reasons for the Proposed Action

The proposed rules would implement specific provisions of the Credit Rating Agency Reform Act of 2006 (the "Act").[460] The Act defines the term "nationally recognized statistical rating organization" as a credit rating agency registered with the Commission, provides authority for the Commission to implement registration,

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459 5 U.S.C. 603.

460 Pub. L. No. 109-291 (2006).

recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies, and directs the Commission to issue final implementing rules no later than 270 days after its enactment.

B. Objectives

The proposed rules would implement specific provisions of the Act. The objectives of the Act are "to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry."[461] The proposed rules are designed to further these objectives and assist the Commission in determining whether an entity should be registered as an NRSRO, monitoring whether an NRSRO complies with the provisions of the Act and rules thereunder, fulfilling the Commission's statutory mandate to adopt rules to implement the NRSRO regulatory program, and provide information regarding NRSROs to the public and to users of credit ratings.

C. Legal Basis

Pursuant to the Exchange Act[462] and, particularly, Section 15E of the Exchange Act.[463]

D. Small Entities Subject to the Rule

Paragraph (a) of Rule 0-10 provides that for purposes of the Regulatory Flexibility Act, a small entity "[w]hen used with reference to an 'issuer' or a 'person' other than an investment company" means "an 'issuer' or 'person' that, on the last day of

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461 See Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006) ("Senate Report").

462 15 U.S.C. 78a et seq.

463 15 U.S.C. 78o-7.

its most recent fiscal year, had total assets of $5 million or less."[464] The Commission believes that an NRSRO with total assets of $5 million or less would qualify as a "small" entity for purposes of the Regulatory Flexibility Act.

As noted above, the Commission believes that approximately 30 credit rating agencies would be registered as an NRSRO. Moreover, as also noted above, the Senate Report accompanying the Act states that the two largest credit rating agencies have about 80% of the market share as measured by revenues. The Senate Report also states that these two firms rate more than 99% of the debt obligations and preferred stock issues publicly traded in the United States. Given these figures, the Commission believes that the majority of the credit rating agencies registered with the Commission would be "small" entities.[465] Consequently, the Commission estimates that, of the approximately 30 credit rating agencies estimated to be registered with the Commission, approximately 20 would be "small" entities for purposes of the Regulatory Flexibility Act.[466]

E. Reporting, Recordkeeping, and Other Compliance Requirements

A credit rating agency seeking to apply to the Commission for registration as a nationally recognized statistical rating organization would apply using proposed Form NRSRO.[467] The Form would elicit certain information and require the credit rating agency to attach a number of documents, including exhibits (some of which would have to be made publicly available and some of which would be eligible for confidential treatment) and certifications from qualified institutional buyers. The public exhibits

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464 17 CFR 240.0-10(a).

465 See 17 CFR 240.0-10(a).

466 Id.

467 Proposed Rule 17g-1.

would consist of information such as performance data for the credit ratings, organizational structure, the methods used by the credit rating agency for issuing credit ratings, the policies used by the credit rating agency to manage activities that could potentially risk the impartiality of its credit ratings, and information about managers and credit analysts. To the extent permitted by law, the confidential exhibits would consist of information about the credit rating agency's financial condition, revenues and credit analyst compensation.

After registration, the credit rating agency (now an NRSRO under the Act) would generally need to promptly update the public information on its Form NRSRO whenever an item or exhibit becomes materially inaccurate. To update information, the NRSRO would furnish the Commission with an amendment using Form NRSRO. In addition, the NRSRO would need to furnish the Commission with an annual certification on Form NRSRO.[468] The annual certification would represent that all information on the form, as amended, continues to be accurate, would require the credit rating agency to list any material changes made during the previous year, and would include an update to the public exhibit relating to the performance statistics of its credit ratings. After its application for registration is approved, the NRSRO would be required to make Form NRSRO and the public exhibits submitted to the Commission, and all amendments, readily accessible to the public.

NRSROs would also be subject to a recordkeeping rule.[469] This rule would require the NRSRO to make and retain certain records relating to the business of issuing credit ratings. These records would assist the Commission, through its examination

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468 Id.

469 Proposed Rule 17g-2.

process, in monitoring whether the NRSRO continues to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity (as required under the Act) and whether the NRSRO was complying with the provisions of the Act, the rules adopted under the act, and the NRSRO's disclosed policies and procedures.

On an annual fiscal year basis, an NRSRO would be required to furnish the Commission with audited financial statements.[470] This requirement is designed to assist the Commission in monitoring whether the NRSRO continues to maintain adequate financial resources to consistently produce credit ratings with integrity. It also is designed to assist the Commission in monitoring whether the NRSRO is complying with provisions of the Act and the rules adopted thereunder the regarding potential conflicts of interest arising from dealings with large customers in terms of revenues earned.

Finally, all NRSROs would be subject to requirements designed to protect their impartiality with respect to issuing credit ratings. First, they would be required to establish, maintain and enforce specific written policies designed to prevent the misuse of material non-public information.[471] Second, NRSROs would be prohibited from having certain general conflicts unless they, as required under the Act, disclosed the conflict and adopted procedures to manage the conflict. Further certain conflicts of interest – for example, rating a security owned by the NRSRO – would be prohibited. Third, NRSROs would be prohibited from engaging in certain practices that the Commission has determined to be unfair, coercive or abusive practices.[472]

F. Duplicative, Overlapping, or Conflicting Federal Rules

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470 Proposed Rule 17g-3.

471 Proposed Rule 17g-4.

472 Proposed Rule 17g-6.

The Commission believes that there are no federal rules that duplicate, overlap, or conflict with the proposed rules.

G. Significant Alternatives

Pursuant to section 3(a) of the RFA,[473] the Commission must consider certain types of alternatives, including: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

The Commission does not believe it is necessary or appropriate to establish different compliance or reporting requirements or timetables; clarify, consolidate, or simplify compliance and reporting requirements under the rule for small entities; or exempt small entities from coverage of the rule, or any part of the rule. The Act and the proposed rules establish a voluntary program of registration and supervision that allows NRSROs the flexibility to develop procedures tailored to their specific organizational structure and business models. The Commission also does not believe that it is necessary to consider whether small entities should be permitted to use performance rather than design standards to comply with the proposed rules as the rules already propose performance standards and do not dictate for entities of any size any particular design standards that must be employed to achieve the objectives of the proposed rules.

H. Request for Comments

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[473] 5 U.S.C. 603(c).

The Commission encourages the submission of comments to any aspect of this portion of the IRFA. Comments should specify costs of compliance with the proposed rules and suggest alternatives that would accomplish the objective of the proposed rules.

The Commission specifically requests comment on the estimate that 30 credit rating agencies would be registered as NRSROs with the Commission, and that 20 of those 30 NRSROs would be small entities for purposes of the Regulatory Flexibility Act.[474] Commenters that disagree with these estimates are requested to describe in detail the basis for their conclusions and identify the sources of any industry statistics they relied on to reach their conclusions.

IX. STATUTORY AUTHORITY

The Commission is proposing Form NRSRO and Rules 17g-1, 17g-2, 17g-3, 17g-4, 17g-5 and 17g-6 under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 3(b), 15E, 17, 23(a) and 36.[475]

Text of Proposed Rules

List of Subjects

17 CFR Parts 240 and 249b

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Commission hereby proposes that Title 17, Chapter II of the Code of Federal Regulation be amended as follows.

PART 240 – GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority for Part 240 continues to read in part as follows:

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474 5 U.S.C. 603.

475 15 U.S.C. 78c(b), 78o-7, 78q, 78w, and 78mm.

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

* * * * *

2. Sections 240.17g-1 through 240.17g-6 are added to read as follows:

Nationally Recognized Statistical Rating Organizations

Sec.

§ 240.17g-1 Application for registration as a nationally recognized statistical rating agency.

(a) Form of registration. A credit rating agency applying to the Commission to be registered under section 15E of the Act (15 U.S.C. 78o-7) as a nationally recognized statistical rating organization with respect to one or more of the categories of credit ratings described in section 3(a)(62)(B) of the Act (15 U.S.C. 78c(a)(62)(B)) must furnish the Commission with an initial application on Form NRSRO (§249b.300 of this chapter) that follows all applicable instructions for the form.

(b) Furnishing and withdrawing initial application. (1) An initial application will be considered furnished to the Commission on the date the Commission receives a complete and properly executed initial application on Form NRSRO that follows all instructions for the form. Information submitted on a confidential basis will be accorded confidential treatment to the extent permitted by law.

(2) The applicant may withdraw an application prior to the date of a Commission order granting or denying the application. To withdraw the application, the applicant must furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

(c) Updating application prior to final action by the Commission. The applicant must promptly furnish the Commission with a written notice if information submitted to the Commission on Form NRSRO, including exhibits and attachments, is found to be or becomes materially inaccurate prior to the date of a Commission order granting or denying the application. The notice must describe the circumstances in which the information was found to be inaccurate. The applicant must also update the application with accurate and complete information by promptly furnishing the Commission with an amended initial application on Form NRSRO that follows all applicable instructions for the form.

(d) Public availability of Form NRSRO. A credit rating agency registered as a nationally recognized statistical rating organization ("rating organization") must make the current Form NRSRO and non-confidential exhibits publicly available by posting them on its Web site or by another comparable and readily accessible means within 5 business days of the date of the Commission order granting the application and,

subsequently, within 5 business days of furnishing an amendment or an annual certification on Form NRSRO.

(e) Amending scope of registration. A rating organization that is registered for fewer than the five categories of credit ratings described in section 3(a)(62)(B) of the Act (15 U.S.C. 78c(a)(62)(B)) may apply to be registered for an additional category by furnishing the Commission with an amendment on Form NRSRO indicating where appropriate on the Form the additional class for which registration is sought and following all applicable instructions for the Form. The application to amend the scope of the registration will be subject to the requirements of this section and section 15E(a)(2) of the Act (15 U.S.C. 78o-7(a)(2)) applicable to an initial application for registration, including with respect to the time periods and requirements for the Commission to grant or deny the application.

(f) Updating Form NRSRO after registration. A rating organization amending its application for registration pursuant to the requirements of section 15E(b)(1) of the Act (15 U.S.C. 78o-7(b)(1)) must promptly furnish the Commission with the amendment on Form NRSRO that follows all applicable instructions for the Form.

(g) Annual certification. A rating organization submitting its annual certification pursuant to the requirements of section 15E(b)(2) of the Act (15 U.S.C. 78o-7(b)(2)) must furnish the Commission with the annual certification on Form NRSRO that follows all applicable instructions for the Form not later than 90 days after the end of each calendar year.

(h) Withdrawal of registration. A rating organization withdrawing its registration must furnish the Commission with a written notice of withdrawal executed by a duly authorized person.

§ 240.17g-2 Records to be made and retained by nationally recognized statistical rating organizations.

(a) Records required to be made and retained. Every credit rating agency registered with the Commission as a nationally recognized statistical rating organization ("rating organization") must make and retain the following books and records, which must be complete and current:

(1) Records of original entry into the rating organization's accounting system and records reflecting entries to and balances in all general ledger accounts of the rating organization for each fiscal year.

(2) Records with respect to each of the rating organization's current credit ratings indicating (as applicable):

(i) The identity of any credit analyst(s) that determined the rating;

(ii) The identity of the person(s) who approved the rating before it was issued;

(iii) The procedures and methodologies used to determine the rating;

(iv) The method by which the credit rating was made readily accessible;

(v) Whether the credit rating was solicited or unsolicited; and

(vi) The date the credit rating action was taken.

(3) A record for each person (for example, an obligor, issuer, underwriter, or other user) that solicits the rating organization to determine or maintain a credit rating indicating:

(i) The identity and principal business address of the person; and

(ii) The credit rating(s) determined for the person.

(4) A record for each subscriber to the credit ratings and/or credit analysis of the rating organization indicating the identity and principal business address of the subscriber and the compensation received from the subscriber.

(5) A record describing each type of service and product offered by the rating organization.

(b) Records required to be retained. A rating organization must retain the following books and records:

(1) All significant records (for example, bank statements, invoices, and trial balances) underlying the information included in the rating organization's annual audited financial statements and schedules furnished to the Commission pursuant to §240.17g-3.

(2) Internal records, including non-public information and work papers, used to determine a credit rating.

(3) Credit analysis reports, credit assessment reports, and private rating reports and internal records, including non-public information and work papers, used to form the basis for the opinions expressed in these reports.

(4) All compliance reports and compliance exception reports that relate to its business as a credit rating agency.

(5) All internal audit plans, internal audit reports, documents relating to internal audit follow-up measures that relate to its business as a credit rating agency, and all records identified by the rating organization's internal auditors as necessary to perform the audit of an activity that relates to its business as a credit rating agency.

(6) All marketing materials that relate to its business as a credit rating agency.

(7) All external and internal communications, including electronic communications, received and sent by the rating organization and its employees relating to initiating, determining, maintaining, changing, or withdrawing a credit rating.

(8) All records made pursuant to paragraph (b) of §240.17g-6.

(9) All Form NRSROs (including information and documents in the exhibits thereto) furnished to the Commission.

(c) Record retention periods. (1) The records required to be retained pursuant to paragraphs (a)(1), (a)(2), and (a)(5) of this section must be retained for three years after the date the record is replaced with an updated record.

(2) The records required to be retained pursuant to paragraphs (a)(3) and (a)(4) of this section must be retained for three years after the date of the last receipt by the person in the record of a service or product of the rating organization.

(3) The records required to be retained pursuant to paragraphs (b)(1) through (b)(9) of this section must be retained for three years after the date the record is made or received by the NRSRO.

(d) Manner of retention. An original or true and complete copy of the original of each record required to be retained pursuant to paragraphs (a) and (b) of this section must be maintained in a manner that, for the applicable retention period specified in paragraph (c) of this section, makes the original record or copy easily accessible to the rating organization's principal office and to any other office that conducted activities causing the record to be made or received.

(e) Third-party record custodian. The records required to be retained pursuant to paragraphs (a) and (b) of this section may be made or retained by a third-party record

custodian, provided the rating organization furnishes the Commission at its principal office in Washington, DC with a written undertaking of the custodian executed by a duly authorized person. The undertaking must acknowledge that the records are the property of the rating organization, will be surrendered promptly on request of the rating organization, and that the custodian will permit the Commission or its representatives to examine the records. The undertaking must be in substantially the following form:

> The undersigned acknowledges that books and records it has made or is retaining for [the rating organization] are the exclusive property of [the rating organization] and the undersigned undertakes that upon the request of [the rating organization] it will promptly provide the books and records to [the rating organization] or the U.S. Securities and Exchange Commission ("Commission") and its representatives and that upon the request of the Commission it will promptly permit examination by the Commission and its representatives of the records at any time or from time to time during business hours, and promptly furnish to the Commission and its representatives a true and complete copy of any or all or any part of such books and records.

A rating organization that agrees with a third-party custodian to have the custodian make or retain any record specified in paragraphs (a) and (b) of this section remains responsible for complying with every provision in this section, notwithstanding the agreement.

(f) Non-resident undertaking. A non-resident rating organization, as defined in paragraph (h) of this section, must undertake to provide books and records to the Commission upon demand. The undertaking must be attached to the rating organization's initial application for registration as a nationally recognized statistical rating organization, signed by a duly authorized person, marked "Non-Resident Books and Records Undertaking," and in substantially the following form:

> Upon a request by the U.S. Securities and Exchange Commission ("Commission") and its representatives, [the rating organization] will furnish at its own expense to the Commission and its representatives, at its principal office

in Washington, DC, an accurate copy of any book(s) and record(s) which [the rating organization] is required to make, keep current, retain, or produce to the Commission pursuant to any provision of the Securities Exchange Act of 1934 or any regulation under that Act. [The rating organization] will produce the requested copy of the book(s) or record(s), in a form acceptable to the Commission and its representatives, including translation into English, within 14 days of receiving the request or within a longer period of time if the Commission consents to that longer time period.

(g) A rating organization must promptly furnish the Commission and its representatives with legible, complete, and current copies of those records of the rating organization required to be retained under this section, or any other records of the rating organization subject to examination under section 17(b) of the Act (15 U.S.C. 78q(b)) that are requested by the Commission and its representatives.

(h) Where used in this section non-resident rating organization means a rating organization that:

(i) If a corporation, is incorporated or has its principal office in a location outside the United States, its territories, or possessions; or

(ii) If a partnership or other unincorporated organization or association, is organized under the laws of a jurisdiction or has its principal office in a location outside the United States, its territories, or possessions.

§ 240.17g-3 Annual audited financial statements to be furnished by nationally recognized statistical rating organizations.

(a) A credit rating agency registered with the Commission as a nationally recognized statistical rating organization ("rating organization") annually must furnish the Commission, at its principal office in Washington, DC, with audited financial statements. The audited financial statements must be prepared in accordance with generally accepted accounting principles, must comply with applicable provisions of

Regulation S-X (§210.1-01 - §210.12-29, of this chapter), must be as of the fiscal year end indicated on the rating organization's current Form NRSRO, and must be furnished not more than 90 calendar days after the end of the fiscal year.

(b) The audited financial statements must include the following supporting schedules:

(1) A schedule separately itemizing the following aggregate revenues (as applicable):

(i) Revenue from determining and maintaining credit ratings;

(ii) Revenue from subscribers;

(iii) Revenue from granting licenses or rights to publish credit ratings;

(iv) Revenue from determining credit ratings that are not made readily accessible (private ratings); and

(v) Revenue from all other services and products offered by the rating organization (include descriptions of any major sources of revenue);

(2) A schedule providing the total aggregate and median annual compensation of the rating organization's credit analysts; and

(3) A schedule listing the 20 largest issuers and subscribers that used credit rating services provided by the rating organization by amount of net revenue received by the rating organization and its affiliates from the issuer or subscriber during the fiscal year. In addition, add to the list any obligor or underwriter that used credit rating services provided by the rating organization if the net revenue received by the rating organization and its affiliates from the obligor or underwriter during the fiscal year equaled or

exceeded the net revenue received from the 20th largest issuer or subscriber. Include the net revenue amount for each customer.

> Note to paragraph (b)(3): A customer would have used the "credit rating services" of the rating organization if the customer was any of the following: an obligor that is rated by the rating organization (regardless of whether the obligor paid for the credit rating); an issuer that has securities or money market instruments rated by the rating organization (regardless of whether the issuer paid for the credit rating); any other person that has paid the rating organization to determine a credit rating with respect to a specific obligor, security, or money market instrument; or a subscriber to the credit ratings of the rating organization. In calculating net revenue received from a customer, the rating organization should include all fees, sales proceeds, commissions, and other revenue received by the rating organization and its affiliates for any type of service or product, regardless of whether related to credit rating services, and net of any fees, sales proceeds, rebates, and monies paid to the customer by the rating organization and its affiliates.

(c) The audited financial statements must be furnished in accordance with the following:

(1) They must be certified by an accountant who is qualified and independent in accordance with paragraphs (a) through (c) of §210.2-01 of this chapter, and the accountant must give an opinion on the financial statements and schedules in accordance with paragraphs (a) through (d) of §210.2-02 of this chapter; and

(2) The rating organization must attach to the financial statements a signed statement by a duly authorized person at the rating organization that the person has responsibility for the financial statements and, to the best knowledge of the person, the financial statements fairly present, in all material respects, the financial condition, results of operations, and cash flows of the rating organization for the period presented.

(d) The Commission may grant an extension of time from any requirements in this section either unconditionally or on specified terms and conditions on the written

request of a rating organization if the Commission finds that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

§ 240.17g-4 Prevention of misuse of material nonpublic information.

The written policies and procedures a nationally recognized statistical rating organization ("rating organization") establishes, maintains, and enforces to prevent the misuse of material nonpublic information in accordance with section 15E(g)(1) of the Act (15 U.S.C. 78o-7(g)(1)) must include:

(a) Procedures designed to prevent the inappropriate dissemination within and outside the rating organization of material nonpublic information obtained in connection with the performance of credit rating services;

(b) Procedures designed to prevent a person associated with the rating organization or any member of an associated person's household from purchasing, selling, or otherwise benefiting from any transaction in securities or money market instruments when the person possesses or has access to material nonpublic information obtained in connection with the performance of credit rating services that affects the securities or money market instruments; and

(c) Procedures designed to prevent the inappropriate dissemination within and outside the rating organization of a pending credit rating action prior to making the action readily accessible.

§ 240.17g-5 Conflicts of interest.

(a) It shall be unlawful for a nationally recognized statistical rating organization ("rating organization") or a person associated with the rating organization to have a

conflict of interest relating to the issuance of a credit rating identified in paragraph (b) of this section, unless:

(1) The rating organization has disclosed the type of conflict of interest on Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (15 U.S.C. 78o-7(a)(1)(B)(vi)); and

(2) The rating organization has implemented policies and procedures to address and manage conflicts of interest in accordance with section 15E(h) of the Act (15 U.S.C. 78o-7(h)).

(b) Conflicts of interest. For purposes of this section, each of the following is a conflict of interest:

(1) Receiving compensation for any type of service or product from a person that is subject to a pending or issued credit rating of the rating organization.

(2) Owning securities or money market instruments of a person that is subject to a pending or issued credit rating of the rating organization.

(3) Receiving compensation from a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(4) Owning securities or money market instruments of, or having any other form of ownership interest in, a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(5) Having any other business, personal, or ownership relationship or affiliation with a person that is subject to a credit rating of the rating organization, an underwriter of securities or money market instruments rated by the rating organization, or a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(6) Being an officer or director of a person that is subject to a credit rating of the rating organization, an underwriter of securities or money market instruments rated by the rating organization, or a subscriber that uses the credit ratings of the rating organization for regulatory purposes.

(7) Any other type of conflict of interest identified by the rating organization on Form NRSRO in accordance with section 15E(a)(1)(B)(vi) of the Act (15 U.S.C. 78o-7(a)(1)(B)(vi)).

(c) Prohibited conflicts. It shall be unlawful for a rating organization to have a conflict of interest relating to the issuance of a credit rating in the following circumstances:

(1) The rating organization issues or maintains a credit rating solicited by a person that, in the most recently ended fiscal year, provided the rating organization and its affiliates with net revenue (as determined under §240.17g-3) equaling or exceeding 10% of the total net revenue of the rating organization and its affiliates for the year;

(2) The rating organization issues or maintains a credit rating with respect to a person where the rating organization, a credit analyst who participated in determining the credit rating, or a person associated with the rating organization responsible for approving the credit rating, owns securities of, or has any other ownership interest in, the rated person or is a borrower or lender with respect to the rated person;

(3) The rating organization issues or maintains a credit rating with respect to a person associated with the rating organization; or

(4) The rating organization issues or maintains a credit rating where a credit analyst who participated in determining the credit rating, or a person associated with the

rating organization responsible for approving the credit rating, is also an officer or director of the person that is subject to the credit rating.

§ 240.17g-6 Prohibited acts and practices.

(a) Prohibitions. It shall be unlawful for a nationally recognized statistical rating organization ("rating organization") to engage in any of the following unfair, coercive, or abusive practices:

(1) Conditioning or threatening to condition the issuance of a credit rating on the purchase by an obligor or issuer, or an affiliate of the obligor or issuer, of any other services or products, including pre-credit rating assessment products, of the rating organization or any person associated with the rating organization.

(2) Issuing, or offering or threatening to issue, a credit rating that is not determined in accordance with the rating organization's established procedures and methodologies for determining credit ratings, based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the rating organization or any person associated with the rating organization.

(3) Modifying, or offering or threatening to modify, a credit rating in a manner that is contrary to the rating organization's established procedures and methodologies for modifying credit ratings based on whether the rated person, or an affiliate of the rated person, purchases or will purchase the credit rating or any other service or product of the rating organization or any person associated with the rating organization.

(4) Issuing or threatening to issue a lower credit rating, or lowering or threatening to lower an existing credit rating, or refusing to issue a credit rating or withdrawing 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 a portion of the assets which comprise the asset pool or the asset-backed or mortgaged-backed securities also are rated by the rating organization. The prohibitions on refusing to issue a credit rating or withdrawing a credit rating shall not apply if the rating organization has rated less than 85% of the market value of the assets underlying the asset pool or the asset-backed or mortgage-backed securities.

(5) Issuing an unsolicited credit rating and communicating with the rated person to induce or attempt to induce the rated person to pay for the credit rating or any other service or product of the rating organization or a person associated with the rating organization.

(b) A rating organization refusing to issue a credit rating or withdrawing a credit rating with respect to an asset pool or the asset-backed or mortgaged-backed security must document in writing the reason for the refusal or withdrawal.

* * * * *

PART 249b– FURTHER FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for Part 249b continues to read in part as follows.

Authority: 15 U.S.C. 78a et seq., unless otherwise noted;

* * * * *

4. Section 249b.300 and Form NRSRO are added to read as follows:

§249b.300 FORM NRSRO, application for registration as a nationally recognized statistical rating organization pursuant to section 15E of the Securities Exchange Act of 1934 and §240.17g-1 of this chapter.

This form shall be used for application for, and amendments to applications for, registration as a nationally recognized statistical rating organization pursuant to section 15E of the Securities Exchange Act of 1934 (15 U.S.C. 78o-7) and §240.17g-1 of this chapter.

Note: The text of Form NRSRO will not appear in the Code of Federal Regulations.

Form NRSRO

OMB APPROVAL
OMB Number: 3235-
Expires:
Estimated average burden hours per response:

APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

Persons who respond to the collection of information contained in this form are not required to respond unless the form displays a currently valid OMB control number.

SEC 1541 (2-07)

APPLICATION FOR REGISTRATION AS A NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION (NRSRO)

☐ INITIAL APPLICATION ☐ AMENDMENT ☐ ANNUAL CERTIFICATION

Briefly describe the nature of the amendment
(attach extra pages if necessary):

_____

Important: Refer to Form NRSRO Instructions for General Instructions, Instructions for an INITIAL APPLICATION, AMENDMENT, and ANNUAL CERTIFICATION, Item-by-Item Instructions, an Explanation of Terms, and the Disclosure Reporting Page (NRSRO).

1. A. Full name:

_____

B. (i) Name under which credit rating business is primarily conducted, if different from Item 1A:

_____

(ii) Any other name under which credit rating business is conducted and where it is used:

_____

C. Address of principal office (do not use a P.O. Box):

_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

D. Mailing address, if different:

_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

E. Contact person (SEE INSTRUCTIONS):

_____
(Name and Title)

_____
(Number and Street) (City) (State/Country) (Zip/Postal Code)

CERTIFICATION:

The undersigned has executed this Form on behalf of, and on the authority of, the Applicant/NRSRO. The undersigned, on behalf of the Applicant/NRSRO, represents that the information and statements contained in this Form, including attachments, all of which are part of this Form, are accurate. If this is an ANNUAL CERTIFICATION, the undersigned, on behalf of the NRSRO, represents that the NRSRO's application on Form NRSRO, as amended, is accurate.

_____ _____
(Date) (Name of the Applicant/NRSRO)

By: _____ _____
(Signature) (Print Name and Title)

2. A. Legal status:

☐ Corporation ☐ Limited Liability Company ☐ Partnership ☐ Other (specify) _____

B. Month and day of fiscal year end: _____

C. The place and date of formation (i.e., state or country where incorporated, where the partnership agreement was filed, or where the entity was formed):

State/Country of formation: _____ Date of formation: _____

3. If a non-resident rating organization, attach to an INITIAL APPLICATION a written undertaking to provide books and records upon Commission request, signed by a person duly authorized by the credit rating agency (SEE INSTRUCTIONS).

4. Designated compliance officer (SEE INSTRUCTIONS):

_____
(Name and Title)

_____
(Number and Street) (City) (State/Country) (Postal Code)

5. Describe in detail below how the non-confidential information and documents submitted to the Commission in the completed INITIAL APPLICATION, any AMENDMENT, and the ANNUAL CERTIFICATION will be made publicly available on the credit rating agency's Web site or through another comparable, readily accessible means (SEE INSTRUCTIONS):

_____

_____

6. COMPLETE ITEM 6 ONLY IF THIS IS AN INITIAL APPLICATION OR IF THIS IS AN APPLICATION TO CHANGE THE SCOPE OF AN EXISTING REGISTRATION TO ADD A CLASS OF CREDIT RATINGS.

A. Indicate below the classes of credit ratings for which the credit rating agency is applying to be registered. For each class, indicate the approximate number of credit ratings the credit rating agency currently has outstanding as of the date of the application and the number of consecutive years immediately preceding the date of this application that the credit rating agency has issued ratings as a credit rating agency, as defined in Section 3(a)(61) of the Exchange Act , with respect to that class (SEE INSTRUCTIONS):

Class of credit rating	Applying for registration	Approximate number of ratings currently outstanding	Consecutive years issued
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		

issuers of government securities as that term is defined in section 3(a)(42) of the Exchange Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

TOTAL	

B. Briefly describe how the credit rating agency makes the credit ratings in the classes indicated in Item 6A readily accessible (SEE INSTRUCTIONS):

_____

_____

C. Check the applicable box and attach certifications from qualified institutional buyers, if required (SEE INSTRUCTIONS):

☐ The Applicant is submitting _____ certifications from qualified institutional buyers as part of this application. Each is marked "Certification from Qualified Institutional Buyer."

☐ The Applicant is exempt from the requirement to submit certifications from qualified institutional buyers pursuant to section 15E(a)(1)(D) of the Exchange Act.

Note: Certifications from qualified institutional buyers should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make them publicly available.

7. The information in Item 7 need only be updated when an NRSRO furnishes an ANNUAL CERTIFICATION or when the NRSRO furnishes an AMENDMENT because information provided in another Item or a non-confidential exhibit has become materially inaccurate or incomplete or to apply to change the scope of its registration.

A. Indicate below each class of credit ratings for which the Registrant is currently registered as an NRSRO. For each class, indicate the approximate number of credit ratings the Registrant currently has outstanding as of the end of the preceding calendar year and the number of consecutive years that the Registrant has issued ratings as a credit rating agency, as defined in Section 3(a)(61) of the Exchange Act, with respect to that class (SEE INSTRUCTIONS):

Class of credit rating	Currently registered	Approximate number of ratings currently outstanding	Consecutive years issued
financial institutions as that term is defined in section 3(a)(46) of the Exchange Act (15 U.S.C. 78c(a)(46)), brokers as that term is defined in section 3(a)(4) of the Exchange Act (15 U.S.C. 78c(a)(4)), and dealers as that term is defined in section 3(a)(5) of the Exchange Act (15 U.S.C. 78c(a)(5))	☐		
insurance companies as that term is defined in section 3(a)(19) of the Exchange Act (15 U.S.C. 78c(a)(19))	☐		
corporate issuers	☐		
issuers of asset-backed securities as that term is defined in 17 CFR 229.1101(c)	☐		

issuers of government securities as that term is defined in section 3(a)(42) of the Act (15 U.S.C. 78c(a)(42)), municipal securities as that term is defined in section 3(a)(29) of the Exchange Act (15 U.S.C. 78c(a)(29)), and foreign government securities	☐		

TOTAL	

B. Briefly describe how the credit rating agency makes the credit ratings in the classes indicated in Item 7A readily accessible (SEE INSTRUCTIONS):

_____

_____

8. Answer each question. Provide information that relates to a "Yes" answer on a Disclosure Reporting Page (NRSRO) and attach to this form (SEE INSTRUCTIONS).		
	YES	**NO**
A. Has the credit rating agency, or any person associated with the credit rating agency, whether prior to or subsequent to becoming associated with the credit rating agency, committed or omitted any act, or been subject to an order or finding, enumerated in subparagraph (A), (D), (E), (G), or (H) of section 15(b)(4) of the Securities Exchange Act of 1934, or any substantially equivalent foreign statute or regulation, or been enjoined from any action, conduct, or practice specified in subparagraph (C) of section 15(b)(4), or any substantially equivalent foreign statute or regulation, in the ten years preceding the date of its INITIAL APPLICATION to the Commission for registration as an NRSRO or at any time thereafter?	☐	☐
B. Has the credit rating agency, or any person associated with the credit rating agency, whether prior to or subsequent to becoming associated with the credit rating agency, been convicted of any crime that is punishable by imprisonment for 1 or more years, and that is not described in section 15(b)(4) of the Securities Exchange Act of 1934, or been convicted of a substantially equivalent crime by a foreign court of competent jurisdiction, in the ten years preceding the date of its INITIAL APPLICATION to the Commission for registration as an NRSRO or at any time thereafter?	☐	☐
C. Is any person associated with the credit rating agency subject to any order of the Commission barring or suspending the right of the person to be associated with an NRSRO?	☐	☐

9. Exhibits (SEE INSTRUCTIONS).

Exhibit 1. Credit ratings performance measurement statistics.

☐ Exhibit 1 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 1 is updated and made a part of this ANNUAL CERTIFICATION.

Exhibit 2. Procedures and methodologies used in determining credit ratings.

☐ Exhibit 2 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 2 is updated and made a part of this AMENDMENT.

Exhibit 3. Policies or procedures adopted and implemented to prevent the misuse of material, nonpublic information.

☐ Exhibit 3 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 3 is updated and made a part of this AMENDMENT.

Exhibit 4. Organizational structure.

☐ Exhibit 4 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 4 is updated and made a part of this AMENDMENT.

Exhibit 5. The code of ethics in effect at the credit rating agency or a statement of the reasons why the credit rating agency does not have a code of ethics.

☐ Exhibit 5 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 5 is updated and made a part of this AMENDMENT.

Exhibit 6. Any conflict of interest relating to the issuance of credit ratings.

☐ Exhibit 6 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 6 is updated and made a part of this AMENDMENT.

Exhibit 7. Policies and procedures to address and manage conflicts of interest.

☐ Exhibit 7 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 7 is updated and made a part of this AMENDMENT.

Exhibit 8. Certain information regarding the credit rating agency's credit analysts and credit analyst supervisors.

☐ Exhibit 8 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 8 is updated and made a part of this AMENDMENT.

Exhibit 9. Certain information regarding the credit rating agency's designated compliance officer and persons who assist the designated compliance officer.

☐ Exhibit 9 is attached and made a part of this INITIAL APPLICATION.

☐ Exhibit 9 is updated and made a part of this AMENDMENT.

Exhibit 10. A list of the largest customers that used credit rating services provided by the credit rating agency by the amount of net revenue received by the credit rating agency and its affiliates from the customer during the fiscal year ending immediately before the date the credit rating agency submits an initial application.

☐ Exhibit 10 is attached and made a part of this INITIAL APPLICATION.

Note: This exhibit should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make it publicly available.

Exhibit 11. Audited financial statements for each of the three fiscal or calendar years ending immediately before the date the credit rating agency submits an initial application.

☐ Exhibit 11 is attached and made a part of this INITIAL APPLICATION.

Note: This exhibit should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make it publicly available.

Exhibit 12. Information regarding revenues for the fiscal or calendar year ending immediately before the date the credit rating agency submits an initial application.

☐ Exhibit 12 is attached and made a part of this INITIAL APPLICATION.

Note: This exhibit should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make it publicly available.

Exhibit 13. The total and median annual compensation of credit analysts.

☐ Exhibit 13 is attached and made a part of this INITIAL APPLICATION.

Note: This exhibit should be marked "Confidential," and will be accorded confidential treatment to the extent permitted by law. A credit rating agency is not required to make it publicly available.

FORM NRSRO INSTRUCTIONS

A. GENERAL INSTRUCTIONS.

1. Form NRSRO is the Application for Registration as a Nationally Recognized Statistical Rating Organization ("NRSRO") under Section 15E of the Securities Exchange Act of 1934 ("Exchange Act"). Exchange Act Rule 17g-1 requires credit rating agencies to use Form NRSRO to submit an INITIAL APPLICATION to apply to register with the U.S. Securities and Exchange Commission ("Commission") as an NRSRO, to submit updated information as required by Section 15E(b)(1) of the Exchange Act as an AMENDMENT to Form NRSRO, and to submit the ANNUAL CERTIFICATION required by Section 15E(b)(2) of the Exchange Act.

2. Exchange Act Rule 17g-1(c) requires a credit rating agency to promptly furnish the Commission with a written notice if information submitted on an INITIAL APPLICATION, including exhibits and attachments, is found to be or becomes materially inaccurate before the Commission has granted or denied the application. The notice must describe the circumstances in which the information was found to be materially inaccurate, and the credit rating agency must promptly update the application with accurate information by furnishing the Commission with an amended INITIAL APPLICATION on Form NRSRO.

3. An INITIAL APPLICATION will be considered furnished to the Commission on the date the Commission receives a complete and properly executed Form NRSRO. Section 15E(a)(2) of the Exchange Act prescribes time periods and requirements for the Commission to grant or deny the application after it has been furnished to the Commission.

4. Type or clearly print all information. Provide the name of the credit rating agency and the date on each page. Use only the current version of Form NRSRO or a reproduction of it.

5. Mark each page of information that is submitted on a confidential basis "Confidential." The Commission will accord that information confidential treatment to the extent permitted by law.

6. Section 15E of the Exchange Act (15 U.S.C. 78o-7) authorizes the Commission to collect the Information on this form from Applicants and NRSROs. The principal purpose of this form is to determine whether an Applicant should be granted registration as an NRSRO and, once registration is granted, whether a credit rating agency continues to meet the criteria for registration as an NRSRO. Intentional misstatements or omissions constitute federal criminal violations under 18 U.S.C. 1001.

The information collection is in accordance with the clearance requirements of Section 3507 of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507). The Commission may not conduct or sponsor, and you are not required to respond to, a collection of information unless it displays a valid Office of Management and Budget (OMB) control number. The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is displayed on the facing page of this form. Send comments regarding this burden estimate or suggestions for reducing the burden to Director, Office of Information Technology, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

The information contained in this form is part of a system of records subject to the Privacy Act of 1974, as amended (5 U.S.C. 552a). The Commission has published in the Federal Register the Privacy Act Systems of Records Notice for these records, and the Commission may make "routine use" disclosure of the information as outlined under the Notice.

7. Exchange Act Rule 17g-2(b)(9) requires a credit rating agency to retain copies of all information and documents submitted to the Commission with Form NRSRO These records must be made available for inspection upon a regulatory request.

8. ADDRESS - The mailing address for Form NRSRO is:

U. S. Securities and Exchange Commission
Form NRSRO Mailbox
Mail Stop
100 F Street, NE
Washington, DC 20549-

B. INSTRUCTIONS FOR INITIAL APPLICATIONS

1. Check the appropriate box at the top of Form NRSRO;
2. All Items must be answered and all required responses must be complete. Enter "None" or "N/A" where appropriate;
3. Provide all required information and attachments, including undertakings, exhibits, certifications, and Disclosure Reporting Pages, as applicable;

4. If information submitted, including exhibits and attachments, is found to be or becomes materially inaccurate before the Commission approves the application, promptly furnish the Commission with accurate information, pursuant to Rule 17g-1(c); and

5. Execute the Form.

C. INSTRUCTIONS FOR AMENDMENTS

1. Submit an AMENDMENT to Form NRSRO in order to:

a. Promptly provide accurate information to the Commission in the event that information on the current Form NRSRO, on any Disclosure Reporting Page (NRSRO), or on Exhibits 2 through 9 becomes materially inaccurate, pursuant to Section 15E(b)(1) of the Exchange Act; or

b. Change the scope of an existing registration to add a class of credit ratings.

2. To submit an AMENDMENT:

a. Check the appropriate box at the top of Form NRSRO and briefly describe the nature of the amendment;

b. Complete Items 1, 2, 4, 5, 7, 8 (with Disclosure Reporting Pages, as applicable), and update, as required, Exhibits 2 through 9, to provide accurate information. (Do not update or attach Exhibits 2 through 9 if the information in them remains materially accurate.) If applying to change the scope of an existing registration, complete Item 6. An NRSRO is not required to update certifications by qualified institutional buyers. (See instructions for Item 6 below.); and

c. Execute the Form.

D. INSTRUCTIONS FOR ANNUAL CERTIFICATIONS

1. Submit an ANNUAL CERTIFICATION on Form NRSRO within 90 days after the end of each calendar year, in accordance with Section 15E(b)(2) of the Exchange Act;

2. Check the appropriate box at the top of Form NRSRO;

3. Complete and update, as required, Items 1, 2, 4, 5, 7, 8 (with Disclosure Reporting Pages, as applicable), and update, as required, Exhibits 2 through 9, to provide accurate and complete information;

4. Update Exhibit 1;

5. Attach a list of all AMENDMENTs submitted during the previous calendar year; and

6. Execute the Form.

E. INSTRUCTIONS FOR SPECIFIC LINE ITEMS

Item 1E. The individual listed as the contact person must be authorized to receive all communications from the Commission and must be responsible for their dissemination within the credit rating agency's organization.

Item 3. Exchange Act Rule 17g-4(c) requires a non-resident rating organization to undertake to provide books and records upon Commission request. The undertaking must be signed by a person duly authorized by the credit rating agency, must be attached to the INITIAL APPLICATION, must be marked "Non-Resident Books and Records Undertaking," and must be in substantially the following form:

> "Upon a request by the U.S. Securities and Exchange Commission ("Commission") and its representatives, [the rating organization] will furnish at its own expense to the Commission and its representatives, at its principal office in Washington, D.C., an accurate copy of any book(s) or record(s) which [the rating organization] is required to make, keep current, retain, or produce to the Commission pursuant to any provision of the Securities Exchange Act of 1934 or any regulation under that Act. [The rating organization] will produce the requested copy of the book(s) or record(s), in a form acceptable to the Commission and its representatives, including translation into English, within 14 days of receiving the request or within a longer period of time if the Commission consents to that longer time period.
>
> _____
>
> Signature"

Item 4. Section 15E(j) of the Exchange Act requires an NRSRO to designate a compliance officer responsible for administering the policies and procedures of the credit rating agency established pursuant to Sections 15E(g) and (h) of the Exchange Act (respectively, to prevent the misuse of material nonpublic information and address and manage conflicts of interest) and for ensuring compliance with applicable securities laws, rules, and regulations.

Item 5. Section 15E(a)(3) of the Exchange Act and Exchange Act Rule 17g-1(d) require a credit rating agency to make certain information and documents submitted to the Commission publicly available on its Web site or through another comparable, readily accessible means within 5 business days of the date of the Commission order granting the application for registration as an NRSRO, and, subsequently, within 5 business days of furnishing an amended Form NRSRO to the Commission. All information and documents submitted to the Commission in the completed INITIAL APPLICATION, any AMENDMENT, and the ANNUAL CERTIFICATION must be made publicly available except Exhibits 10 through 13, the certifications from qualified institutional buyers, and the non-resident

undertaking. Describe in detail how that information will be made readily accessible. If the information and documents will be posted on the credit rating agency's Web site, for example, give the Internet address and link to the information and documents.

Item 6. Complete Item 6 only if submitting an INITIAL REGISTRATION or changing the scope of an existing registration to add a class of credit ratings.

Item 6A. Pursuant to Section 15E(a)(1)(B)(vii) of the Exchange Act, a credit rating agency applying for registration as an NRSRO must disclose in the application the classes of credit ratings for which the credit rating agency is applying to be registered. Indicate these classes by checking the appropriate box or boxes. Pursuant to the definition of "nationally recognized statistical rating agency" in Section 3(a)(62) of the Exchange Act, a credit rating agency must have been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration as an NRSRO. For each class of credit ratings, provide the approximate number of ratings the credit rating agency currently has outstanding and the number of consecutive years immediately preceding the date of the application that the credit rating agency has issued ratings as a credit rating agency, as defined in Section 3(a)(61) of the Exchange Act, with respect to that class.

Item 6B. Pursuant to Section 3(a)(61)(A) of the Exchange Act, a "credit rating agency" issues "credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee." Briefly describe how the credit rating agency makes the credit ratings in the classes indicated in Item 6A readily accessible for free or for a reasonable fee.

Item 6C. Section 15E(a)(1)(B)(ix) of the Exchange Act requires that an application for registration as an NRSRO include written certifications from qualified institutional buyers, as defined in paragraph Section 3(a)(64) of the Exchange Act, except that, under Section 15E (a)(1)(D), a credit rating agency is not required to submit these certifications if it has received a no-action letter from Commission staff prior to August 2, 2006 stating that the staff would not recommend enforcement action to the Commission against any broker or dealer that uses credit ratings issued by the credit rating agency to compute capital charges under Exchange Act Rule 15c3-1.

If the credit rating agency is required to submit certifications, paragraph Section 15E(a)(1)(C) of the Exchange Act requires the credit rating agency to submit a minimum of 10 certifications from qualified institutional buyers, none of which is affiliated with the credit rating agency. Each certification may address more than one class of credit ratings. Of the submitted certifications, at least two must address each class of credit rating identified in Item 6A under "Applying for Registration." If this is an AMENDMENT to an existing registration to add one or more classes

of credit ratings to the scope of its NRSRO registration, the NRSRO must submit at least two certifications that address each additional class of credit ratings.

The required certifications must be signed by a person duly authorized by the certifying entity, must be notarized, must be marked "Certification from Qualified Institutional Buyer," and must be in substantially the following form:

"I, [Executing official], am authorized by [Certifying entity] to execute this certification on behalf of [Certifying entity]. I certify that all actions by stockholders, directors, general partners, and other bodies necessary to authorize me to execute this certification have been taken and that [Certifying entity]:

(i) Meets the definition of a 'qualified institutional buyer' as set forth in section 3(a)(64) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(64)) pursuant to following subsection(s) of 17 CFR 230.144A(a)(1) [insert applicable citations];

(ii) Has seriously considered the credit ratings of [the credit rating agency] in the course of making investment decisions for at least the three years immediately preceding the date of this certification, in the following classes of credit ratings:

[Applicable classes of credit ratings]; and

(iii) Has not received compensation either directly or indirectly from [the credit rating agency] for executing this certification.

_____

Signature"

The certifications should be marked "Confidential," and the Commission will accord them confidential treatment to the extent permitted by law. A credit rating agency is not required to make them publicly available.

Item 7. Check the appropriate boxes indicating the classes of credit ratings for which the credit rating agency is currently registered as an NRSRO. Complete other parts of this Item according to the instructions for Item 6.

Item 8. Answer each question by checking the appropriate box. Information that relates to an affirmative answer must be provided on a Disclosure Reporting Page (NRSRO) and attached to Form NRSRO. The Disclosure Reporting Page (NRSRO) is attached to these instructions.

Item 9. Exhibits. Section 15E(a)(1)(B) of the Exchange Act requires an application for registration as an NRSRO to contain certain specific information and documents and, pursuant to Section 15E(a)(1)(B)(x), any other

information and documents concerning the applicant and any person associated with the applicant that the Commission requires as necessary or appropriate in the public interest or for the protection of investors.

A. INITIAL APPLICATION. An INITIAL APPLICATION must include Exhibits 1 through 13.

B. AMENDMENT. Update Exhibits 2 through 9 promptly with new information and documents whenever the existing information or documents contained in the exhibit becomes materially inaccurate (see Section 15E(b)(1) of the Exchange Act). Do not update Exhibits 10 through 13 after registration is granted.

C. ANNUAL CERTIFICATION. Section 15E(b)(2) of the Exchange Act requires an NRSRO to certify annually that the information and documents attached to Form NRSRO are accurate and to list any material changes that occurred to the information and documents during the previous year. Section 15E(b)(1) of the Exchange Act requires that an NRSRO amend the information provided with Exhibit 1 in the ANNUAL CERTIFICATION.

D. If any information or document required to be included with any exhibit is maintained in a language other than English, provide both the original document (or a true and complete copy of the original document) and a version of the document translated into English. Attach a certification by an authorized person that the translated version is a true, accurate, and complete English translation of the information or document.

E. Attach exhibits to Form NRSRO in numerical order. Bind each exhibit separately, and mark each exhibit or bound volume of the exhibit with the appropriate exhibit number. The information provided in the exhibits must be sufficiently detailed to allow for verification. The information and documents required to be provided in Exhibits 1 through 9 must be made publicly available (see Item 5); the information and documents required to be provided in Exhibits 10 through 13 should be marked "Confidential." The Commission will accord them confidential treatment to the extent permitted by law. The credit rating agency is not required to make them publicly available.

Exhibit 1. This exhibit must include credit ratings performance measurement statistics over short-term, mid-term, and long-term periods (as applicable) of the credit rating agency through the most recent calendar year-end, including, as applicable: historical down-grade and default rates within each credit rating category (ranking) of the credit rating agency. As part of this exhibit, define the credit ratings used by the credit rating agency and explain the performance measurement statistics, including the metrics used to determine the statistics.

Exhibit 2. This exhibit must include the procedures and methodologies that the credit rating agency uses to determine credit ratings, including unsolicited credit ratings. The procedures and methodologies furnished in this exhibit should include, as applicable: policies for determining whether to initiate a credit rating; a

description of the public and non-public sources of information used in determining credit ratings, including information and analysis provided by third-party vendors; a description of any quantitative and qualitative models and metrics used to determine credit ratings; procedures for interacting with the management of a rated obligor or issuer of rated securities or money market instruments; the structure and voting process of committees that review or approve credit ratings; procedures for informing rated obligors or issuers of rated securities or money market instruments about credit rating decisions and for appeals of final or pending credit rating decisions; procedures for monitoring, reviewing, and updating credit ratings; and procedures to withdraw, or suspend the maintenance of, a credit rating.

For purposes of this exhibit: Unsolicited credit rating means a credit rating that the credit rating agency determines without being requested to do so by the issuer or underwriter of the rated securities or money market instruments or the rated obligor.

Exhibit 3. This exhibit must include policies or procedures established, maintained, and enforced by the credit rating agency to prevent the misuse of material, nonpublic information as required by Section 15E(g) of the Exchange Act and 17 CFR 240.17g-4.

Exhibit 4. This exhibit must include a description of the organizational structure of the credit rating agency, including, as applicable, an organizational chart that identifies the credit rating agency 's ultimate and sub-holding companies, subsidiaries, and material affiliates; an organizational chart showing the divisions, departments, and business units of the credit rating agency; and an organizational chart showing the managerial structure of the credit rating agency, including the designated compliance officer identified in Item 4.

Exhibit 5. This exhibit must include a copy of the written code of ethics in effect at the credit rating agency or a statement of the reasons why the credit rating agency does not have a written code of ethics.

Exhibit 6. This exhibit must identify in general terms the types of conflicts of interest relating to the issuance of credit ratings by the credit rating agency including, as applicable: whether the credit rating agency receives compensation from rated obligors, issuers of rated securities or money market instruments, and underwriters of rated securities or money market instruments to determine or maintain a credit rating and for other services (identify the services); whether an affiliate of the credit rating agency owns securities of, or has any other form of ownership interest in, a rated obligor, issuer of rated securities or money market instruments, or underwriter of rated securities or money market instruments; whether the credit rating agency's employees

are permitted to own securities of a rated obligor or issuer of rated securities or money market instruments; whether the credit rating agency receives compensation from entities that use its credit ratings for regulatory purposes and for other services (identify the services); whether the credit rating agency, or an affiliate, owns securities of, or has any other form of ownership interest in, an entity that uses credit ratings for regulatory purposes; whether the credit rating agency's employees are permitted to own securities of an entity that uses credit ratings for regulatory purposes; and whether the credit rating agency, its affiliates, or its employees have any other business relationship or affiliation with a rated obligor, issuer of rated securities or money market instruments, underwriter of rated securities or money market instruments, or entity that uses credit ratings for regulatory purposes. In addition, identify each entity that is an underwriter of rated securities or money market instruments or that uses credit ratings for regulatory purposes that is also a person associated with the credit rating agency.

Exhibit 7. This exhibit must include the written policies and procedures established, maintained, and enforced by the credit rating agency pursuant to Section 15E(h) of the Exchange Act to address and manage conflicts of interest.

Exhibit 8. This exhibit must include the following information regarding each of the credit rating agency's credit analysts and each officer and employee of the credit rating agency responsible for supervising the credit rating agency's credit analysts:

- Name.
- Title and brief description of responsibilities, including whether a supervisor.
- Employment history.
- Post-secondary education.
- Whether employed by the credit rating agency full-time (at least 35 hours per week) or part-time.

For purposes of this exhibit: Credit analyst means an individual associated with the credit rating agency who is responsible for determining a credit rating using either a quantitative model, a qualitative model and analysis, or a combination of these methods.

Exhibit 9. This exhibit must include the following information about the credit rating agency's designated compliance officer (identified in Item 4) and any other persons that assist the designated compliance officer in carrying out the responsibilities set forth in Section 15E(j) of the Exchange Act:

- Name.
- Title and brief description of responsibilities.
- Employment history.
- Post secondary education.
- Whether employed by the credit rating agency full-time (at least 35 hours per week) or part-time.

Exhibit 10. This exhibit must include a list of the largest customers that used credit rating services provided by the credit rating agency by the amount of net revenue received by the credit rating agency and its affiliates from the customer during the fiscal year ending immediately before the date the credit rating agency submits an INITIAL APPLICATION. In making this list, the credit rating agency should first determine the 20 largest issuer and subscriber customers in terms of net revenue received by the credit rating agency and its affiliates from the issuer or subscriber. Next, the credit rating agency should add to the list any obligor or underwriter that used credit rating services provided by the credit rating agency if the net revenue received by the credit rating agency and its affiliates from the obligor or underwriter during the fiscal year equaled or exceeded the net revenue received from the 20th largest issuer or subscriber. In making the list, rank the customers from largest to smallest and include the net revenue amount for each customer.

For purposes of this exhibit:

Net revenue means all fees, sales proceeds, commissions, and other revenue received by the credit rating agency and its affiliates for any type of service or product, regardless of whether related to credit rating services, and net of any fees, sales proceeds, rebates, and other monies paid to the customer by the credit rating agency and its affiliates; and

Credit rating services means any of the following: rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings to a subscriber.

Exhibit 11. This exhibit must include financial statements of the credit rating agency, which must include a balance sheet, an income statement and statement of cash flows, and a statement of changes in owners' equity, audited by an independent public accountant, for each of the three fiscal or calendar years ending immediately before the date it submits an INITIAL APPLICATION to the Commission, subject to the following:

If the credit rating agency is a division, unit, or subsidiary of a parent company, the credit rating agency can provide audited consolidated and consolidating financial statements of the parent company.

If the credit rating agency does not have audited financial statements for one or more of the three fiscal or calendar years ending immediately before the date it submits an INITIAL APPLICATION to the Commission, it can provide unaudited financial statements for the applicable year or years, but the credit rating agency must provide audited financial statements for the fiscal or calendar year ending immediately before the date it submits an INITIAL APPLICATION to the Commission. The credit rating agency must attach to the unaudited financial statements a certification by a person duly authorized by the credit rating agency to make the certification that the person has responsibility for the financial statements and that to the best knowledge of the person making the certification the financial statements fairly present, in all material respects, the financial condition, results of operations, and cash flows of the rating organization for the period presented.

Exhibit 12. This exhibit must include the following information, as applicable, regarding the credit rating agency's aggregate revenues for the fiscal or calendar year ending immediately before the date it furnishes an INITIAL APPLICATION to the Commission:

- Revenue from determining and maintaining credit ratings;
- Revenue from subscribers;
- Revenue from granting licenses or rights to publish credit ratings;
- Revenue from determining credit ratings that are not made readily accessible (private ratings); and
- Revenue from all other services and products offered by the rating organization (include descriptions of any major sources of revenue).

Exhibit 13. This exhibit must include the total and median annual compensation of the credit rating agency's credit analysts.

F. **EXPLANATION OF TERMS.** For purposes of Form NRSRO, the following definitions and descriptions apply:

1. COMMISSION - The U. S. Securities and Exchange Commission.
2. CREDIT RATING - An assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments [Section 3(a)(60) of the Exchange Act].
3. CREDIT RATING AGENCY [Section 3(a)(61) of the Exchange Act] - Any person:

- engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;
- employing either a quantitative or qualitative model, or both to determine credit ratings; and
- receiving fees from either issuers, investors, and/or other market participants.

4. NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION [Section 3(a)(62) of the Exchange Act] - A credit rating agency that:
   - has been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration as an NRSRO;
   - issues credit ratings certified by qualified institutional buyers with respect to:
     - financial institutions, brokers, or dealers;
     - insurance companies;
     - corporate issuers;
     - issuers of asset-backed securities;
     - issuers of government securities, municipal securities, or securities issued by a foreign government; or
     - a combination of one or more of the above; and
   - is registered as an NRSRO.
5. NON-RESIDENT RATING ORGANIZATION [Exchange Act Rule 17g-4(a)] - A nationally recognized statistical rating organization that:
   - If a corporation, is incorporated in or has its principal office in, a location outside the United States, its territories, or possessions;
   - If a partnership or other unincorporated organization or association, has its principal office in a location outside the United States, its territories, or possessions.
6. PERSON - An individual, partnership, corporation, trust, limited liability company, or other organization.
7. PERSON ASSOCIATED WITH THE CREDIT RATING AGENCY - Any partner, officer, director, or branch manager of the credit rating agency (or any person occupying a similar status or performing similar functions), any person directly or indirectly controlling, controlled by, or under common

control with a credit rating agency, or any employee of a an credit rating agency [Section 3(a)(63) of the Exchange Act].

8. QUALIFIED INSTITUTIONAL BUYER - An entity listed in 17 CFR 230.144A(a) that is not affiliated with the credit rating agency [Section 3(a)(64) of the Exchange Act].

DISCLOSURE REPORTING PAGE (NRSRO)

This Disclosure Reporting Page (DRP) is to be used to report information related to affirmative responses to **Item 8** of Form NRSRO.

Use a separate DRP for each event or proceeding. Attach additional pages as necessary.

Name of credit rating agency _____ Date _____

Check Item being responded to:

☐ Item 8A

☐ Item 8B

☐ Item 8C

The individual(s) or entity(ies) for whom this DRP is being filed is (are):

☐ The credit rating agency

☐ The credit rating agency and one or more associated persons

☐ One or more associated persons

If this DRP is being filed for one or more associated persons, provide the full name of the associated person(s):

_____

If this DRP provides information relating to a "Yes" answer to Item 8A, describe the act(s) that was (were) committed or omitted; or the order(s) or finding(s); or the injunction(s) (provide the relevant statute(s) or regulation(s)) and provide jurisdiction(s) and date(s):

_____

If this DRP provides information relating to a "Yes" answer to Item 8B, describe the crime(s) and provide jurisdiction(s) and date(s):

_____

If this DRP provides information relating to a "Yes" answer to Item 8C, attach the relevant Commission order(s) and provide date(s):

_____

☐ This DRP should be removed from Form NRSRO because the person(s) is (are) no longer associated with the credit rating agency

By the Commission.

Nancy M. Morris
Secretary

Dated: February 2, 2007

Commissioner Casey Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55228 / February 2, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12558

In the Matter of JACKIE G. GROSS, SR., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934 ("Exchange Act") against Jackie G. Gross, Sr. ("Respondent" or "Gross").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b)(6) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

Document 5 of 22

III.

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

1. Gross, age 66, resides in Plano, Texas. From late 2001 through September 30, 2003, Gross was the president, chief executive officer and sole owner of Morgan Spaulding, Inc. ("Morgan Spaulding"), a registered broker-dealer. During the same period, he was also president and owner of Telvest Communications, LLC ("Telvest"), a privately held limited liability company that performed services for issuers and overseas brokerage firms in connection with Regulation S offerings.

2. On January 29, 2007, a final judgment was entered by consent against Gross, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Jackie Gross, et al., Civil Action Number 3-05CV1251-N, in the United States District Court for the Northern District of Texas.

3. The Commission's complaint alleged that from late 2001 through September 30, 2003, Telvest, representing itself as a U.S.-based escrow agent, facilitated the unregistered Regulation S offerings of 13 U.S.-based issuers that sold approximately $14.7 million in shares to investors in the United Kingdom and other countries. Only a limited portion (approximately 30 to 45 percent) of the invested proceeds was actually remitted to the issuers. The rest went to: (1) overseas brokerage firms as undisclosed commissions; (2) Telvest and Gross; and (3) other individuals as "finder fees." Telvest failed to disclose, in confirmations to investors or elsewhere, that approximately 55 to 70 percent of the purchase price of the Regulation S offerings was sent to parties other than the issuers. Instead, the confirmations disclosed only a fee of either $50 or one percent, leaving investors with the false impression that nearly all of the purchase price would be remitted to the issuing companies. After payments to overseas brokerage firms, finders, and issuers, Telvest netted approximately $1.6 million.

4. The Commission's complaint further alleged that Gross controlled the operations of both Telvest and Morgan Spaulding. He signed the agreements between Telvest and the issuers, the overseas brokerage firms, and the finders; closely supervised the Morgan Spaulding employee who worked full time administering the Regulation S offerings; and directed transfers of money from Telvest to the issuers, overseas brokerage firms and finders.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act that Respondent Gross be, and hereby is, barred from association with any broker or dealer.

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

By the Commission.

Nancy M. Morris
Secretary

Chairman Cox and Commissioner Campos Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
February 5, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12559

In the Matter of **TRAUTMAN WASSERMAN & COMPANY, INC., GREGORY O. TRAUTMAN, SAMUEL M. WASSERMAN, MARK BARBERA, JAMES A. WILSON, JR., JEROME SNYDER, AND FORDE H. PRIGOT,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, AND SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act"), and Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Trautman Wasserman & Company, Inc. ("TWCO"), Gregory O. Trautman ("Trautman"), Samuel M. Wasserman ("Wasserman"), Mark Barbera ("Barbera"), James A. Wilson, Jr. ("Wilson"), Jerome Snyder ("Snyder"), and Forde H. Prigot ("Prigot") ("Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

Overview

1. This matter concerns a scheme to defraud mutual funds through late trading and deceptive market timing of mutual funds through TWCO, a registered broker-dealer. Between January 2001 and September 2003, TWCO accepted thousands of orders from its hedge fund customers to trade mutual funds after 4:00 p.m. ET, but executed the trades as though they had

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been received prior to 4:00 p.m. ET. In addition, TWCO employed deceptive tactics to evade mutual funds' efforts to restrict TWCO's hedge fund customers' market timing of mutual funds. This illegal conduct generated significant revenues for TWCO and harmed mutual fund investors by diluting the value of their investment.

2. TWCO's mutual fund trading department consisted principally of two registered representatives ("RRs"), Wilson and Scott A. Christian ("Christian"). Wilson, who supervised Christian, directed the late trading and market timing schemes, and he personally entered and processed customers' late trading orders. Christian handled day-to-day communications with customers, and he regularly accepted and entered late trades. In carrying out the fraudulent late trading scheme, Wilson and Christian created records falsely indicating that customers had placed trades before 4 p.m. Further, numerous mutual funds notified Wilson, Christian, and others at TWCO that frequent trading by TWCO's customers violated prohibitions in the mutual funds' prospectuses, and the mutual funds instructed TWCO to stop permitting its customers to trade those funds. Christian and others, acting at Wilson's direction, then employed deceptive tactics to continue trading the mutual funds that had requested TWCO's customers to stop.

3. TWCO's senior management participated in or was otherwise aware of the late trading scheme. Indeed, Trautman, TWCO's chief executive officer ("CEO"), variably referred to the ability to trade late as TWCO's "elixir," "magic potion," or "special juice."

4. Trautman, Wasserman, TWCO's chairman, and Barbera, TWCO's chief financial officer ("CFO"), participated in various discussions concerning late trading at TWCO. Trautman, with Barbera's assistance, also arranged for late trading for one of his customers. In addition, TWCO had a proprietary trading account that bought and sold shares of mutual funds. TWCO officers and employees, including Trautman and Barbera, placed late trades for TWCO's proprietary account on the basis of news and market conditions after the market close, but those trades were priced at that day's net asset value (NAV).

5. TWCO's former chief administrative officer, Snyder, and its former chief compliance officer, Prigot, also participated in TWCO's fraudulent market timing. Snyder and Prigot each took steps to deceive mutual fund companies about TWCO's customers' market timing to evade the mutual fund companies' efforts to curtail the practice.

Respondents

6. **TWCO**, based in New York, New York, was at all relevant times a broker-dealer registered with the Commission.

7. **Trautman**, age 39, is a resident of New York, New York. Trautman is the co-founder and CEO of TWCO. At all relevant times, Trautman was associated with TWCO. He holds Series 4, 7, 24, 27, 55, and 63 licenses.

8. **Wasserman,** age 70, is a resident of Riverdale, New York. Wasserman is the co-founder and chairman of TWCO. At all relevant times, Wasserman was associated with TWCO.

Wasserman was also president of Trautman Wasserman Capital Advisers, Inc. and Trautman Wasserman Capitol Advisers, Inc., which were registered with the Commission as investment advisers from December 2000 through April 2001 and from January 2002 through June 2002, respectively. Wasserman holds or has held Series 00, 1, 3, 4, 5, 15, 63, and 65 licenses.

9. **Wilson,** age 36, is a resident of New York, New York. At all relevant times, Wilson was a RR associated with TWCO. Wilson holds Series 7 and 63 licenses.

10. **Barbera,** age 49, is a resident of Bronxville, NY. Barbera has been CFO of TWCO since 1993. At all relevant times, Barbera was associated with TWCO. Barbera holds or has held Series 3, 4, 7, 24, 27 and 63 licenses.

11. **Snyder,** age 66, is a resident of Lakewood, NJ. Snyder was chief administrative officer of TWCO from 1999 until December 31, 2002, and he has served as a consultant to TWCO between May 14, 2004 and the present. During 2002, Snyder was the de facto chief compliance officer of TWCO. At all relevant times, Snyder was associated with TWCO. Snyder holds or has held Series 1, 3,4, 5, 7, 8, 12, 15, 24, 40, 53, 55, 63, and 65 licenses.

12. **Prigot,** age 64, is a resident of Park Ridge, NJ. Prigot was a compliance officer of TWCO beginning in January 2002. Prigot was the chief compliance officer of TWCO from February 2003 to October 2005. At all relevant times, Prigot was associated with TWCO. Prigot holds or has held Series 4, 7, 24, 27, 55, 63, and 66 licenses.

Market Timing and Late Trading

13. Market timing includes (a) frequent buying and selling of shares of the same mutual fund or (b) buying or selling mutual fund shares in order to exploit inefficiencies in mutual fund pricing. Market timing, while not illegal per se, can harm other mutual fund shareholders because it can dilute the value of their shares. Market timing can also disrupt the management of the mutual fund's investment portfolio and cause the targeted mutual fund to incur costs borne by other shareholders to accommodate frequent buying and selling of shares by the market timer.

14. Rule 22c-1(a) under the Investment Company Act requires investment companies issuing redeemable securities, their principal underwriters and dealers, and any person designated in the fund's prospectus as authorized to consummate transactions in securities issued by the fund to sell and redeem fund shares at a price based on the current net asset value ("NAV") next computed after receipt of an order to buy or redeem. Mutual funds generally determine the daily price of their mutual fund shares as of 4:00 p.m. ET. In these circumstances, orders received before 4:00 p.m. ET must be executed at the price determined as of 4:00 p.m. ET that day. Orders received after 4:00 p.m. ET must be executed at the price determined as of 4:00 p.m. ET the next trading day.

15. "Late trading" refers to the practice of placing orders to buy or sell mutual fund shares after the time as of which a mutual fund has calculated its NAV (usually as of the close of trading at 4:00 p.m. ET), but receiving the price based on the prior NAV already determined as

of 4:00 p.m. ET. Late trading enables the trader to profit from market events that occur after 4:00 p.m. ET but that are not reflected in that day's price. In particular, the late trader obtains an advantage – at the expense of the other shareholders of the mutual fund – when he learns of market moving information and is able to purchase (or sell) mutual fund shares at prices set *before* the market moving information was released. Late trading violates Rule 22c-1(a) under the Investment Company Act. Late trading also harms shareholders, for instance, when late trading dilutes the value of their shares.

Late Trading At TWCO

16. In 2000, Wasserman began attempting to set up a mutual fund trading operation at TWCO. Wasserman recruited Wilson and Christian, who were at that time working at another broker-dealer. While interviewing for their positions at TWCO, Wilson and Christian learned that TWCO's clearing broker, Banc of America Securities, LLC ("B of A"), offered a mutual fund trading system that could be used to enter mutual fund trade orders until 8:30 p.m. ET. Wasserman, who managed TWCO's relationship with B of A, arranged meetings between Wilson, Christian, and B of A representatives so that they could discuss the mutual fund trading platform. After these meetings, Wilson and Christian realized that they could directly enter mutual fund trades into this system, thereby bypassing the B of A mutual fund desk.

17. Wasserman then hired Wilson and Christian, and they began working at TWCO.

18. Soon after Wilson and Christian started working at TWCO in December 2000, TWCO retained a computer consultant to develop software for entering orders into the B of A trading system effectively on a large scale.

19. Although the B of A system allowed orders to be entered and processed as late as 8:30 p.m. ET, Wilson and Christian were aware that they were supposed to receive orders from customers by 4:00 p.m. ET in order to execute them at that day's price. For example, B of A's "Mutual Funds Processing" manual that B of A provided to TWCO required that: "All orders should be received and time stamped by the close of the NYSE, 4 PM EST."

20. Wilson and Christian then contacted their former market timing customers as well as other prospective customers to pitch the advantages of the market timing and late trading system that they were developing at TWCO. In return, Wilson extracted extra compensation for providing late trading. For example, on April 9, 2001, the manager of a hedge fund, Hedge Fund A, that was interested in late trading sent an e-mail to Wilson complaining that TWCO was "earning double what everyone else takes home on this business," and that "[y]ou currently earn 2% p.a. [per annum]." Further, the manager of Hedge Fund A complained that "[y]our facility for late trading is not the only one we have," and that "[i]n all other cases we pay 1% p.a." On April 11, 2001, Wilson sent an e-mail to Hedge Fund A's manager indicating that "**we are the only place to trade late past 530**" (emphasis in original), and "thus you have to pay more." On May 1, 2001, the hedge fund manager notified Wilson by e-mail that Hedge Fund A was sending funds to begin trading. The hedge fund manager described how the late trading would work as follows:

In essence, most of it will be done by you within certain parameters that we will give you each day. In the majority of cases, your decision point will be 5:30pm NY time. In a few cases, your decision point will be 6:30pm – I know, slave labor...whatever will you do working that late!

21. Wilson supervised Christian and directed the daily operations of their late trading and market timing business. At Wilson's direction, Christian and another TWCO employee entered tens of thousands of late trades for Wilson's customers. Moreover, Wilson directed Christian and the other employee to create false records, "for compliance reasons," intended to show that TWCO had received the customer's trading orders prior to 4:00 p.m. ET.

22. On a daily basis, customers sent tentative instructions to trade mutual fund shares to TWCO during the day, beginning at approximately 12 noon E.T. TWCO treated these trading instructions as order tickets. As the trading instructions came in, Christian would collect them, but he would not enter the orders or time stamp the order tickets. Rather, Christian waited until shortly before 4:00 p.m. ET to time stamp the order tickets.

23. Christian sometimes forgot to time stamp the order tickets before 4:00 p.m. ET, resulting in some order tickets that were stamped after 4:00 p.m. ET. Wilson eventually gave Christian an alarm clock, which Christian set to go off shortly before 4:00 p.m. ET to remind him to stamp the order tickets. When the alarm went off, Christian and the other TWCO employee would time stamp the trading instructions. This practice made it appear as if TWCO received the instructions shortly before 4:00 p.m. ET.

24. However, Christian and the other employee did not enter the orders into the B of A mutual fund trading system when they time stamped the orders. Instead, between 4:00 p.m. ET and 6:30 p.m. ET, Wilson, Christian, or the other employee spoke with customers to get their final trading decisions.

25. Sometimes customers gave final trading instructions that were "cancellations" or partial cancellations of the tentative orders placed earlier in the day. Often, customers submitted wholly new orders that were not part of the tentative instructions they had submitted earlier in the day. Only then did Christian or the other employee enter the trading orders, without creating a new or modified order ticket reflecting the actual order or with the correct time stamp on the ticket.

26. TWCO routinely accepted mutual fund trading instructions for Hedge Fund A, as well as for two other hedge funds, Hedge Fund B and Hedge Fund C, well past 4:00 p.m. ET and often as late as between 5:00 and 6:45 p.m. ET. For these customers, virtually all the trading in mutual funds at TWCO consisted of late trading.

27. Wilson also personally took customers' mutual fund orders to engage in late trading. For example, tape recordings made at Hedge Fund B of telephone calls indicate that Wilson accepted mutual fund orders at 4:41 p.m. ET on February 14, 2003, at 5:17 p.m. ET on September 27, 2001, and at 6:08 p.m. ET on December 18, 2001. After receiving these orders, Wilson then entered the trades so they could be executed at the same day's NAV.

28. Further, Wilson was fully aware of the procedures that Christian and the other employee routinely used for executing late trades. For example, on February 14, 2003, at 4:41 p.m. ET, a trader at Hedge Fund B telephoned TWCO and said, "Hey, Jim, it's [a representative of Hedge Fund B]. ... You got Scott or [the other employee] there to take some trades?" Wilson replied, "I can help you," and proceeded to accept Hedge Fund B's late trading decisions. Wilson then said, "Let me just read this back to you, I haven't done this in a while, I'm in an embarrassing situation." On September 27, 2001 at 5:17 p.m. ET, the same representative of Hedge Fund B telephoned TWCO and asked for Christian. Wilson said that Christian had just stepped away, offered to take the order, and said he would "grab the sheets" off Christian's desk, referring to the trading instructions sent by Hedge Fund B and time stamped by TWCO before 4:00 p.m. ET. Wilson proceeded to accept Hedge Fund B's instructions as to which trades on the trading instructions it wished to confirm, cancel, or modify. Wilson concluded by telling Hedge Fund B's representative that he could call with additional trading decisions until 5:30 p.m. ET.

29. Further, as evident from his April 11, 2001 email to Hedge Fund A quoted above (demanding higher fees because of the value of late trading), Wilson knew that TWCO's hedge fund customers benefited from the ability to late trade. Wilson knew that customers factored into their trading decisions after-hours news announcements and market conditions. For example, he knew from e-mails with Hedge Fund A that the hedge fund based its trading instructions on parameters for after-hours index futures prices that Hedge Fund A provided to TWCO.

30. At Wilson's direction, Christian and the other TWCO employee regularly helped customers follow calendars of corporate earnings announcements and relayed to customers information regarding notable developments after the market close. Further, Christian frequently provided customers shortly after 4:00 p.m. ET with newly-calculated mutual fund NAVs reflecting the current day's pricing. This allowed customers to compare the NAVs of mutual funds against after hours trading in stocks in those funds, and thereby compute with some degree of precision the actual trading profit they would make on a given late trade.

TWCO Partners Approved and/or Participated in Late Trading

31. An executive committee consisting of the firm's principals, including Trautman, Wasserman, and Barbera, managed TWCO. The executive committee held regular weekly meetings and other ad hoc meetings to discuss the business of the firm and to engage in planning and decision-making. Trautman, Wasserman, and Barbera were well aware of Wilson's and Christian's illegal late trading.

TWCO Gave False Assurances About the Legality of Late Trading

32. In June 2002, a principal of Hedge Fund C developed concerns about the legality of late trading and requested to meet with TWCO's principals. The principal and another Hedge Fund C representative then met with Trautman, Wasserman, Wilson, and Christian at TWCO's offices. Trautman informed the Hedge Fund C representatives that outside counsel and internal compliance had reviewed the practice and considered it to be legal.

33. Trautman's representation concerning consultation with outside counsel was false. In fact, TWCO had not consulted with outside counsel concerning the legality of late trading.

34. Following this meeting, Hedge Fund C continued to late trade through TWCO. At a subsequent meeting with Wasserman, Wilson, and Christian on or about March 11, 2003, the Hedge Fund C principal explained how late trading allowed him to profit by making trading decisions on the basis of news after 4:00 p.m. ET and stated that he therefore wanted to "ramp up" his investments with TWCO.

35. Subsequently, in or about early April 2003, Hedge Fund C invested an additional $25,000,000 through TWCO for the purpose of mutual fund trading.

Trautman Engaged in Late Trading for One of His Customers

36. Trautman offered late trading to at least one of his customers ("Customer 89001"). With Barbera present, Trautman explained to Customer 89001 that when deciding to purchase shares of mutual funds, for instance, TWCO would use a "trigger." The trigger was when the price of stock futures contracts rose by 1.5% in after-hours (post-4:00 p.m. ET) trading. Trautman told Customer 89001, and Barbera confirmed to Customer 89001, that Trautman had made money on 13 of 15 trades using this system. Customer 89001 then invested with TWCO. TWCO placed Customer 89001's funds in a TWCO brokerage account. Subsequently, Trautman placed late trades for Customer 89001's account.

Trautman, Wasserman, and Barbera Sought to Obtain Timing Capacity as Part of the Late Trading Scheme

37. The TWCO partners actively participated in the mutual fund business by seeking timing capacity from fund companies. In particular, Trautman used a personal friendship with a fund manager at one fund complex to obtain large amounts of capacity. Further, Wasserman used his long-standing contacts at another fund complex to increase TWCO's capacity in those funds. Neither Trautman nor Wasserman disclosed to the fund complexes that TWCO would use the capacity for late trading.

38. Barbera also engaged in efforts to obtain capacity. At various times in 2002 and 2003, Barbera sought timing capacity from other entities that could be used for mutual fund trading on behalf of TWCO's customers.

39. Barbera participated in making arrangements for Hedge Fund C to obtain a loan to be used in mutual fund trading.

40. In September 2002, Barbera also helped negotiate and drafted a letter agreement setting forth the fee arrangement for a $5 million discretionary account established by one customer, which Trautman, Wasserman, Barbera, Wilson, and Christian knew would be used for late trading. Barbera knew that late trading would be used for this account and that Trautman

planned to lie to the holders of the account by claiming that TWCO would simply use a "black box" trading system.

41. Also in the spring of 2003, Barbera and Christian sought to develop a relationship with a data processing firm for the purpose of enabling TWCO to engage in late trading apart from the B of A system.

Late Trading in TWCO's Proprietary Accounts

42. Wilson also persuaded TWCO's partners to establish a proprietary account with the firm's money to serve as the basis for a TWCO managed hedge fund. In late 2001, TWCO opened a mutual fund trading account, and TWCO ultimately deposited approximately $500,000 into the account. Initially, the TWCO proprietary account copied the market timing trades of a TWCO customer. When the account started losing money, Trautman took charge of trading in the account. Trautman then began to make trading decisions in the account based on news developments that occurred after 4:00 p.m. ET.

43. Subsequently, Trautman often went to Wilson's and Christian's office at TWCO after the market close to decide whether to place mutual fund trades in the TWCO account based on news and market conditions after 4:00 p.m. ET. Trautman occasionally referred to the ability to trade late on news or post-4:00 p.m. ET futures market conditions as the firm's "elixir," "magic potion," or "special juice."

44. Barbera monitored the TWCO proprietary account for risk-management purposes. Barbera was also aware that Trautman, Wilson, and Christian were making trading decisions based on post-4:00 p.m. ET news and market activity. Additionally, on one or more occasions Barbera made trading decisions for the TWCO proprietary account after 4:00 p.m. ET.

Wilson Directed TWCO's Deception of Mutual Funds That Sought To Curtail Market Timing

45. In March 2001, as TWCO began large-scale market timing for its customers, mutual fund complexes began notifying TWCO that the funds restricted or prohibited such transactions. For example, on March 16, 2001, a fund complex wrote Christian to warn him about excessive trading by customer accounts in one of the complex's mutual funds. The letter explained that excessive trading could hurt the mutual fund's performance and that the fund's prospectus therefore reserved to the fund complex the right to refuse an exchange request if there were more than two exchanges from the same fund in any three-month period. The letter notified Christian that "exchange activities in your client's account have become excessive and we are writing you in an effort to have you and your clients adhere to the guidelines stated in our Prospectus," and warned that further excessive trading would result in a trading freeze in the accounts.

46. In total, during the period March 2001 through April 2003, TWCO, Wilson, and Christian received 307 "kick out" letters from 40 mutual fund families that addressed trading activity in 113 accounts.

47. In response, Wilson and Christian attempted to deceive mutual fund companies and evade their restrictions. Wilson had learned many of these techniques from his hedge fund customers while Wilson was working at other broker-dealers. Wilson explained these techniques to Christian, and directed him to employ them.

48. Based on Wilson's instructions, Christian opened multiple accounts for TWCO's market timing customers and entered transactions using one of numerous RR numbers. Christian did this because he understood that mutual fund companies would be less likely to detect market timing by a customer if the customer's trades occurred in numerous accounts with different account numbers, account names, or RR identification numbers.

49. More specifically, TWCO "cloned" accounts to evade mutual funds' restrictions. For example, a fund complex sent a letter to TWCO on February 22, 2002 concerning account number 70087, an account that TWCO maintained for Hedge Fund A, warning that the account was approaching the limit on exchanges. On March 4, 2002, Christian opened two new accounts, each with a new account number (70089 and 70110), for the same entity, and two days later entered a market timing trade in one of the mutual fund complex's mutual funds. Similarly, on June 4, 2002, the same fund complex sent to TWCO a letter imposing restrictions on trading by account number 70104, an account that TWCO maintained for Hedge Fund B. On June 7, 2002, Christian opened a new account for the same entity with a new account number (70139), and less than three weeks later began trading the fund complex's mutual funds using the new account.

50. Consistent with this deceptive practice, TWCO opened a total of 140 accounts for eleven institutional customers. These included 68 accounts for its customer Hedge Fund A; 35 accounts for Hedge Fund B; nine accounts for Hedge Fund C; 15 accounts for Hedge Fund D; and five accounts for Hedge Fund E. Christian prepared the new account forms, which he then submitted to Snyder or Prigot for approval and signature.

51. Christian, assisted by Snyder and/or Prigot, also established 16 different RR identification numbers at TWCO for use in mutual fund trading, as a means of evading restrictions imposed by mutual funds that tracked excessive trading through RR numbers.

52. Beginning in early 2002, a subordinate informed Wasserman that mutual funds frequently sought to curtail TWCO's market timing activities and that Christian established multiple RR identification numbers for the purpose of evading restrictions by mutual funds. Wasserman did not object to, or otherwise stop, this conduct.

Snyder Facilitated Fraudulent Market Timing

53. Snyder supervised Wilson and Christian during much of the time period that TWCO engaged in deceptive market timing. Snyder received numerous warning or kick out letters from mutual funds. Snyder received a number of these letters from funds during the approximately seven-month period that he acted as chief compliance officer in addition to serving as chief

administrative officer. Despite receiving these letters, Snyder failed to act to stop Wilson and Christian from market timing as the funds requested.

54. During the period he was chief administrative officer, Snyder was responsible for obtaining RR identification numbers for TWCO RRs by calling B of A and getting numbers assigned. Snyder obtained numerous RR ID numbers for Wilson and Christian, which they then used to engage in deceptive market timing.

55. Snyder also signed numerous account opening forms as the firm's principal, including during the period he was serving as TWCO's chief compliance officer. This enabled TWCO to create duplicate accounts for customers and continue to market time mutual funds without the funds' knowledge. For instance, between June 25 and June 29, 2001, Snyder signed new account forms to create four accounts for Hedge Fund A, and on August 30, 2001, he signed new account forms to create an additional five accounts for Hedge Fund A.

56. Further, on at least one occasion Snyder misrepresented the purpose of mutual fund trades to a representative of a mutual fund complex. The representative of the mutual fund complex asked Snyder if he knew who were the TWCO RRs attached to accounts that had recently made fourteen mutual fund trades worth $500,000 each. Snyder responded that it was probably a "house account." When the representative asked who handled those accounts, Snyder responded that he did. In fact, Snyder knew that the RRs attached to the trades were Wilson and Christian, who were using a so-called "house account" to conceal their identities and thus to evade the mutual fund complex's restrictions on trading. The representative of the mutual fund complex then informed Snyder that there was a potential problem with the accounts because they appeared to be set up for market timing. Although Snyder knew that all of Wilson's and Christian's business related to market timing of mutual funds, Snyder falsely stated that, to his knowledge, the accounts were not being used for market timing.

Prigot Facilitated Fraudulent Market Timing

57. Prigot was aware that mutual funds were trying to curtail Wilson's and Christian's trading. Prigot received numerous kick out letters from mutual funds. In addition, Prigot was responsible for dealing with mutual fund complexes that had questions about TWCO's mutual fund market timing customers.

58. Snyder explained to Prigot that, when mutual fund complexes asked who controlled accounts that the fund complexes suspected were engaged in market timing, Prigot should tell the fund complexes that the accounts were "house accounts." On at least two occasions, Prigot informed mutual fund representatives who called TWCO and questioned certain trading that the accounts in question were house accounts. Prigot knew, however, that the accounts belonged to customers of Wilson and Christian and were engaged in market timing.

59. In addition, Prigot served as a principal at TWCO. In this capacity, Prigot signed numerous account opening forms for Wilson's and Christian's market timing customers. Prigot

thus enabled TWCO to create duplicate accounts, which Wilson and Christian used to enable their customers to continue to market time mutual funds without the funds' knowledge.

VIOLATIONS

60. As a result of the conduct described above, TWCO, Wilson, Trautman, Wasserman, and Barbera willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities. Among other things, Wilson participated in a scheme with TWCO's customers to defraud mutual funds and their shareholders by engaging in late trading. The late trading scheme involved implicit, material false representations that TWCO received trades from customers prior to 4:00 p.m. ET. Trautman, Wasserman, and Barbera were well aware of this late trading scheme and they solicited customers to late trade, gave false assurances to customers concerning the legality of late trading, and/or took other steps such as setting up customer accounts and negotiating capacity from mutual funds to be used for late trading. In addition, Trautman, Wasserman, and Barbera approved using TWCO assets for late trading of mutual funds, and Trautman, Barbera, and Wilson personally made late trading decisions. Further, Wilson defrauded mutual funds and their shareholders when he and Christian misrepresented and concealed the identities of TWCO's RRs and customers, as well as the nature of their customers' market timing activity, from the mutual funds. Wilson, Trautman, Wasserman, and Barbera each acted knowingly and/or recklessly in engaging in these activities, and by virtue of their positions at TWCO, their scienter is imputed to TWCO.

61. In the alternative, as a result of the conduct described above, Wilson, Wasserman, Trautman, and Barbera willfully aided and abetted and caused TWCO's and TWCO's customers' violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities. TWCO and its customers violated Section 10(b) of the Exchange Act and Rule 10b-5. Wilson, Trautman, Wasserman, and Barbera each substantially assisted these violations. Specifically, TWCO engaged in late trading in its proprietary account, thereby defrauding mutual funds and their shareholders. Additionally, Wilson participated in a scheme with his customers to defraud mutual funds and their shareholders by engaging in late trading. The late trading scheme involved implicit, material false representations that TWCO received trades from customers prior to 4:00 p.m. ET. Trautman, Wasserman, and Barbera were aware of this late trading scheme. They solicited customers to late trade, gave false assurances to customers concerning the legality of late trading, and/or took other steps such as setting up customer accounts and negotiating capacity from mutual funds to be used for late trading. Further, Wilson defrauded mutual funds and their shareholders when he and Christian misrepresented and concealed the identities of TWCO's RRs and customers, as well as the nature of customers' market timing activity, from the mutual funds. Wilson, Trautman, Wasserman, and Barbera were all generally aware that their conduct was wrongful.

62. As a result of the conduct described above, TWCO willfully violated Section 15(c) of the Exchange Act and Rule 10b-3 thereunder, which prohibit fraudulent conduct by brokers or dealers in connection with the purchase or sale of securities. Among other things, TWCO participated in a scheme with its customers to defraud mutual funds and their shareholders by

engaging in late trading. The late trading scheme involved implicit, material false representations that TWCO received trades from customers prior to 4:00 p.m. ET. Trautman, Wasserman, Barbera, and Wilson were well aware of this late trading scheme and they accepted and entered late trades, solicited customers to late trade, gave false assurances to customers concerning the legality of late trading, and/or took other steps such as setting up customer accounts and negotiating capacity from mutual funds to be used for late trading. In addition, Trautman, Wasserman, and Barbera approved using TWCO assets for late trading of mutual funds, and Trautman, Barbera, and Wilson personally made late trading decisions. Further, Wilson defrauded mutual funds and their shareholders when he and Christian misrepresented and concealed the identities of TWCO's RRs and customers, as well as the nature of their customers' market timing activity, from the mutual funds. Wilson, Trautman, Wasserman, and Barbera each acted knowingly and/or recklessly in engaging in these activities, and by virtue of their positions at TWCO, their scienter is imputed to TWCO.

63. As a result of the conduct described above, Wilson, Wasserman, Trautman, Barbera, Snyder, and Prigot willfully aided and abetted and caused TWCO's violations of Section 15(c) of the Exchange Act and Rules 10b-3 thereunder, which prohibit fraudulent conduct by brokers or dealers in connection with the purchase or sale of securities. As discussed above, TWCO violated Section 15(c) of the Exchange Act and Rule 10b-3. Wilson, Wasserman, Trautman, Barbera, Snyder, and Prigot substantially assisted this violation. Wilson and his customers defrauded mutual funds and their shareholders by engaging in late trading. The late trading scheme involved implicit, material false representations that TWCO received trades from customers prior to 4:00 p.m. ET. Trautman, Wasserman, and Barbera were aware of this late trading scheme. They solicited customers to late trade, gave false assurances to customers concerning the legality of late trading, and/or took other steps such as setting up customer accounts and negotiating capacity from mutual funds to be used for late trading. In addition, Trautman, Wasserman, and Barbera approved using TWCO assets for late trading of mutual funds, and Trautman and Barbera personally made late trading decisions. Further, Wilson defrauded mutual funds and their shareholders when he and Christian misrepresented and concealed the identities of TWCO's RRs and customers, as well as the nature of customers' market timing activity, from the mutual funds. Snyder and Prigot received numerous warning or kick out letters from mutual funds, but they failed to stop the market timing as the funds requested. Snyder created multiple RR numbers for Wilson and Christian. Snyder and Prigot signed numerous account opening forms for TWCO. Wilson and Christian then used the multiple RR numbers and accounts to market time mutual funds. After mutual funds questioned whether certain trades were market timing trades, Snyder and Prigot falsely told mutual fund complexes' representatives that money invested at the mutual fund belonged to a TWCO house account, and indicated that the trades were not market timing trades. Wilson, Trautman, Wasserman, Barbera, Snyder, and Prigot were all generally aware that their conduct was wrongful.

64. As a result of the conduct described above, Trautman, Wasserman, Wilson, and Barbera willfully aided and abetted and caused violations of Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act. Rule 22c-1 prohibits dealers in a mutual fund's shares, among others, from executing a trade in that mutual fund's shares at that day's NAV if the trade was received after the time as of which the mutual fund has calculated that day's NAV (e.g., 4:00 p.m. ET). TWCO's clearing firm, B of A, had dealer agreements with the primary underwriters of

several mutual funds that were late traded by TWCO's customers. B of A sold and redeemed fund shares at prices not based on the current NAV next computed after receipt of an order to buy or redeem to facilitate the late trading engaged in by these customers. Thus, B of A willfully and directly violated Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act. Wilson, TWCO, Trautman, Wasserman and Barbera substantially assisted this violation. TWCO, with the knowledge and approval of TWCO principals Trautman, Wasserman and Barbera, late-traded in TWCO's own proprietary account. Wilson and his subordinates received numerous orders for trades in those mutual funds after 4:00 p.m. ET, yet entered the trades in the B of A system such that they would receive the current day's NAV. Thus, B of A violated Rule 22c-1, and Trautman, Wasserman, Wilson, and Barbera aided and abetted and caused B of A's violations.

65. As a result of the conduct described above, TWCO willfully violated Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, which require registered brokers and dealers to make and keep current certain specified books and records, including a memorandum of each brokerage order and other instruction given or received for the purchase or sale of a security and to note on the memorandum the time at which it received the order. Specifically, Wilson directed his subordinates to create falsified books and records by time stamping order tickets prior to 4:00 p.m. ET to create the appearance that customers made final trading decisions prior to 4:00 p.m. ET. Moreover, although customers routinely made their trading decisions after 4:00 p.m. ET, no TWCO employee created an order ticket reflecting this post-4:00 p.m. ET order. As a result of this conduct, TWCO failed to maintain order tickets that accurately reflected the time that TWCO received customers' final trading decisions.

66. As a result of the conduct described above, Wilson willfully aided and abetted and caused TWCO's violations of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder, which require registered brokers and dealers to make and keep current certain specified books and records, including a memorandum of each brokerage order and other instruction given or received for the purchase or sale of a security and to note on the memorandum the time at which it received the order. As discussed above, TWCO violated Section 17(a) of the Exchange Act and Rule 17a-3 by failing to keep accurate order tickets. Wilson substantially assisted this conduct. Specifically, Wilson directed his subordinates to time stamp order tickets prior to 4:00 p.m. ET to create the appearance that customers made final trading decisions prior to 4:00 p.m. ET. Wilson knew that the customers did not make their final trading decisions at the time reflected on the order tickets.

67. As a result of the conduct described above, Snyder and Prigot willfully aided and abetted and caused TWCO's, Wilson's, Christian's, and their customers' violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent practices in connection with the purchase or sale of securities. TWCO, Wilson, Christian, and their customers violated Section 10(b) of the Exchange Act and Rule 10b-5, as described above. For example, TWCO, Wilson, Christian, and their customers engaged in late trading and deceptive market timing. Snyder and Prigot substantially assisted this conduct. For example, Snyder and Prigot received numerous warning or kick out letters from mutual funds, but they failed to stop the market timing as the funds requested. Snyder created multiple RR numbers for Wilson and Christian. Snyder and Prigot also signed numerous account opening forms for TWCO. Wilson and Christian then used the multiple RR numbers and accounts to deceive mutual funds about the identity of

their customers in order to market time mutual funds. Additionally, after mutual funds contacted Snyder and Prigot and asked if particular trading was market timing, Snyder and Prigot falsely told mutual fund complexes' representatives that money invested at the mutual fund belonged to a TWCO house account. Snyder and Prigot were generally aware that their conduct was wrongful.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement, prejudgment interest, and civil penalties pursuant to Section 21B of the Exchange Act, and against Wasserman pursuant to Sections 203(f) and 203(k) of the Investment Advisers Act.

C. Whether, pursuant to Section 8A of the Securities Act and Section 21C of the Exchange Act, TWCO should be ordered to cease and desist from committing or causing violations of Section 17(a) of the Securities Act, Sections 10(b), 15(c), and 17(a) of the Exchange Act and Rules 10b-3, 10b-5, and 17a-3 thereunder and whether TWCO should be ordered to pay disgorgement and prejudgment interest.

D. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 9(f) of the Investment Company Act, Trautman, Wasserman, Barbera, and Wilson should be ordered to cease and desist from committing or causing violations of Section 17(a) of the Securities Act, Sections 10(b), 15(c), and 17(a) of the Exchange Act and Rules 10b-3 and 10b-5 thereunder (and in the case of Wilson Rule 17a-3 thereunder), and Rule 22c-1, as adopted under Section 22(c) of the Investment Company Act, and whether Trautman, Wasserman, Barbera, and Wilson should be ordered to pay disgorgement and prejudgment interest.

E. Whether, pursuant to Section 21C of the Exchange Act, Snyder and Prigot should be ordered to cease and desist from committing or causing violations of Sections 10(b) and 15(c) of the Exchange Act and Rules 10b-3 and 10b-5 thereunder and whether Snyder and Prigot should be ordered to pay disgorgement, prejudgment interest, and civil penalties.

IV.

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

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

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

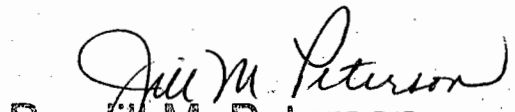
This Order shall be served forthwith upon Respondents personally or by certified mail.

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

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

By the Commission.

Nancy M. Morris
Secretary



By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55242 / February 6, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12561

In the Matter of

BYRON NERNOFF,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTION

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Byron Nernoff ("Respondent" or "Nernoff").

II.

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

III.

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

1. Nernoff, 64 years old, is a resident of Roslyn Heights, New York. Between January 1999 and March 2001, Nernoff solicited investors for Growth Benefit Systems. During that time period, Nernoff acted as an unregistered broker or dealer when he offered and sold securities

for Growth Benefit Systems, and was associated with unregistered brokers or dealers. Nernoff has never been associated with a registered broker or dealer.

2. On January 16, 2007, a final judgment was entered by consent against Nernoff, permanently enjoining him from future violations of Sections 5(a), 5(c) and 17(a) of the Securities Act and Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, in a civil action entitled Securities and Exchange Commission v. Jack Calvin, et al., Civil Action No. 03-CV-10586-MEL (D. Mass.), in the United States District Court for the District of Massachusetts.

3. The Commission's complaint alleged, among other things, that Nernoff offered and sold unregistered securities--while not being registered as a broker or dealer or associated with a registered broker or dealer--in Growth Benefit Systems, a purported "Prime Bank" trading program that did not exist. The complaint also alleged that the Growth Benefit Systems securities were sold through Nernoff and salespeople that he recruited. The salespeople were not registered as brokers or dealers. Nernoff was responsible for calculating commission payments and shared commissions with the salespeople. Based on his conduct, Nernoff was associated with salespeople who were operating as brokers or dealers.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Nernoff be, and hereby is, barred from association with any broker or dealer.

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

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 232, 239, 270 and 274

[Release Nos. 33-8781, IC-27697; File Number S7-05-07]

RIN 3235-AJ59

EXTENSION OF INTERACTIVE DATA VOLUNTARY REPORTING PROGRAM ON THE EDGAR SYSTEM TO INCLUDE MUTUAL FUND RISK/RETURN SUMMARY INFORMATION

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing rule amendments to extend the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit supplemental tagged information contained in the risk/return summary section of their prospectuses. A mutual fund choosing to tag its risk/return summary information also would continue to file this information in HTML or ASCII format, as currently required. This extension of the voluntary program is intended to help us evaluate the usefulness to investors, third-party analysts, registrants, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information.

DATES: Comments should be submitted on or before [insert date 30 days after publication in the Federal Register].

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

Electronic comments:

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

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-05-07 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

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

All submissions should refer to File Number S7-05-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: If you have questions about the proposed rules, please contact Alberto H. Zapata, Senior Counsel, Christopher Kaiser, Branch Chief, or Brent J. Fields, Assistant Director, Office of Disclosure Regulation, Division of Investment Management, at (202) 551-6784, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-5720. If you have questions about the EDGAR system, please contact Richard Heroux, EDGAR Program Manager, at (202) 551-8800, in the Office of Information Technology.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission ("Commission") is proposing for comment amendments to rules 401[1] and 402[2] of Regulation S-T[3], rule 8b-33[4] under the Investment Company Act of 1940 ("Investment Company Act"), and Form N-1A[5] under the Investment Company Act and the Securities Act of 1933 ("Securities Act").

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1 17 CFR 232.401.

2 17 CFR 232.402.

3 17 CFR 232.10 et seq.

4 17 CFR 270.8b-33.

5 17 CFR 239.15A and 274.11A.

Table of Contents

I. BACKGROUND

A. Interactive Data and XBRL

For the past several years, the Commission has been evaluating the expanded use of interactive data tagging as a tool to improve the timeliness and accessibility of the information contained in filings with the Commission under the federal securities laws.[6] Data tagging uses standard definitions (or data tags) to translate text-based information into data that is interactive, that is, data that can be retrieved, searched, and analyzed through automated means.[7]

Interactive data has enormous potential to enable investors and other market participants to analyze and compare data from different sources more efficiently and effectively and to exchange information across various software platforms automatically.

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[6] See SEC to Rebuild Public Disclosure System to Make It 'Interactive', Securities and Exchange Commission Press Release, Sept. 25, 2006, available at: http://www.sec.gov/news/press/2006/2006-158.htm (Commission awards contracts totaling $54 million to transform public company disclosure system to create a dynamic real-time search tool with interactive capabilities) ("September 25 Press Release"); Commission Announces Interactive Data Roundtable on New Software to Make Better Information a Reality, Securities and Exchange Commission Press Release, Sept. 25, 2006, available at: http://www.sec.gov/news/press/2006/2006-160.htm; Commission Announces Roundtable Series Giving Investors and Analysts Better Financial Data via Internet, Securities and Exchange Commission Press Release, Mar. 9, 2006, available at: http://www.sec.gov/news/press/2006-34.htm; SEC Offers Incentives for Companies to File Financial Reports with Interactive Data, Securities and Exchange Commission Press Release, Jan. 11 2006, available at: http://www.sec.gov/news/press/2006-7.htm; SEC Announces Initiative to Assess Benefits of Tagged Data in Commission Filings, Securities and Exchange Commission Press Release, July 22, 2004, available at: http://www.sec.gov/news/press/2004-97.htm.

[7] The Commission's Electronic Data Gathering, Analysis, and Retrieval System ("EDGAR") has allowed certain tagged data since its inception, for example, by using Standard Generalized Markup Language and Extensible Markup Language ("XML") to tag form-specific information (such as the form type, central index key, and file number) that accompanies electronic documents submitted on EDGAR. More recently, EDGAR has employed HyperText Markup Language ("HTML") to format documents and made limited use of XML related to financial and business information contained within certain EDGAR submissions.

Through interactive data, static text-based information can be transformed into dynamic databases that can readily be searched and analyzed, facilitating the comparison of information across companies, reporting periods, and industries. Tagged information can help investors, analysts, and other users to mine the wealth of information contained in detailed paper disclosure documents, providing users with the ability to access precisely the information in which they are interested and to analyze that data.

Interactive data also provides a significant opportunity to automate information processing throughout the business and reporting cycle, with the potential to increase accuracy and reduce costs. By ensuring that information is classified properly at each step of the cycle, and minimizing the need for human intervention and, therefore, human error, interactive data may improve the quality of information at decreased cost. These benefits can begin at the time of an initial transaction and carry forward to the point of disclosure in a Commission filing and, ultimately, to the use of the disclosed information by investors and other market participants. At each step in the process, interactive data offers the potential to replace manual reentry of information with automated processing of previously tagged data.

Tags are standardized through the development of taxonomies, which are essentially data dictionaries that describe individual items of information and mathematical and definitional relationships among the items. As tagging has continued to gain prominence in recent years, there has been substantial progress in developing data tagging taxonomies related to a language for the electronic communication of business

and financial data known as eXtensible Business Reporting Language ("XBRL").[8] XBRL was developed as an open source specification that describes a standard format for tagging financial and other information to facilitate the preparation, publication, and analysis of that information by software applications.[9] XBRL was developed and continues to be supported by XBRL International, a collaborative consortium of approximately 450 organizations representing many perspectives in the financial reporting community.[10] Organizations in the consortium include issuers, public accounting firms, software companies, filing agents, data aggregators, stock exchanges, regulators, financial services companies, and industry associations.[11] XBRL International and its related entities have been developing standard taxonomies that are designed to classify and define financial information in accordance with U.S. Generally Accepted Accounting Principles ("GAAP") and Commission regulations. The Commission recently announced that it is contracting with XBRL US, Inc., the U.S. based arm of XBRL International, to help complete the writing of XBRL taxonomies that would enable companies in all industries to file financial reports with the Commission using XBRL.[12]

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8 See Edward Hand, "XBRL: The Future of Business Reporting," NETWORK COMPUTING, Aug. 31, 2006, available at: http://www.networkcomputing.com/showArticle.jhtml?articleID=192202551&pgno=1.

9 "Open Source" means that the software can be used by anyone without charge and is being developed in an open and collaborative setting. For a more detailed discussion about XBRL, see "How XBRL Works" on the XBRL International Web site available at: http://www.xbrl.org/HowXBRLWorks/.

10 See "About the Organisation" page and subpages on the XBRL International Web site, available at: http://www.xbrl.org/AboutTheOrganisation/.

11 See "Member Organisations" page and subpages on the XBRL International Web site, available at: http://xbrl.org/viewmembers.aspx.

12 September 25 Press Release, supra note 6.

B. The Voluntary Program

As part of our evaluation of the potential of interactive data tagging technology, the Commission adopted rules in 2005 instituting a program that permits filers, on a voluntary basis, to submit specified, supplemental disclosure tagged in XBRL format as an exhibit to certain filings on the Commission's Electronic Data Gathering, Analysis and Retrieval System ("EDGAR").[13] The Commission adopted the voluntary program to help evaluate the usefulness of data tagging and XBRL to registrants, investors, the Commission, and the marketplace.[14] In 2006, the Commission initiated an interactive data test program, in which companies, including investment companies, voluntarily agree to furnish financial data in XBRL format for at least one year and provide feedback on their experiences, including the costs and benefits.[15]

Under the voluntary program, filers may submit financial information using XBRL as an exhibit to the filing to which it relates, an amendment to such filing, or, if

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13 Securities Act Release No. 8529 (Feb. 3, 2005) [70 FR 6556 (Feb. 8, 2005)] ("XBRL Adopting Release"). See also Securities Act Release No. 8496 (Sept. 27, 2004) [69 FR 59094 (Oct. 1, 2004)] ("XBRL Proposing Release"); Securities Act Release No. 8497 (Sept. 27, 2004) [69 FR 59111 (Oct. 1, 2004)] (concept release soliciting comment on data tagging).

14 XBRL Adopting Release, supra note 13, 70 FR at 6556.

15 More Companies Join SEC's Program to Use Interactive Data for Financial Statements, Securities and Exchange Commission Press Release, June 20, 2006, available at: http://www.sec.gov/news/press/2006/2006-99.htm; 17 Companies Join SEC Pilot Program to Use "Interactive Data" in Financial Reports, Securities and Exchange Commission Press Release, Mar. 29, 2006, available at: http://www.sec.gov/news/press/2006-43.htm; SEC Offers Incentives for Companies to File Financial Reports with Interactive Data, Securities and Exchange Commission Press Release, Jan. 11, 2006, available at: http://www.sec.gov/news/press/2006-7.htm. For more information about the Commission's interactive data initiatives, see the Commission Web page "Spotlight On: Interactive Data and XBRL Initiatives" available at: http://www.sec.gov/spotlight/xbrl.htm.

the filer is eligible, to a filing on Form 8-K[16] or Form 6-K.[17] The XBRL exhibits submitted in the voluntary program are supplemental submissions that do not replace the required American Standard Code for Information Interchange ("ASCII") or Hypertext Markup Language ("HTML") versions of the financial information they contain.[18] The data currently permitted in XBRL exhibits is limited to financial information.

The voluntary program permits any registrant to participate merely by submitting an XBRL exhibit in the required manner. XBRL exhibits are publicly available but are considered furnished rather than filed.[19] Although XBRL exhibits are required to accurately reflect the information that appears in the corresponding part of the official filing, the purpose of submitting XBRL data is to test the related format and technology and, as a result, investors and others should continue to rely only on the official version of a filing and not on the XBRL exhibit in making investment decisions. We have included cautionary language to this effect on the Commission Web site.[20]

C. Tagging of Mutual Fund Information

The current voluntary program extends to investment companies, including open-end management investment companies ("mutual funds").[21] Investment companies

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16 17 CFR 249.308.

17 17 CFR 249.306.

18 See EDGAR Filer Manual, Volume II, Section 5.1 (Version 3, Feb. 2006).

19 See infra note 57 and accompanying text.

20 See "XBRL Data Submitted in the XBRL Voluntary Program on EDGAR" page on the Commission Web site, available at: http://www.sec.gov/Archives/edgar/xbrl.html.

21 See SEC XBRL Voluntary Program Extends to Investment Companies, Securities and Exchange Commission Press Release, Aug. 8, 2005, available at: http://www.sec.gov/news/press/2005-112.htm.

may presently submit XBRL exhibits only to Form N-CSR,[22] the semi-annual filing to submit certified shareholder reports, or to Form N-Q,[23] the quarterly report of portfolio holdings.[24]

As part of our evaluation of data tagging, the Commission held a roundtable in June 2006 that focused, in part, on the role of data tagging and interactive data in improving the quality of mutual fund disclosures. Representatives from investor groups, the mutual fund industry, analysts, and others discussed how the Commission could leverage the power of interactive data and other technology to provide mutual fund investors with better information.[25]

Significant discussion at the June roundtable concerned the importance of providing mutual fund investors with better, more user-friendly access to key information, such as information about investment objectives and strategies, risks, and

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22 17 CFR 249.331 and 274.128.

23 17 CFR 249.332 and 274.130.

24 Voluntary participants must use the standard U.S. GAAP investment management taxonomy (Version 2.1) approved by XBRL International. See EDGAR Filer Manual, Volume II, Section 5.2.4.1 (Version 3, Feb. 2006); "Frequently Asked Questions about the XBRL Voluntary Filing Program" page on the Commission Web site, available at: http://www.sec.gov/info/edgar/xbrlfaq032105.htm.

25 See Transcript of June 12 Interactive Data Roundtable, June 12, 2006, available at: http://www.sec.gov/spotlight/xbrl/xbrlofficialtranscript0606.pdf ("June 12 Roundtable Transcript"); Webcast Archive of June 12 Interactive Data Roundtable, June 12, 2006, available at: http://www.connectlive.com/events/secxbrl/. See also Agenda of October 3 Interactive Roundtable, Oct. 3, 2006 available at: http://www.sec.gov/spotlight/xbrl/xbrlroundagenda-100306.htm; Webcast Archive of October 3 Interactive Data Roundtable, Oct. 3, 2006, available at: http://www.connectlive.com/events/secinteractivedata100306/ ("October 3 Roundtable Webcast") (second Commission interactive data roundtable, focusing on new software using interactive data to provide investor-friendly research tools).

costs.[26] This key information is included in the mutual fund prospectus,[27] but it can be difficult for investors to extract this key information from lengthy prospectuses, which often cover multiple funds and contain a wealth of other information. Much of this information is required to be included in the risk/return summary section of the prospectus,[28] and tagging this information could provide powerful tools for investors.[29]

We believe that exploring the tagging of the information in the risk/return summary section is an important step in our interactive data program. With almost half of all U.S. households owning mutual funds,[30] typically to fund their education, retirement, and other basic needs, improving the quality of mutual fund disclosure is important to millions of Americans. Tagging of key mutual fund information could help to streamline the delivery of mutual fund information and provide investors, analysts, and others with improved tools to compare funds based upon, among other things, costs, investment objectives, strategies, and risks. In addition, the risk/return summary

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26 See Barbara Roper, Director of Investor Protection, Consumer Federation of America, June 12 Roundtable Transcript, supra note 25, at 20 & 22. See also Paul G. Haaga, Jr., Executive Vice President, Capital Research and Management Company, id. at 90; William D. Lutz, Ph.D., Professor of English, Rutgers University, id. at 88; Elisse B. Walter, Senior Executive Vice President, NASD, id. at 40-41.

27 Items 2 and 3 of Form N-1A [17 CFR 239.15A and 274.11A] (risk/return summary section of the prospectus).

28 Id.

29 See Chairman Christopher Cox, June 12 Roundtable Transcript, supra note 25, at 8 ("Interactive data, the tagging of these key facts [in the prospectus] so that they can easily be identified and extracted[,] offers the possibility of dramatic improvement over traditional disclosure delivery for mutual fund investors."); Paul Schott Stevens, President and Chief Executive Officer, Investment Company Institute, id. at 72 ("XBRL tagging can help turn the Risk/Return Summary into an even more powerful tool than the Commission envisioned when it first adopted it in 1998 as a way to help investors compare one fund with another through the standardization of the information and the format in which it's presented.").

30 2006 Investment Company Fact Book, at 47, Investment Company Institute (2006), available at: http://www.icifactbook.org/pdf/2006_factbook.pdf.

information is largely narrative in format, and exploring the viability of tagging this information will provide us with valuable insights as we assess the potential for tagging other primarily narrative information.

As noted above, XBRL International has approved an investment management XBRL U.S. GAAP financial reporting taxonomy.[31] That taxonomy generally does not extend to the information in the risk/return summary section. In March 2006, the Investment Company Institute (the "ICI")[32] announced an initiative to create a taxonomy to cover the risk/return summary information in the prospectus.[33] The ICI recently released its draft risk/return summary taxonomy and announced that it would provide a 45-day period for public review and comment.[34] We are proposing amendments to the voluntary program that would, if adopted, permit mutual funds to tag the information in the risk/return summary section of their prospectuses using the taxonomy developed by the ICI.

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31 Supra note 24.

32 The ICI is a national association of the American investment company industry.

33 Stevens Calls for Greater Use of Internet; Announces Initiative to Develop XBRL Data Tagging Technology, ICI Press Release, Mar. 20, 2006, available at: http://ici.org/statements/nr/06_news_mfimc.html#TopOfPage; Remarks of Paul Schott Stevens, President and Chief Executive Officer, Investment Company Institute, at the Mutual Funds and Investment Management Conference, Mar. 20, 2006, available at: http://ici.org/statements/remarks/06_mfimc_stevens_spch.html#TopOfPage; Statement of the Investment Company Institute at the June 12, 2006 Interactive Data Roundtable, available at: http://www.sec.gov/news/press/4-515/ici050906.pdf.

34 ICI Unveils Draft XBRL Taxonomy For Public Review, Investment Company Institute Press Release, Jan. 4, 2007, available at: http://www.ici.org/home/07_news_xbrl_txnmy.html#TopOfPage. The taxonomy, as well as instructions for commenting on the taxonomy, are available at http://members.ici.org/xbrl. See also Statements of SEC Chairman Christopher Cox and Division of Investment Management Director Andrew Donohue Regarding the Investment Company Institute's Mutual Fund Interactive Data Taxonomy, Securities and Exchange Commission Press Release, Jan. 4, 2007, available at: http://www.sec.gov/news/press/2007/2007-2.htm.

II. DISCUSSION

As part of our ongoing effort to evaluate the usefulness of data tagging, we are proposing amendments to extend the voluntary program to enable mutual funds to submit exhibits containing tagged risk/return summary information attached to EDGAR filings.[35] We expect to permit any mutual fund to participate, without pre-approval, merely by submitting the risk/return summary information in the required manner. As we continue to gain experience with interactive data, we will evaluate the benefits of data tagging to investors, analysts, and others. If, in the future, we consider requiring filers to tag the risk/return summary information, that would be the subject of a separate rulemaking proposal.

A. Expansion of Voluntary Program Content

Currently, the XBRL data furnished under the voluntary program must consist of at least one item from a list of enumerated mandatory content ("Mandatory Content"), including financial statements, earnings information, and, for registered management investment companies, financial highlights or condensed financial information.[36] This may be accompanied by one or more related items from a list of optional content, including (1) audit opinions; (2) interim review reports; (3) reports of management on the financial statements; (4) certifications; (5) management's discussion and analysis of financial condition and results of operations; (6) management's discussion and analysis

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35 The proposed amendments, if adopted, would not alter the voluntary program as it applies to the furnishing of XBRL information by non-investment companies.

36 Rule 401(b)(1) of Regulation S-T [17 CFR 232.401(b)(1)].

or plan of operation; (7) operating and financial review and prospects; and (8) management's discussion of fund performance.[37]

We propose to add the risk/return summary information set forth in Items 2 and 3 of Form N-1A as a new item of Mandatory Content.[38] As with all tagged exhibits under the voluntary program, submissions of tagged exhibits containing risk/return summary information would be supplemental and would not replace the required HTML or ASCII version of the information called for in Form N-1A. Volunteers would be required to file their complete official registration statements to ensure that all investors have access to information upon which to base their investment decisions.[39] While tagged exhibits would be required to reflect the same information contained in the risk/return summary section of the related official Form N-1A filing, we emphasize that investors and others should continue to rely on the official filing rather than the tagged exhibit.

Any mutual fund submitting tagged risk/return summary information would be required to include this information as an exhibit to an amendment to a previous filing on

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37 Rule 401(b)(2) of Regulation S-T [17 CFR 232.401(b)(2)].

38 Proposed rule 401(b)(1)(iv).

39 Consistent with the current voluntary program, once received by the Commission, the official filing and the tagged risk/return summary information submitted as exhibits to the official filing would undergo technical validations. The official filing would continue to follow the normal process for receipt and acceptance. That is, it would be suspended if it fails its validation criteria. If the official filing meets its validation criteria, but any tagged risk/return summary document submitted as an exhibit to the official filing fails its own validation criteria, all tagged documents would be removed and the official filing would be accepted and disseminated without the tagged documents. The volunteer would be notified of the submission problem with the tagged documents. If the official filing failed to meet the required receipt and acceptance process and was suspended for any reason, any tagged risk/return summary information submitted with the official filing would also be suspended.

Form N-1A.[40] Form N-1A filings, which contain mutual fund registration statements (or amendments thereto), differ from the other filings used in the voluntary program in that they are often subject to revision prior to effectiveness. For this reason, the proposed rules would not permit the submission of a tagged exhibit that is related to a registration statement or an amendment that is not yet effective. More specifically, the proposed rules would provide that a tagged exhibit to a Form N-1A filing, whether the filing is an initial registration statement or an amendment thereto, could be submitted only as an amendment to the filing to which the tagged exhibit relates and only after the effective date of such filing.[41] An exhibit containing tagged risk/return summary information could be submitted under rule 485(b) of the Securities Act, which provides for immediate effectiveness of amendments filed to make non-material changes and for certain other purposes, and would only need to contain the new exhibit, a facing page, a signature page, a cover letter explaining the nature of the filing, and a revised exhibit index. Filers submitting tagged risk/return summary information should not include the ICI taxonomy in their submissions as this taxonomy will be stored as a part of the EDGAR system.

Similar to the current voluntary program, volunteers would be free to submit tagged risk/return summary information regularly or from time to time, and volunteers could stop and start as they choose. Participating in the voluntary program would not create a continuing obligation for a volunteer to submit tagged risk/return summary

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40 See proposed rule 401(a) of Regulation S-T; proposed rule 8b-33. A mutual fund submitting tagged risk/return summary information as an exhibit to Form N-1A would be required to name each document "EX-100" as specified in the EDGAR Filer Manual. Proposed rule 8b-33. We also propose a technical amendment to General Instruction B.4.(b) of Form N-1A to add rule 8b-33 to the list of general provisions that apply to the filing of registration statements on Form N-1A.

41 Proposed rule 401(a); see also proposed rule 8b-33.

information as an exhibit to a subsequent post-effective amendment. A volunteer would, however, be required to amend any tagged risk/return summary exhibits that do not comply with the content and format requirements of rule 401, e.g., because they do not reflect the same information as the corresponding official filing.[42]

We also propose amendments that will require investment companies to tag information in a manner that will permit the information for each class[43] to be separately identified.[44] Currently, rule 8b-33 under the Investment Company Act requires that investment companies participating in the voluntary program submit tagged documents in a manner that will permit the information for each series of an investment company registrant[45] and each contract of an insurance company separate account[46] to be separately identified.[47] We propose to amend this rule to require that investment companies submit tagged documents in a manner that will permit the information for

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42 XBRL Adopting Release, supra note 13, 70 FR at 6559 n. 48. See rule 401(c)(1) (requires tagged exhibits to reflect the same information as corresponding official filing).

43 A mutual fund may issue more than one class of shares that represent interests in the same portfolio of securities with each class, among other things, having a different arrangement for shareholder services or the distribution of securities, or both. Rule 18f-3 under the Investment Company Act [17 CFR 270.18f-3].

44 Proposed rule 8b-33.

45 A mutual fund may issue multiple "series" of shares, each of which is preferred over all other series in respect of assets specifically allocated to that series. Rule 18f-2 under the Investment Company Act [17 CFR 270.18f-2]. Each series is, in effect, a separate investment portfolio.

46 Variable annuity contracts and variable life insurance contracts are issued through insurance company separate accounts.

47 Rule 8b-33 under the Investment Company Act [17 CFR 270.8b-33].

each class to be separately identified because expense and performance information in the risk/return summary is class-specific.[48]

The amendments we are proposing also would provide mutual funds with an additional option to submit tagged financial highlights or condensed financial information. Currently, mutual funds may submit this information as an exhibit to Form N-CSR.[49] The proposals, if adopted, also would permit mutual funds to submit their financial highlights or condensed financial information as a tagged exhibit to an amendment to the Form N-1A filing to which the information relates.[50]

We request comment on the proposed expansion of the voluntary program to include risk/return summary information.

- Is it beneficial to tag mutual fund risk/return summary information? Is this portion of the mutual fund prospectus an appropriate place to begin evaluating the

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48 We have previously indicated that rule 8b-33 would require investment companies to submit tagged XBRL documents separately for each series of an investment company registrant. See XBRL Proposing Release, supra note 13, 69 FR at 59097 n. 49. Under proposed amended rule 8b-33, a mutual fund would not be required to submit tagged risk/return summary information in separate documents for each series or class, provided that the information is tagged in such a manner that the information may be separately identified by series and class.

49 Rule 401(a) and (b)(1)(iii) of Regulation S-T [17 CFR 401(a) and (b)(1)(iii)] (permitting financial highlights or condensed financial information set forth in Item 8(a) of Form N-1A to be submitted as Mandatory Content); rule 8b-33. Mutual funds must include their financial highlights or condensed financial information in every annual and semi-annual report transmitted to shareholders. Items 22(b)(2) and (c)(2) of Form N-1A (requiring annual or semi-annual reports to include the information required by Item 8(a) of Form N-1A). Mutual funds must include a copy of their annual or semi-annual report transmitted to shareholders with their Form N-CSR filed with the Commission. Item 1 of Form N-CSR.

50 Proposed rule 8b-33 (permitting tagged exhibits under the voluntary program to be submitted on Form N-1A); Item 8(a) of Form N-1A (requiring mutual funds to provide financial highlights information); rule 401(a) and (b)(1)(iii) of Regulation S-T (permitting information set forth in Item 8(a) of Form N-1A as Mandatory Content under the voluntary program).

tagging of non-financial information? Is there other mutual fund information that should be included in the voluntary program?

- What effect would tagged data have on investors', analysts', and other users' ability to analyze mutual funds' risk/return summary disclosure? Would tagged risk/return summary information have an effect on the usefulness of disclosure in Commission filings?
- We are not proposing to amend that portion of rule 401(b)(1) that currently requires that Mandatory Content "consist of a complete set of information for all periods presented in the corresponding official EDGAR filing." Should mutual funds that submit tagged risk/return summary information be required to tag all of the information in the risk/return summary section of the corresponding official filing or should they be permitted to tag some, but not all, of the information? For example, if a fund's official filing contains information for more than one series or class, should the fund be permitted to submit tagged risk/return summary information for fewer than all of the series and classes? As another example, should a mutual fund be permitted to tag discrete portions of the risk/return summary information, such as cost and performance information, while not tagging others, such as narrative information?
- Should mutual funds be permitted to submit tagged risk/return information related to registration statements or post-effective amendments that are not yet effective? Would this raise any liability issues? If mutual funds are permitted to submit tagged risk/return summary information prior to effectiveness, what safeguards would be appropriate? For example, should funds be required to submit revised

tagged documents if there are any changes (or any material changes) to the risk/return summary disclosure in the effective registration statement or amendment and/or should there be additional required disclosure to specifically caution investors and others that the information may differ from that in the effective filing?

- The proposed amendments would not create a continuing obligation for a volunteer to submit tagged risk/return summary information as an exhibit to a subsequent post-effective amendment. When a mutual fund that has submitted tagged risk/return summary information amends its registration statement, should we require the fund to submit updated tagged risk/return summary information? Should it depend on the materiality of the amendments? How would a requirement to update tagged exhibits affect participation in the voluntary program? If we do not impose a continuing obligation to update tagged exhibits, should we require additional disclosure or other safeguards?
- Will the proposed amendment to rule 8b-33, providing that investment companies must tag information in a manner that will permit the information for each class to be separately identified, raise any issues with respect to any investment company information that may be tagged under the voluntary program? Should we specify that only risk/return summary information must be tagged in a manner that will permit the information for each class to be separately identified? Will the risk/return summary taxonomy in its current state of development permit the information for each series and class to be separately identified? If not, how should it be modified to permit this?

- Should mutual funds be required to submit separate tagged risk/return summary exhibits for each series or class? Instead, should they be permitted to submit exhibits that combine multiple series or classes of the same registrant, provided that the information is tagged in such a manner that the information may be separately identified by series and class?
- We plan to permit all filers on Form N-1A to submit documents containing tagged risk/return summary information as exhibits to their official Form N-1A filings so long as they comply with the requirements of the voluntary program. Should we limit participation, such as by size or type of mutual fund? If so, what should be the criteria for participating? If so, why?
- What steps can we take to encourage mutual funds to participate in the expanded voluntary program?

B. Required Disclosure

Under the current voluntary program, any official filing with which tagged exhibits are submitted must disclose that the purpose of submitting the tagged exhibits is to test the related format and technology and, as a result, investors should not rely on the exhibits in making investment decisions.[51] We are proposing that this disclosure be required in the exhibit index of any Form N-1A filing that includes a tagged exhibit.[52]

The current voluntary program also requires any official filing with which tagged exhibits are submitted to disclose that the information contained in the exhibits is

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51 Rule 401(d)(1)(ii) of Regulation S-T [17 CFR 232.401(d)(1)(ii)].

52 Proposed rule 401(d)(2)(i). Rule 483(a) of Regulation C [17 CFR 230.483(a)] requires, among other things, that a registration statement of a registered investment company "contain an exhibit index, which should immediately precede the exhibits filed with such registration statement."

"unaudited" or "unreviewed."[53] We are proposing to require this disclosure in a Form N-1A filing with which tagged financial highlights or condensed financial information is submitted. We are not proposing to require this disclosure in a Form N-1A filing when the tagged exhibits to the filing contain only risk/return summary information because this information is not ordinarily audited or reviewed by an independent auditor.[54]

We request comment on the proposed cautionary disclosures that would be required to accompany the submission of tagged information that accompanies a Form N-1A filing.

- Should we require the disclosure concerning whether the information is "unaudited" or "unreviewed" to accompany exhibits containing tagged risk/return summary information?
- Is additional or different language necessary for the cautionary disclosures?
- Is the exhibit index to a Form N-1A filing the appropriate place for the cautionary disclosures?

C. Liability Issues

We propose to extend to tagged risk/return summary information limited protection from liability that is similar to the protection provided under the current voluntary program. As is the case with the current program, we would provide this protection because liability remains for the official filing, and the program is experimental, contains certain safeguards, and should not unnecessarily deter volunteers from participating.

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53 Rule 401(d)(1)(i) of Regulation S-T [17 CFR 232.401(d)(1)(i)].

54 Proposed rule 401(d)(1)(i).

Currently, tagged exhibits are not deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 ("Exchange Act")[55] or Section 34(b) of the Investment Company Act,[56] or otherwise subject to the liability of these sections.[57] In addition, the current rules also provide more general relief from liability under the securities laws, including the Securities Act, the Exchange Act, the Trust Indenture Act of 1939, and the Investment Company Act, for information in a tagged exhibit that complies with the content and format requirements of the voluntary program to the extent that the information in the corresponding portion of the official EDGAR filing was not materially false or misleading.[58]

Unlike the filings currently included in the voluntary program, Form N-1A is a registration form under both the Securities Act and the Investment Company Act; and volunteers submitting tagged exhibits to that form also could face potential registration statement liability under the Securities Act. As a result, we propose to extend the liability protection under the voluntary program to include Section 11 of the Securities Act.[59]

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55 15 U.S.C. 78r.

56 15 U.S.C. 80a-33(b).

57 Rule 402(a)(1) under Regulation S-T [17 CFR 232.402(a)(1)]. Further, because the tagged documents are not filed under the Exchange Act, they are not incorporated by reference into registration statements filed under the Securities Act or prospectuses they contain. These protections apply regardless of whether the documents are exhibits to a document otherwise incorporated by reference into a filing.

58 Rule 402(b) of Regulation S-T [17 CFR 232.402(b)].

59 In addition, the current provisions of rule 402(a) would apply to tagged risk/return summary information. In particular, a tagged exhibit on Form N-1A would not be deemed incorporated by reference into another filing, regardless of whether the tagged exhibit is an exhibit to a document otherwise incorporated by reference into another filing. Rule 402(a)(2) under Regulation S-T [17 CFR 232.402(a)(2)]. All other liability and antifraud provisions of the Securities Act, Exchange Act, and Investment Company Act would apply. Rule 402(a)(3) under Regulation S-T [17 CFR 232.402(a)(3)]. For example, material misstatements or omissions in a tagged submission would continue to

Specifically, we propose to amend rule 402(a) to provide that tagged exhibits are not deemed filed for purposes of Section 11 or otherwise subject to the liabilities of that section. In addition, we propose to amend rule 402(a) to state explicitly that tagged exhibits are not part of any registration statement to which they relate.[60] We will continue to caution users on the Commission's Web site that documents submitted under the voluntary program should not be relied upon for making investment decisions, and users should continue to rely on the company's official filing.[61]

We do not propose to modify the provision that affords volunteers general relief from liability under the federal securities laws to the extent that the information in the corresponding portion of the official EDGAR filing was not materially false or misleading.[62] That provision includes liability protections under the Securities Act, and it would apply to tagged documents submitted as exhibits on Form N-1A.

We request comment on the proposed liability protections for tagged risk/return summary information.

- Is it necessary or appropriate to extend liability protection to Section 11 of the Securities Act? Should we modify the proposed liability provisions in any way?

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be subject to liability under Section 10(b) [15 U.S.C. 78j(b)] and rule 10b-5 [17 CFR 240.10b-5] under the Exchange Act.

60 Section 11 of the Securities Act applies to "any part of the registration statement, when such part became effective." The Commission takes a similar approach with unofficial PDF copies contained in electronic submissions. See Rule 104(d) of Regulation S-T [17 CFR 232.104(d)]. Similar to the other protections in the current voluntary program, Section 11 liability relief, under the proposed rules, would not extend to the information the official filing contains.

61 See supra note 20.

62 Rule 402(b). We are, however, proposing technical amendments to rule 402(b) to replace each reference to "Item 401" with "Rule 401." Proposed rule 402(b).

- Should the tagged risk/return summary information be considered filed or furnished for purposes of the voluntary program? Should the tagged risk/return summary documents be deemed not to be part of any registration statement to which they relate?
- With regard to risk/return summary submissions, are the proposed liability provisions sufficient to protect volunteers and to encourage participation in the voluntary program? To encourage participation in the voluntary program, should liability protections be increased beyond those proposed? Would investors have sufficient protection under the proposed amendments? For the protection of investors, should liability protections be decreased from those proposed?

D. The Risk/Return Summary Taxonomy and Software Tools

As discussed above, the taxonomy to tag the risk/return summary information is being developed by the Investment Company Institute. The ICI has released the draft risk/return summary taxonomy for public review and comment, and we expect that the ICI will submit the taxonomy to XBRL US, Inc., for evaluation and approval in accordance with their procedures.[63] In light of the purpose of the voluntary program, which is to test and evaluate tagging technology, we anticipate permitting mutual funds to submit documents containing risk/return summary information that is tagged using the ICI's taxonomy prior to final approval of the taxonomy by XBRL US, Inc.

Commercial off-the-shelf products that provide means to view tagged information in a rendered, or human readable, format and to compare or analyze tagged information

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[63] XBRL US, Inc., represents the United States to XBRL International. XBRL US, Inc., is responsible for organizing and sponsoring taxonomies from the United States, including the main accounting standards for United States business reporting.

are available. We will assess whether to provide such software tools on our Web site for use with risk/return summary information. For example, the Commission Web site currently provides access to a prototype XBRL Web application that converts tagged data received in the current voluntary program into rendered format.[64] If we do provide rendering or analysis tools, we intend to include appropriate cautionary language to the effect that investors should rely only on the information in the official version of a filing and not on the tagged documents submitted as part of the voluntary program in making investment decisions. While we may decide to proceed with the expansion of the voluntary program without providing rendering or analysis tools, we will continue to evaluate the use of such tools to aid the investing public.

We request comment on the proposed use of the ICI's risk/return summary taxonomy and the need for the development of rendering and other tools.

- Is the taxonomy for risk/return summary information created by the ICI sufficiently developed that we should permit its use in the voluntary program? If not, explain what changes or procedural steps are needed prior to use. What specific criteria should be applied to determine whether the risk/return summary taxonomy is sufficiently developed?
- Is there anything related to the process for developing and approving the risk/return summary taxonomy that should affect its use or otherwise raise concerns?
- The process for approving a taxonomy as XBRL includes testing and technical modification. Should the Commission permit use of a risk/return summary

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64 See "Interactive Financial Report Viewer — Preview Release" Web page on the Commission Web site, available at: http://www.sec.gov/spotlight/xbrl/xbrlwebapp.htm.

taxonomy in the voluntary program that has not been acknowledged or approved as XBRL?

- A tagged submission that a volunteer creates can adhere to either a standard taxonomy or a standard taxonomy with extensions. Extensions to a standard taxonomy are additional tags defined by a particular user that further refine the tags contained in the standard taxonomy. We expect that mutual funds will be permitted to submit extensions to the standard risk/return summary taxonomy. Given the narrative format of much risk/return summary information, does tagging of this information raise particular problems with regard to extensions or other facets of data tagging? For what purposes would mutual funds want or need to make use of extensions? Are there sufficient software tools available to develop extensions to the risk/return summary taxonomy, if necessary? To what extent would the use of extensions reduce the comparability among risk/return summary information that is tagged? Are there any reasons why the use of extensions would be inappropriate with regard to risk/return summary information?
- What are the advantages and disadvantages of the Commission providing on its Web site tools to render the tagged risk/return summary information in human readable form or to permit users to analyze and compare tagged risk/return summary information submitted by different mutual funds? If we were to provide a rendering tool, what, if any, liability or other concerns would be raised by the fact that the presentation would be different from the risk/return summary information as presented in a registrant's official prospectus? What, if any,

liability or other concerns would analytical or comparison tools raise? What, if any, disclaimers would be necessary to address any liability concerns related to rendering, analytical, or comparison tools? If we were to provide a rendering tool, would it hinder the ability of a volunteer to present its tagged risk/return summary information in as much detail as, and in a manner substantially similar to, its official filing? If we do not provide rendering, analytical, or comparison tools, would it hinder participation in the voluntary program or limit our ability to explore the usefulness of tagged risk/return summary information?

E. Effective Date

If we adopt the proposed amendments, we expect the effective date to be thirty days after publication of the adopting release in the Federal Register. The Commission requests comment on this proposed effective date.

III. GENERAL REQUEST FOR COMMENTS

We request comment not only on the specific issues we discuss in this release, but on any other approaches or issues that we should consider in connection with the proposed amendments. We seek comment from any interested persons, including those required to file information with us on the EDGAR system, as well as investors, disseminators of EDGAR data, industry analysts, EDGAR filing agents, and any other members of the public.

IV. PAPERWORK REDUCTION ACT

The proposed rule and form amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[65]

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65 44 U.S.C. 3501 et seq.

We are submitting the proposed collection of information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507(d) and 5 CFR 1320.11. Provision of information under the proposed amendments would be voluntary and would not be kept confidential. An agency may not conduct or sponsor, and a person is not required to respond to, an information collection unless it displays a currently valid OMB control number.

The title for the collection of information is "Voluntary XBRL-Related Documents" (OMB Control No. 3235-0611). The proposed amendments would extend the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings.

A. Reporting and Cost Burden Estimate

1. The Voluntary Program

We are proposing to increase the burden associated with the existing collection of information for Voluntary XBRL-Related Documents to reflect the proposed amendments, which would extend the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings. The proposed expansion of the voluntary program would be open to any mutual fund choosing to participate. We estimate that 10% of the 545 fund complexes that have mutual funds, or 55 fund complexes, would each submit documents containing tagged risk/return summary information for one mutual fund.[66] This estimate is higher than the

[66] In the case of a mutual fund with multiple series, our estimate treats each series as a separate mutual fund.

number of mutual funds participating in the current voluntary program. However, we believe that additional mutual funds will participate in the proposed expanded voluntary program.[67]

Submission of tagged risk/return summary information would not directly affect the burden of preparing the mutual funds' registration statements or the registrants' official EDGAR filings. In order to provide tagged risk/return summary information, a participating mutual fund would have to tag the risk/return summary section of its prospectus using the risk/return summary taxonomy and potentially develop taxonomy extensions and would submit an exhibit to its filing. Based on our previous estimates and our experience with registrants who have submitted tagged financial information in the current voluntary program, we estimate that the initial creation of tagged documents containing risk/return summary information would require, on average, approximately 110 burden hours per mutual fund,[68] and the creation of such tagged documents in

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67 The ICI has stated that it will launch an educational effort to encourage mutual funds to use the risk/return summary taxonomy to tag the information in their EDGAR filings. ICI Details Project to Extend XBRL to Key Investor Information, Investment Company Institute Press Release, June 12, 2006, available at: http://www.ici.org/statements/nr/06_news_xbrl.html#TopOfPage.

68 In the current voluntary program, we estimated that an initial set of submissions would require an average of 130 burden hours, 75% of which (or 97.5 hours) represents the internal burden hour estimate. See XBRL Adopting Release, supra note 13, at 70 FR 6563; XBRL Proposing Release, supra note 13, 69 FR at 59101. Based upon our experience with filers who have submitted tagged financial information in the current voluntary program, we believe that this burden estimate for submitting an initial set of submissions may have been too high. See, e.g., Indra K. Nooyi, Chief Executive Officer, PepsiCo, Inc., October 3 Roundtable Webcast, supra note 25 (initial submission in voluntary program required approximately 60 to 80 total labor hours); John Stantial, Director of Financial Reporting, United Technologies Corporation, June 12 Roundtable Transcript, supra note 25, at 160 (initial submission in voluntary program required about 80 hours of effort). We, therefore, estimate that the initial creation of tagged documents containing risk/return summary information would require, on average, approximately 110 burden hours per mutual fund, 75% of which (or 82.5 hours) represents the internal burden hour estimate. These estimates more closely approximate the experience of filers in the current voluntary program.

subsequent years would require an average 10 burden hours per mutual fund.[69] Because the PRA estimates represent the average burden over a three-year period, we estimate the average hour burden for the submission of tagged documents containing risk/return summary information for one mutual fund to be approximately 43 hours.[70]

Based on the estimates of 55 participants submitting tagged documents containing risk/return summary information for one mutual fund per year and incurring 43 hours per submission we estimate that, in the aggregate, the industry would incur an additional 2,365 burden hours associated with the proposed amendments.[71] We further estimate that 75% of this burden increase, or approximately 1,774 hours, would be borne internally by the mutual fund complex. We estimate that this internal burden increase converted to dollars would amount to approximately $384,958.[72]

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69 In the current voluntary program, we estimated that each set of submissions, after the initial set, would take 10 burden hours. See XBRL Adopting Release, supra note 13, at 70 FR 6563; XBRL Proposing Release, supra note 13, 69 FR at 59101. We continue to believe that this estimate is appropriate.

70 (110 hours in the first year + 10 hours in the second year + 10 hours in the third year) ÷ 3 years = 43 hours. While the PRA requires an estimate based on a hypothetical three years of participation, a registrant, as noted earlier, could participate in the expanded voluntary program by submitting tagged risk/return summary information over a shorter period or even just once as the registrant chooses.

71 55 documents per year x 43 hours per submission = 2,365 hours.

72 This cost increase is estimated by multiplying the increase in annual internal hour burden (1,774) by the estimated hourly wage rate of $217.00. The estimated wage figure is based on published rates for compliance attorneys and programmer analysts outside New York City, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding effective hourly rates of $271 and $199, respectively. See Securities Industry Association, Report on Management & Professional Earnings in the Securities Industry 2005 (Sept. 2005) ("SIA Report"). The estimated wage rate was further based on the estimate that compliance attorneys would account for one quarter of the hours worked and senior system analysts would account for the remaining three quarters, resulting in a weighted wage rate of $217.00 (($271 x .25) + ($199 x .75)).

We also estimate that 25% of the burden, or approximately 591 hours, would be outsourced to external professionals and consultants retained by the mutual fund complex at an average cost of $266.25 per hour for a total annual increase of approximately $157,354.[73] In addition, it is our understanding that many participants would also have annual software licensing costs. We estimate that the cost of licensing software would be $333 per participant per year, for a total annual increase of $18,315.[74] Altogether the total annual increase in external costs related to the proposed amendment would be $175,669.[75]

Our cost estimates are intended to reflect both initial and ongoing costs over a three-year period. In calculating these costs, we have tried to take into account, among other things, the current state of reporting process automation, automation that likely

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73 591 hours x $266.25 per hour = $157,354. The estimated wage figure is based on published rates for attorneys and senior programmers outside New York City, modified to account for an 1800-hour work-year and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead, yielding effective hourly rates of $312 and $251, respectively. See SIA Report, supra note 72. The estimated wage rate was further based on the estimate that attorneys would account for one quarter of the hours worked and senior programmers would account for the remaining three quarters, resulting in a weighted wage rate of $266.25 (($312 x .25) + ($251 x .75)).

74 $333 per participant x 55 participants = $18,315. The estimated annual cost of the software comes from our previous voluntary program estimate PRA. See XBRL Adopting Release, supra note 13, at 70 FR 6563 and n. 113. That estimate was based on our discussions with software providers and others familiar with XBRL. We estimated that the cost of licensing software would range from $200 to $3,000 each year, with the majority of companies licensing less complex software in the $200 to $500 range. We set our software cost estimate at $500, which is the highest cost for the simpler XBRL software license, and we assumed that the first year license fee would be waived (based upon our understanding that software providers indicated that they would provide these products for free in the initial stages of the voluntary program). Because the PRA estimates represent the average burden over a three-year period, we estimated the average burden for software license costs to be $333 per year. Id.

75 This annual total consists of $157,354 in outside professional costs plus $18,315 in software costs.

would be introduced in connection with the initial cost incurred, and the efficiencies that likely would be realized over the course of three years.

2. Regulation S-T

Regulation S-T (OMB Control No. 3235-0424) specifies the requirements that govern the electronic submission of documents. The proposed amendments would revise rules under Regulation S-T, but the associated increase in burden is reflected in the "Voluntary XBRL-Related Documents" collection of information as described above.

B. Request for Comments

We request comment to evaluate the accuracy of our estimates pursuant to 44 U.S.C. 3506(c)(2)(B) and solicit comments with regard to:

- Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;
- Whether our estimate of the burden of the proposed collection of information is accurate;
- Whether there are ways to enhance the quality, utility, and clarity of the information to be collected; and
- Whether there are ways to minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Any member of the public may direct to the Commission any comments concerning the accuracy of these cost and burden estimates and any suggestions for reducing them. Persons who desire to submit comments on the collection of information

requirements should direct their comments to the OMB, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy of the comments to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549, with reference to File No. S7-05-07. Requests for materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-05-07, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549. Because OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, your comments are best assured of having their full effect if OMB receives them within 30 days of publication.

V. COST/BENEFIT ANALYSIS

The Commission is sensitive to the costs and benefits imposed by its rules. The goal of the voluntary program is to increase EDGAR's efficiency and utility and to enhance the usefulness to investors of the information collected through EDGAR. In order to evaluate data tagging further, we have proposed amendments to extend the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings.

A. Benefits

We believe that tagged information may allow more efficient and effective retrieval, research, and analysis of company information through automated means. The proposed expansion of the voluntary program would assist us in assessing whether using

interactive data tags enhances users' ability to analyze and compare mutual fund risk/return summary information included in mutual funds' filings with the Commission. The proposed expansion of the voluntary program to include narrative, non-financial information, such as that contained in the risk/return summary, also would facilitate our ability to assess further the technical requirements of processing tagged documents using EDGAR.

Currently, a number of companies use computers and data entry staff to mine risk/return summary information provided by mutual funds on EDGAR in order to populate databases that are used to package information for sale to analysts, funds, investors, and others. Permitting funds to tag risk/return summary information in Commission filings would aid this data-mining process in that it would identify points of data at the source, which could reduce the cost to populate databases and improve the accuracy of that data. Additionally, the expanded voluntary program may benefit funds and the public by permitting experimentation with data tagged using the risk/return summary taxonomy.

In the future, the availability of potentially more accurate tagged information about mutual funds could also reduce the cost of research and analysis and create new opportunities for companies that compile, provide, and analyze data to produce more value added services. Enhanced access to tagged information also has the potential to allow retail investors (or financial advisers assisting such investors) to perform more personalized and sophisticated analyses and comparisons of mutual funds, which could result in investors making better informed investment decisions, and therefore in a more efficient distribution of assets by investors among different funds. This may, in turn, also

contribute to increased competition among mutual funds and result in a more efficient allocation of resources among competing investment products. Although it is not possible to quantify precisely the beneficial effects of more efficient allocation of investors' assets and increased competition, they may be significant, given the size of the mutual fund industry.

B. Costs

The proposed expansion of the voluntary program would lead to some additional costs for funds choosing to submit tagged documents containing risk/return summary information as exhibits to their Form N-1A filings. For purposes of the PRA, we estimated that the increase in annual internal burden hours to the industry would be 1,774 hours, which would amount to approximately $384,958 and that the increase in annual external costs would amount to approximately $175,669 for a total estimated increase of $560,627 on an annual basis.[76]

We based these cost estimates upon, among other things, experience with filers who have submitted tagged financial information in the current voluntary program.[77] Due to the ongoing nature of the project to develop the risk/return summary taxonomy, however, we have limited data to quantify the cost of implementing the use of interactive data tags applied to risk/return summary information, and we seek comments and supporting data on our estimates with regard to the proposed amendments. In the future, there may be additional costs to current users of EDGAR data. For example, companies that currently provide tagging and dissemination of EDGAR data may experience

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[76] See supra Section IV.A.1.

[77] See supra note 68.

decreased demand for their services. These entities have developed certain products and services based on data in EDGAR; many entities disseminate, repackage, analyze, and sell the information. Allowing mutual funds to submit tagged risk/return summary information, even voluntarily, may have an impact on entities providing EDGAR-based services and products. Because the Commission does not regulate all these entities, it is currently not feasible to accurately estimate the number or size of these potentially affected entities. The limited, voluntary nature of the program will help the Commission assess the effect, if any, on these entities. Additionally, the availability of mutual fund tagged data on EDGAR may provide these companies with alternative business opportunities.

C. Request for Comments

We request comment on all aspects of this cost-benefit analysis, including identification of any additional costs or benefits of, or suggested alternatives to, the proposed rule and form amendments. Commenters are requested to provide empirical data and other factual support for their views to the extent possible.

VI. PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 2(c) of the Investment Company Act[78] and section 2(b) of the Securities Act[79] require the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

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78 15 U.S.C. 80a-2(c).

79 15 U.S.C. 77(b).

The proposed amendments would extend the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings. The expansion of the voluntary program is intended to help us evaluate the usefulness to investors, third-party analysts, mutual funds, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information. Because compliance with the proposed amendments would be voluntary, the Commission estimates that the impact of the proposal would be limited. However, because the tagging of risk/return summary information has the potential to facilitate analysis of that information, we believe that the proposed amendments could promote efficiency by allowing us and others to gain experience with tagged mutual fund information in Commission filings.

Further, tagging of the risk/return summary information has the potential to help streamline the delivery of mutual fund information, and provide investors and others with improved tools to compare funds based upon, among other things, costs, investment objectives, strategies, and risks. We believe that the potential to streamline the delivery of mutual fund information and to provide investors and others with improved mutual fund comparison tools could promote efficiency and competition through more efficient allocation of investments by investors and more efficient allocation of assets among competing funds. In the future, companies that currently provide tagging and dissemination of EDGAR data may experience decreased demand for their services. The availability of mutual fund tagged data on EDGAR, however, may provide these companies with alternative business opportunities. We do not anticipate that the

proposed amendments would have a significant impact on capital formation. Finally, because the proposals are designed to permit mutual funds to provide information in a format that we believe would be more useful to investors, we believe that the proposed amendments are appropriate in the public interest and for the protection of investors.

We request comment on whether the proposed amendments, if adopted, would promote efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

VII. INITIAL REGULATORY FLEXIBILITY ANALYSIS

We prepared this Initial Regulatory Flexibility Analysis ("IRFA") in accordance with the Regulatory Flexibility Act.[80] The proposed amendments would extend the current interactive data voluntary reporting program to enable mutual funds voluntarily to submit tagged information contained in the risk/return summary section of their prospectuses on EDGAR as exhibits to Form N-1A filings.

A. Reasons for, and Objectives of, the Proposals

The purpose of the proposed amendments is to help us evaluate the usefulness to investors, third-party analysts, mutual funds, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information. We believe the proposed expanded voluntary program would enable us to further study the extent to which interactive data tags enhance the comparability of that data, the usefulness of data tags for dissemination, and our staff's ability to review and assess the accuracy and adequacy of that data. The proposed expanded voluntary program would also help us assess the effect of interactive data tags on the quality and transparency of risk/return

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[80] 5 U.S.C. 603 et seq.

summary information, as well as the compatibility of data tagging with the Commission's disclosure requirements.

More specifically, we believe that the proposed expanded voluntary program would better enable us to study the extent to which interactive data enhances the:

- search capability of the EDGAR database to allow more efficient and effective extraction and analysis of specific data,
- capability to perform comparisons among mutual funds, and
- ability to perform analyses of mutual fund data and whether it would reduce the resources needed for data analysis.

In addition, we believe the proposed expanded voluntary program would enhance our ability to evaluate the:

- impact on the staff's ability to review filings on a more timely and efficient basis,
- use of tagged data for risk assessment and surveillance procedures, and
- compatibility of interactive data with reporting quality, transparency, and other Commission reporting requirements.

B. Legal Basis

We are proposing rule and form amendments under the authority set forth in Sections 5, 6, 7, 10, 19(a), and 28 of the Securities Act and Sections 6(c), 8, 24(a), 30, and 38 of the Investment Company Act.

C. Small Entities Subject to the Proposed Rules

The proposed expansion of the voluntary program may have an effect on mutual fund participants in the voluntary program. Under Rule 0-10 under the Investment Company Act, an investment company is a small entity if it, together with other

investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[81] We estimate that there are approximately 131 mutual funds that meet this definition. A smaller subset of those issuers may voluntarily submit tagged risk/return summary information under the voluntary program, but, because submitting risk/return summary information would be voluntary, we anticipate that only complexes with sufficient resources would elect to participate. To date, no small entity mutual funds have elected to participate in the current voluntary program.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The voluntary program is designed to assist us in assessing the feasibility of using interactive data on a broader basis. Experience with the current voluntary program indicates that the cost of participating in the expanded program, the associated burden on the EDGAR system, and the possible effect of the expanded voluntary program on those entities that use the EDGAR data would be minimal. Nevertheless, the impact of the proposed amendments remains somewhat speculative at this point.

No registrant would be required to submit tagged documents under the proposed extension to the voluntary program. The submission of tagged risk/return summary information would require a participating mutual fund to tag the risk/return summary section of its prospectus using the risk/return summary taxonomy and potentially develop extensions and to submit exhibits to its filing. Volunteers may also need to purchase software or retain a consultant to assist in tagging data. For purposes of the PRA, we

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[81] 17 CFR 270.0-10.

estimated that each volunteer, including small entities, would incur approximately 43 burden hours and $333 in software costs annually.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe that there are no rules that duplicate, overlap, or conflict with the proposals.

F. Agency Action to Minimize the Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish the stated objective, while minimizing any significant adverse impact on small entities. The purpose of the proposed amendments is to help us evaluate the usefulness to investors, third-party analysts, mutual funds, the Commission, and the marketplace of data tagging and, in particular, of tagging mutual fund information. Submitting documents containing tagged risk/return summary information would be entirely voluntary. We have considered different or simpler procedures for small entities, including:

- The establishment of different compliance or reporting requirements or timetables;
- The clarification, consolidation, or simplification of the proposed requirements;
- The use of performance rather than design standards; and
- Exemption from coverage.

For tagged data to provide benefits such as ready comparability, however, the data tagging system cannot have alternative procedures. Similarly, in order to achieve the benefits of interactive data tagging, use of a single data tagging technology is necessary. If we determine to require data tagging in the future, we will look to the results of the

voluntary program, including those of the proposed expansion of the program to risk/return summary information, to find alternatives to minimize any burden on small entities. We solicit comment on how the proposals could be modified to minimize the effect on small entities.

G. Request for Comments

We encourage the submission of comments with respect to any aspect of this Initial Regulatory Flexibility Analysis. In particular, we request comment on the number of small entities that would be affected by the proposals; the existence or nature of the potential effect of the proposals on small entities as discussed in the analysis; how to quantify the effect of the proposal; and how different procedures, if necessary, could be provided for small entities while remaining consistent with our goal to assess tagged data. We ask commenters to describe the nature of any effect and provide empirical data and other factual support for their views, if possible. These comments will be considered in preparing the Final Regulatory Flexibility Analysis, if the proposals are adopted, and will be placed in the same public file as comments on the proposal.

VIII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[82] a rule is "major" if it results or is likely to result in:

- an annual effect on the economy of $100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment, or innovation.

The Commission requests comment on the potential impact of the proposed

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82 Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

amendments on the U.S. economy on an annual basis. Commenters are requested to provide empirical data to support their views.

IX. STATUTORY AUTHORITY

The Commission is proposing the rule amendments outlined above under Sections 5, 6, 7, 10, 19(a), and 28 of the Securities Act [15 U.S.C. 77e, 77f, 77g, 77j, 77s(a), and 77z-3] and Sections 6(c), 8, 24(a), 30, and 38 of the Investment Company Act [15 U.S.C. 80a-6(c), 80a-8, 80a-24(a), 80a-29, and 80a-37].

List of Subjects in 17 CFR Parts 232 and 239

Reporting and recordkeeping requirements, Securities.

List of Subjects in 17 CFR Parts 270 and 274

Investment Companies, Reporting and recordkeeping requirements, Securities.

TEXT OF PROPOSED RULE AND FORM AMENDMENTS

For the reasons set forth above, the Commission proposes to amend title 17, Chapter II of the Code of Federal Regulations as follows:

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

1. The general authority citation for Part 232 is revised to read as follows:

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

* * * * *

2. Amend § 232.401 by:

a. Revising the first sentence of paragraph (a);

b. Removing the word "or" at the end of paragraph (b)(1)(ii);

c. Removing the period at the end of paragraph (b)(1)(iii) and adding in its place "; or";

d. Adding new paragraph (b)(1)(iv);

e. Revising paragraph (d)(1)(i); and

f. Removing the term "or 20-F" and in its place adding ", 20-F or N-1A (§§ 239.15A and 274.11A of this chapter)" in paragraph (d)(2)(i).

The addition and revisions read as follows:

§ 232.401 XBRL-Related Document Submissions.

(a) An electronic filer that participates in the voluntary XBRL (eXtensible Business Reporting Language) program may submit XBRL-Related Documents (§232.11) in electronic format as an exhibit to: (1) the filing (other than a Form N-1A filing) to which the XBRL-Related Documents relate; (2) an amendment to such filing, but, in the case of a Form N-1A filing, an amendment made only after the effective date of the Form N-1A filing to which the XBRL-Related Documents relate; or (3) if the electronic filer is eligible to file a Form 8-K (§249.308 of this chapter) or a Form 6-K (§249.306 of this chapter), a Form 8-K or a Form 6-K, as applicable, that references the filing to which the XBRL-Related Documents relate if such Form 8-K or Form 6-K is submitted no earlier than the date of that filing. * * *

(b) * * *

(1) * * *

(iv) The risk/return summary information set forth in Items 2 and 3 of Form N-1A (§ 239.15A and § 274.11A of this chapter).

* * * * *

(d) * * *

(1) * * *

(i) That the financial information contained in the XBRL-Related Documents is "unaudited" or "unreviewed," as applicable (but only if the mandatory content contained in the XBRL-Related Documents contains information other than risk/return summary information submitted under paragraph (b)(1)(iv) of this section);

* * * * *

3. Amend § 232.402(a)(1) to read as follows:

§ 232.402 Liability for XBRL-Related Documents.

(a) * * *

(1) Are not deemed filed for purposes of section 11 of the Securities Act (15 U.S.C 77k), section 18 of the Exchange Act (15 U.S.C. 78r), or section 34(b) of the Investment Company Act (15 U.S.C. 80a-33(b)), or otherwise subject to the liabilities of these sections, and are not part of any registration statement to which they relate;

* * * * *

4. Amend § 232.402(b) by replacing each reference to "Item 401" with "Rule 401".

PART 239 – FORMS PRESCRIBED UNDER THE SECURITIES ACT OF 1933

5. The general authority citation for Part 239 is revised to read as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 77z-2, 77z-3, 77sss, 78c, 78l, 78m, 78n, 78o(d), 78u-5, 78w(a), 78ll, 78mm, 80a-2(a), 80a-3, 80a-8, 80a-9, 80a-10, 80a-13, 80a-24, 80a-26, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

* * * * *

PART 270 – GENERAL RULES AND REGULATIONS, INVESTMENT COMPANY ACT OF 1940

6. The authority citation for Part 270 continues to read in part as follows:

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, and 80a-39, unless otherwise noted.

* * * * *

7. Amend § 270.8b-33 to read as follows:

§ 270.8b-33 XBRL-Related Documents.

A registrant that participates in the voluntary XBRL (eXtensible Business Reporting Language) program may submit, in electronic format as an exhibit to a filing on Form N-1A (§§ 239.15A and 274.11A of this chapter), Form N–CSR (§§ 249.331 and 274.128 of this chapter), or Form N–Q (§§ 249.332 and 274.130 of this chapter) to which they relate, XBRL-Related Documents (§ 232.11 of this chapter). A registrant that submits XBRL-Related Documents as an exhibit to a form must name each XBRL-Related Document "EX 100" as specified in the EDGAR Filer Manual and submit the XBRL-Related Documents in such a manner that will permit the information for each series and class of an investment company registrant and each contract of an insurance company separate account to be separately identified. A registrant may submit such exhibit with, or in an amendment to, the Form N-CSR or Form N-Q filing to which it relates, or in an amendment to the Form N-1A filing to which it relates, in accordance with rule 401 of Regulation S-T (§232.401).

PART 274 – FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

8. The authority citation for Part 274 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-8, 80a-24, 80a-26, and 80a-29, unless otherwise noted.

* * * * *

9. Amend General Instruction B.4.(b) of Form N-1A (referenced in §§ 239.15A and 274.11A) by replacing "8b-32 [17 CFR 270.8b-1 – 270.8b-32]" with "8b-33 [17 CFR 270.8b-1 – 270.8b-33]".

Note: The text of Form N-1A will not appear in the Code of Federal Regulations.

By the Commission.

Nancy M. Morris
Secretary

February 6, 2007

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

February 12, 2007

IN THE MATTER OF ONE PRICE CLOTHING STORES, INC. File No. 500-1	:	ORDER OF SUSPENSION OF TRADING

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of One Price Clothing Stores, Inc. ("One Price"), a Delaware Corporation formerly headquartered in Duncan, South Carolina, which trades in the Pink Sheets under the symbol "ONPRQ," because it has not filed any periodic reports since the period ended November 1, 2003.

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

Therefore, IT IS ORDERED, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the above listed company is suspended for the period from 9:30 a.m. EST, February 12, 2007 through 11:59 p.m. EST, on February 26, 2007.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

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UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 55304 / February 13, 2007

Admin. Proc. File No. 3-12564

In the Matter of the Application of

NAVISTAR INTERNATIONAL CORPORATION

For Review of Action Taken by the

New York Stock Exchange LLC

ORDER DENYING STAY

On February 7, 2007, Navistar International Corporation ("Navistar") requested that the Commission summarily stay the decision of the New York Stock Exchange LLC ("NYSE" or "Exchange") to remove the entire class of common stock and the entire class of convertible junior preference stock, series D of Navistar from listing and registration on the Exchange. 1/ The NYSE determined that Navistar's securities were no longer eligible for listing on the Exchange because Navistar has failed to file its annual report for fiscal year 2005 with the Commission.

I.

Exchange Act Section 13(a) requires issuers of securities registered under Exchange Act Section 12 to file periodic and other reports with the Commission containing such information as

1/ Commission Rule of Practice 401(d)(2) provides that we may consider a stay of an action by a self-regulatory organization summarily, without notice and opportunity for hearing. 17 C.F.R. § 201.401(d)(2); see also Section 19(d)(2) of the Securities Exchange Act of 1934, 15 U.S.C. § 78s(d)(2) (stating that the appropriate regulatory agency may consider summarily the question of whether to grant a stay of a self-regulatory organization's action).

the Commission's rules prescribe. 2/ Pursuant to Section 13(a), the Commission has promulgated Rules 13a-1 and 13a-13, which require issuers to file annual and quarterly reports. 3/

An NYSE-listed company that fails to file its annual report with the Commission in a timely manner is subject to the procedures contained in NYSE Rule 802.01E. This rule provides for NYSE monitoring of the company during the six-month period from the filing due date until the annual report is filed. If the company fails to file the annual report within this time, the NYSE has discretion to allow the company's securities to be traded for up to an additional six-month period.

Rule 802.01E ¶ 7 also provides that the NYSE has discretion to continue listing a company whose annual report is more than twelve months late in "certain unique circumstances," if the Exchange determines that the company "may have a position in the market (relating to both the nature of its business and its very large publicly-held market capitalization) such that its delisting from the Exchange would be significantly contrary to the national interest and the interests of public investors." 4/ In the event the Exchange makes such a determination, it may, in its "sole discretion," consider allowing an extension beyond the twelve-month period if five additional criteria are satisfied. 5/

2/ 15 U.S.C. § 78m.

3/ 17 C.F.R. §§ 240.13a-1 and 13a-13.

4/ The Exchange's discretion to allow a company to continue to be listed beyond the initial twelve-month period set forth in Rule 802.01.E ¶ 7 will expire on December 31, 2007. See Order Approving Rule Change Amending Annual Report Timely Filing Requirements, Exchange Act Rel. No. 55198 (Jan. 30, 2007), __ SEC Docket ____, ____. If, prior to December 31, 2007, the Exchange had determined to continue listing a company beyond the initial twelve-month period and the company fails to file its periodic annual report by December 31, 2007, suspension and delisting procedures will commence in accordance with the procedures set out in Section 804 of the Listed Company Manual. Id.

5/ These criteria are: (1) the company's continuing compliance with applicable quantitative and qualitative listing standards; (2) its continued ability to meet current debt obligations and adequately finance operations; (3) its progress, as reported to the Exchange, in completing its financial statements; (4) whether it has been publicly transparent on its status, issuing press releases regarding its progress in completing its financial statements and providing other information regarding its financial status; and (5) the reasonable expectation that the company will be able to resume timely filings in the future.

On January 17, 2006, Navistar announced that it would not timely file its annual report for the fiscal year ended October 31, 2005. Pursuant to Rule 802.01E, Navistar traded on the NYSE during an initial six-month grace period following its failure to file its fiscal 2005 Form 10-K in January 2006. On April 7, 2006, Navistar announced that it would restate its financial results for the fiscal years 2002 through 2004, and for the first nine months of fiscal year 2005, and stated that these financial statements "should no longer be relied upon because of errors in such financial statements." 6/ In July 2006, Navistar submitted a formal request for an additional six-month period to continue trading its securities. On July 24, 2006, NYSE staff granted Navistar an extension of up to six additional months, through February 1, 2007.

During a meeting on October 12, 2006, Navistar disclosed to NYSE staff that Navistar estimated its revised timing for completion of the 2005 annual report had been extended beyond February 1, 2007 by approximately four months. In response, NYSE staff stated that February 1, 2007 was an absolute deadline and that it marked the end of the maximum period that Navistar could be listed without filing the 2005 annual report with the Commission. On December 6, 2006, Navistar informed NYSE staff of a formal presentation Navistar had made to the Commission's Division of Market Regulation on December 5, 2006. The presentation outlined the reasons that Navistar believed it should be allowed to remain listed pursuant to the "national interest" exception contained in Rule 802.01E ¶ 7.

On December 15, 2006, Navistar announced that it would not complete its 2005 financial statements by February 1, 2007, and therefore would not do so until after the twelve-month period to complete the filing as permitted under Rule 802.01E. 7/ In a letter dated December 15, 2006, NYSE Regulation staff notified Navistar of its decision to suspend trading in, and to commence procedures to delist, Navistar's listed securities and, on that same date, the NYSE announced this decision in a press release. 8/ On December 18, 2006, Navistar requested a review of that decision by the NYSE Regulation Board of Directors Committee for Review (the "Review Committee"). NYSE Regulation determined that trading in Navistar's securities would continue through the NYSE's review process.

On January 30, 2007, the Review Committee held a hearing after receiving briefs, witness statements, and other documents from Navistar and NYSE Regulation staff in support of their

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6/ Navistar International Company, Form 8-K, at 3 (2006).

7/ Navistar represents to us that it "expects to complete its restatement in 2007 and to be current with all filing requirements for public companies by the end of the calendar year."

8/ Press Release, NYSE and NYSE Arca Suspend Trading in Navistar International Corporation: Move to Remove from the Lists (Dec. 15, 2006), http://www.nyse.com/Frameset.html?nyseref=&displayPage=/press/1166094393003.html

respective positions. 9/ Navistar addressed the application of Rule 802.01E ¶ 7 to its situation. On February 6, 2007, the Review Committee affirmed the decision of NYSE Regulation staff to suspend and delist Navistar's securities. On this same date, NYSE Regulation announced that Navistar's securities would be suspended from trading prior to the opening on February 14, 2007. Also on February 6, 2007, the NYSE filed a Form 25 with the Commission notifying us of NYSE's intention to remove Navistar from listing and registration on the Exchange at the opening of business on February 16, 2007, pursuant to the provisions of Exchange Act Rule 12d2-2. 10/ On February 7, 2006, the Commission received Navistar's Rule 420 Application for Review of the Review Committee's decision affirming the suspension and delisting and the Motion for Summary Expedited Stay. On February 9, 2006, the NYSE informed the Commission that it was "neutral on whether or not the Commission should grant such an immediate interim stay."

II.

Under Rule of Practice 401(d), we may stay an action of the NYSE upon a motion by a person aggrieved by such action. 11/ In determining under Rule 401(d) whether to stay Navistar's delisting from the NYSE, we consider (1) whether there is a strong likelihood that Navistar will succeed on the merits of its application for review, (2) whether, absent a stay, Navistar will suffer irreparable injury, (3) whether there will be substantial harm to the public if we stay the delisting, and (4) whether staying the delisting will serve the public interest. 12/

9/ The following witnesses testified on behalf of Navistar: Daniel C. Ustian, Navistar's Chairman, President, and Chief Executive Officer; William A. Caton, Navistar's Executive Vice-President and Chief Financial Officer; James H. Keyes, Chairman of the Audit Committee of Navistar's Board of Directors; and Timothy P. Flynn, Chairman and Chief Executive Officer of KPMG LLP, Navistar's current auditors. Counsel for Navistar also distributed to the Review Committee copies of affidavits from Heather Kos, Navistar's Director of Investor Relations, and Terry Endsley, Navistar's Treasurer.

10/ 17 C.F.R. § 240.12d2-2.

11/ 17 C.F.R. § 201.401(d).

12/ Rules of Practice, 60 Fed. Reg. 32738, 32772 (1995) (comment to Rule 401); JD American Workwear, Inc., Securities Exchange Act Rel. No. 43283 (Sept. 12, 2000), 73 SEC Docket 748, 752; Robert J. Prager, Exchange Act Rel. No. 50634 (Nov. 4, 2004), 84 SEC Docket 162, 163 (citing Cuomo v. Nuclear Regulatory Comm'n, 772 F.2d 972, 974 (D.C. Cir. 1988)).

Commission review of the suspension and delisting of Navistar is governed by Exchange Act Section 19(f). 13/ Pursuant to Section 19(f), the Commission must dismiss an application for review of an NYSE delisting if we find that "the specific grounds on which such [delisting] . . . is based exist in fact, that such [delisting] . . . is in accordance with the rules of [NYSE], and that such rules are, and were applied in a manner, consistent with the purposes of [the Exchange Act]." 14/

We first address whether Navistar is strongly likely to succeed on the merits. Then we will address the harm and public interest considerations.

A. Likelihood of Success on the Merits

Although any final determination must await a review on the merits, it appears, based on the briefs filed by the parties thus far, that Navistar has not established a strong likelihood that it will prevail on the merits. It is undisputed that the specific grounds on which NYSE based it delisting determination, that Navistar has failed to file its annual report for the fiscal year ended October 31, 2005, exist in fact, and it appears unlikely that Navistar will be able to establish that NYSE's delisting determination was not in accordance with its rules or the purposes of the securities laws.

Navistar makes three main arguments: (1) the NYSE staff refused to consider whether Navistar meets the requirements of Rule 802.01E ¶ 7 and thereby violated the Due Process Clause of the Fifth Amendment; (2) the NYSE failed to explain why Navistar does not meet the requirements of Rule 802.01E ¶ 7; and (3) Navistar meets the requirements of Rule 802.01E ¶ 7. The first two are procedural arguments; the last concerns the substance of Rule 802.01E ¶ 7.

First, Navistar argues that the NYSE staff said several times it could not consider Rule 802.01E ¶ 7 because of the staff's "perception that the Commission viewed the Rule with disfavor" and contends that "NYSE staff never told Navistar that the staff had considered and determined that Navistar did not meet the threshold requirements" of Rule 802.01E ¶ 7. However, it is the determination reached by the Review Committee, and not the NYSE staff, that is the subject of our review. 15/

13/ 15 U.S.C. § 78s(f).

14/ Fog Cutter Capital Group, Inc., Exchange Act Rel. No. 52993 (Dec. 21, 2005), 86 SEC Docket 3164, 3169-70, aff'd, __ F.3d __ (D.C. Cir. 2007). Navistar has not alleged that the decision imposes any unnecessary or inappropriate burden on competition under the Act. See 15 U.S.C. § 78s(f); Fog Cutter, 86 SEC Docket at 3170 n.13.

15/ Cf. James B. Chase, Exchange Act Rel. No. 47476 (Mar. 10, 2003) 79 SEC Docket 2892, 2901 n.26 ("The [NASD's] Hearing Panel's decision is not before us on review; rather it is

(continued...)

The Review Committee's decision states that the record establishes that NYSE considered Navistar's possible qualification for continued listing pursuant to Rule 802.01.E ¶ 7 and determined that it did not meet the threshold criteria. Specifically, the Review Committee cited NYSE staff's declaration filed before the Review Committee that Navistar's market capitalization was not large enough and that there was no evidence that delisting would have an impact on the national interest. The NYSE staff determined that "unlike Fannie Mae, the only company to which the 'national interest' exception has been applied to date, Navistar has a relatively modest market capitalization and there was no evidence that delisting would have an impact on the national infrastructure such as the risk to the national housing market that was posed by delisting Fannie Mae." 16/

Thus, contrary to Navistar's claim, this determination was not based solely on the size of Navistar's market capitalization, but also on a determination that delisting Navistar was unlikely to have an impact on national interests or the markets beyond the market for Navistar's stock. Navistar's claim that the NYSE's application of Rule 802.01.E ¶ 7 unfairly discriminates in favor of large companies misperceives the national interest analysis. The express terms of the Rule make "very large publicly-held market capitalization" one of two criteria necessary to determine that delisting would be significantly contrary to the national interest.

The Review Committee also stated that it "fully considered all of the evidence presented to it by the Company and NYSE Regulation in reaching its decision to affirm the decision of NYSE Regulation Staff." Navistar was allowed a full opportunity to raise any issue before the Review Committee and was not limited to issues raised by the NYSE staff in its December 15, 2006 determination. The submissions to date indicate that the Review Committee explicitly considered whether Navistar met the requirements of the Rule with respect to the nature of its business and the size of its market capitalization.

Navistar maintains that it was denied due process in NYSE's delisting determination. The NYSE is required by Exchange Act Section 6(b)(7) to "provide a fair procedure for . . . the prohibition or limitation by [the NYSE] of any person with respect to access to services offered

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15/ (...continued)
the NAC decision we consider here."); Charles V. Mercer. Jr., 46 S.E.C. 65, 70 (1975) ("And the decision that we review here is that made by the [NASD's] Board of Governors, not the one reached by the District Committee."). Rule 12d2-2(b)(1)(ii), 17 C.F.R. § 240.12d2-2(b)(1)(ii), requires an exchange to have rules providing an opportunity for appeal to the exchange's board or a committee thereof in order to strike a class of securities from listing.

16/ Declaration of Richard G. Ketchum and Glenn W. Tyranski, Exhibit 1 to the Memorandum submitted to the Review Committee by NYSE staff, paragraph 13.

by [the NYSE] or a member thereof." 17/ Navistar has not demonstrated that the NYSE's consideration of Navistar's delisting was unfair. After NYSE staff determined that Navistar should be delisted, Navistar requested review of that decision by the Review Committee. The Review Committee's opinion states that Navistar "was given a full opportunity to present oral argument, witness testimony, and any additional evidence it wished to present regarding whether its circumstances did, in fact, qualify it for continued listing under Section 802.01E." 18/ Prior to the Review Committee hearing, Navistar and NYSE staff presented briefs, witness statements, and other documents in support of their positions. On January 30, 2007, counsel for Navistar and NYSE staff presented oral argument. Navistar presented four witnesses who testified on its behalf and submitted the affidavits of two other witnesses. Navistar also submitted a written presentation that expressed the company's view of its significance to the national interest. Based on the record before us, it appears that the review procedure complied with NYSE's rules. Navistar had not suggested that it was prevented from presenting relevant evidence or that it lacked sufficient time to formulate its position. We conclude that, at this stage of the proceeding, it does not appear likely that Navistar will succeed on the merits of its due process claim.

Navistar contends that it satisfies Rule 802.01E ¶ 7 because delisting from the NYSE would be contrary to the interests of public investors and the national interest due to its position in the market with respect both to the nature of its business and its size. Even assuming that Navistar had met the threshold requirements for continued listing on the Exchange pursuant to NYSE Rule 802.01E ¶7, the Rule provides that the determination to allow the company to continue listing beyond the twelve-month period rests with the "sole discretion" of the Exchange. In approving NYSE Rule 802.01E, we stated that the rule provides the Exchange with "limited discretion" and "limited flexibility" to allow a company that is more than twelve months late in filing its annual report with the Commission to remain listed on the Exchange. 19/ We stated that although there might be "certain very rare circumstances" in which delisting could be too

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17/ 15 U.S.C. § 78f(b)(7). Navistar contends that trading and listing on the NYSE is a "property interest." We assume without deciding that this is the case for purposes of this stay application, because Navistar has failed to establish a likelihood that it will prevail on its claim that it was deprived of due process.

18/ To the extent that Navistar argues that it was deprived of due process by the NYSE staff's December 15, 2006 decision, any defect was cured by the Review Committee's subsequent hearing. See In re Hancock, 192 F.3d 1083, 1086 (7th Cir. 1999) (holding that "generally speaking, 'procedural errors are cured by holding a new hearing in compliance with due process requirements'") (citing Batanic v. Immigration and Naturalization Service, 12 F.3d 662, 667 (7th Cir. 1993)).

19/ Order Granting Approval to a Proposed Rule Change Relating to Section 802.01E of the Listed Company Manual Concerning Continued Listing of Companies that Fail to File Their Securities Exchange Act of 1934 Annual Reports in a Timely Manner, Exchange Act Rel. No. 53152 (Jan. 19, 2006), 87 SEC Docket 515, 517.

inflexible, continued listing must be balanced against the "critical importance" of "ensuring that listed companies have filed accurate, up-to-date annual reports under the Act." 20/

Thus, under the Rule, the Exchange nearly always should determine not to extend the twelve-month period for a late filer to remain listed on the Exchange. The refusal to exercise discretion in most cases is consistent with the purposes of the Exchange Act given the importance of current financial information about the issuer. Based on the briefs and materials filed by the parties thus far, Navistar has failed to establish a strong likelihood that it will be able to show that the NYSE exercised its discretion in this proceeding in a manner inconsistent with its rules or the purposes of the Exchange Act.

Rule 802.01E ¶ 7 provides a single, narrow exception to the presumption that delisting will occur if a company does not cure its status as a late filer within twelve months. The standard contained in Rule 802.01E ¶ 7 is meant to apply only to those companies where a "disruption in the orderly market for their securities would have serious implications not just for those companies and their shareholders but also for the country as a whole." 21/ Navistar states that it is the nation's largest combined commercial truck and mid-range diesel engine producer with a market capitalization of over $3.2 billion. According to Navistar, it has a level of specialization and experience in the truck industry that allows it to supply military vehicles to the United States for use in Iraq and Afghanistan. These facts alone, however, fail to establish a substantial likelihood that NYSE abused its discretion by concluding that Navistar's delisting would not be significantly contrary to the national interest or have serious implications for the country as a whole. Navistar does not contend, and nothing in the briefs or other submissions to date supports the conclusion, that the NYSE's delisting of Navistar will prevent it from continuing to operate its business and to provide military vehicles for use in Iraq and Afghanistan.

Navistar asserts further that its has complied with the additional five criteria for continued listing contained in Rule 802.01E ¶ 7. These additional five criteria are to be considered only if and after the NYSE determines that a late filer meets the national interest threshold criteria. To permit continued listing of companies that do not satisfy the threshold criteria would open the exemption to a broad category of companies and is not consistent with the purpose of the Rule.

Navistar argues that the NYSE failed to explain how delisting will protect the interest of shareholders or qualify for the national interest exception. As a preliminary matter, under Rule 802.01E ¶ 7, the NYSE is not required to undertake such an analysis and provide an explanation. Rather, in a situation in which a company has failed to file timely its annual report with the Commission, delisting is presumed to be appropriate unless the Exchange determines, in its "sole discretion," that delisting would be significantly contrary to the national interest and the interest of the investing public. Maintaining a listing is to occur only in "unique" and "very rare

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20/ Id.

21/ Id.

circumstances." This presumption is based on the belief that information in the annual report is critical to investors and our national market. "Requiring public companies to file appropriate reports ensures the maintenance of fair and honest markets in securities. Such reports provide a valuable function by disseminating information to the investing public." 22/ Moreover, as we have stated previously, "[t]he Commission strongly believes that listed companies that no longer satisfy exchange listing standards should be delisted quickly in accordance with exchange rules and the Exchange Act." 23/ In these circumstances, delisting serves to "protect the public from being misled into believing that these companies retain the imprimatur of an exchange listing." 24/ Rule 802.01E makes clear that an issuer's failure to file timely its annual report provides a basis for a decision to delist. The Exchange must provide a well reasoned analysis and explanation when it chooses to exercise its discretion to depart from this criterion and permit continued listing.

B. Harm and Public Interest Considerations

Navistar argues that delisting would unfairly penalize Navistar and its shareholders. We have held that the fact that a security is delisted does not necessarily result in irreparable harm to the issuer because its securities may continue to trade in other markets. 25/ According to the Form 25, Navistar anticipates that its securities will be quoted on the Pink Sheets Electronic Quotation Service following the suspension. Navistar also may seek to be listed on the Exchange if it achieves compliance with the Commission's reporting requirements. Although we realize that the existing Navistar shareholders may be disadvantaged, this detriment is outweighed by the public interest in Navistar's compliance with the disclosure requirements so that both existing

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22/ SC&T Int'l, Inc., 54 S.E.C. 320, 326 (1999) (citing Exchange Act § 2, 15 U.S.C. § 78b).

23/ Removal from Listing and Registration of Securities Pursuant to Section 12(d) of the Securities Exchange Act of 1934, Exchange Act Rel. No. 52029 (July 14, 2005), 85 SEC Docket 3615, 3618.

24/ Id.

25/ JD American Workwear, Inc., Exchange Act Rel. No. 43283 (Sept. 12, 2000), 73 SEC Docket 748, 753-54 (citing Millenia Hope, Exchange Act Rel. No. 42739 (May 1, 2000), 72 SEC Docket 965, 966); see also East St. Louis Laborers' Local 100 v. Bellon Wrecking & Salvage Co., 414 F.3d 700, 704 (7th Cir. 2005) (claims of "speculative injuries" do not demonstrate irreparable harm); Wisconsin Gas Co. v. FERC, 758 F.2d 669, 674 (D.C. Cir. 1985) ("injury must be certain and great; it must be actual and not theoretical").

and prospective investors on the NYSE will have full, current information about Navistar. 26/ Moreover, in this particular case we note that Navistar's stock has risen approximately forty percent since December 15, 2006, when the NYSE announced its initial delisting decision, and that the stock reached a new fifty-two week high on the day after the NYSE filed Form 25 notifying the Commission of the NYSE's intent to delist Navistar on February 16, 2007. 27/ Given these facts, Navistar has failed to establish that it will suffer irreparable harm or that there will be substantial harm to the public absent a stay of the NYSE's delisting decision.

Accordingly, IT IS ORDERED that the motion to stay the ruling by the New York Stock Exchange LLC to delist Navistar International Corporation and to suspend trading of its securities be, and it hereby is, denied.

By the Commission.

Nancy M. Morris
Secretary

26/ JD American Workwear, 73 SEC Docket at 754 (citing Millenia Hope, 72 SEC Docket at 966-67); see also Biorelease Corp., 52 S.E.C. 219, 224 (1995) (noting that, while delisting may hurt existing investors, their interests are outweighed by prospective future investors).

27/ Navistar's Executive Vice-President stated that "[w]herever we are listed, we are committed to continued communications with our shareholders." Press Release, Navistar International Corporation, Navistar Says NYSE Moves to Delist Company from Exchange; Trading Suspension Set for Feb. 14; Appeal Planned (Feb. 6, 2007), http://ir.navistar.com/releasedetail.cfm?ReleaseID=228892.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

CORRECTED

SECURITIES EXCHANGE ACT OF 1934
Release No. 55287 / February 13, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2555 / February 13, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12567

In the Matter of	:	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**
THE DOW CHEMICAL COMPANY,	:	
Respondent.	:	

I.

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

II.

In anticipation of the institution of these proceedings, the Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting

Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, as set forth below ("Order").[1]

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

Summary

This matter involves Dow's violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA") through numerous improper payments made by DE-Nocil Crop Protection Ltd. ("DE-Nocil"), a fifth-tier subsidiary of Dow, from 1996 to 2001, to Indian government officials to register several agro-chemical products slated for marketing in time for India's growing season. DE-Nocil paid an estimated $200,000 in improper payments and gifts to Indian government officials at the state and federal levels. None of these payments were accurately reflected in Dow's books and records. Additionally, Dow's system of internal accounting controls failed to prevent the payments.

Respondent

1. Dow is a Delaware corporation with corporate headquarters in Midland, Michigan, that manufactures and sells chemicals, plastic materials, agricultural and other specialized products and services. Its common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

Other Relevant Entities

2. During the time period 1996 to 2001, DE-Nocil, headquartered in Mumbai, India, was a fifth-tier subsidiary of Dow that manufactured and marketed pesticides and other products primarily for use in the Indian agriculture industry. DE-Nocil was established in 1994 as a joint venture when a majority-owned Dow subsidiary, DowElanco, acquired a 51% ownership interest in the agro-chemicals business of a local Indian company, National Organic Chemicals Industry Ltd. ("Nocil") owned by a prominent Indian family. In 1997, DowElanco became a wholly-owned subsidiary of Dow and was re-named Dow AgroSciences LLC ("DAS"), a Delaware limited liability company. As of March 2001, DAS' stake in DE-Nocil was 75.7%. On January

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[1] The Commission has contemporaneously filed a complaint in the United States District Court for the District of Columbia against Dow alleging violations of Section 13(B)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act") and seeking a civil penalty. Without admitting or denying the Commission's allegations, Dow has consented to the entry of a final judgment by the Court that requires Dow to pay a $325,000 civil penalty. *See SEC v. The Dow Chemical Company*, Case No. 07CV00336 (D.D.C.) (filed February 13, 2007).

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

13, 2005, Dow attained 100% ownership of DE-Nocil, and on March 31, 2005, DE-Nocil changed its name to Dow AgroSciences India Pvt. Ltd.

Facts

A. The Indian Government Regulatory Framework Affecting DE-Nocil

3. Before it could market its products in India, DE-Nocil was required by Indian law to obtain government registration for its products. This process involved registration both at the federal and state levels. At the federal level, the principal regulator was an agency called the Central Insecticides Board ("CIB"). The CIB was comprised of twenty-nine officials charged with examining safety and health issues related to agricultural chemicals. Within the CIB was a Registration Committee composed of six persons that recommended whether to grant registrations and when they would be granted. A key member of the Registration Committee (the "CIB Official") held considerable influence within the Committee. He was able to determine if and when a company's agricultural chemical product would be registered and, in fact, the CIB Official would refuse or delay registrations unless he received financial payments. This individual left the CIB in 2000. Dow is not aware of any similar requests made by CIB officials after the CIB Official left.

4. In addition to the CIB, there were a number of state government officials in India that had some regulatory and enforcement authority regarding agro-chemical businesses like DE-Nocil. These included "licensing officers" in each state, whose approval was necessary for producing, warehousing and selling product in a particular state. The state officials also included inspectors, 30,000 to 40,000 in number, who could prevent the sale of a product by drawing samples and falsely claiming that the samples were misbranded or mislabeled. Misbranding or mislabeling carried significant potential penalties. Companies could challenge accusations of misbranding or mislabeling in court. However, rather than face a suspension in sales of products caused by the false accusations, companies would make petty cash payments to state inspectors.

B. DE-Nocil's Improper Payment Practice and Improper Accounting

5. DE-Nocil's commercial vice-president, who later became a consultant to DE-Nocil, and DE-Nocil's technical development leader, developed an improper payment practice to facilitate the registration of DE-Nocil's products to the CIB. The practice involved directing improper payments to the CIB Official through the use of consultants and unrelated companies.

6. Beginning in 1996, DE-Nocil personnel began accumulating funds off DE-Nocil's books to be available to pay the CIB Official contemporaneously with DE-Nocil's product registration applications. DE-Nocil personnel enlisted one of DE-Nocil's contractors, an Indian product formulator that mixed and packaged products for DE-Nocil, to accumulate funds on DE-Nocil's behalf. The contractor, through agreement with DE-Nocil, added fictitious charges called "incidental charges" on its bills to DE-Nocil. The contractor agreed to accumulate and

segregate the funds representing these "incidental charges" and to disburse these funds as directed by DE-Nocil. When needed, DE-Nocil contacted the contractor and asked it to disburse funds to third party "consultants" who delivered the funds to the CIB Official. DE-Nocil made approximately $20,000 in improper payments to the CIB Official through this contractor.

7. DE-Nocil also made an improper payment to the CIB Official through a second contractor, which was also one of DE-Nocil's product formulators. In this case, the second contractor, through an agreement with DE-Nocil, issued DE-Nocil a false invoice for $12,000 in capital equipment. DE-Nocil paid the contractor the $12,000, which was then delivered to the CIB Official. The payment was authorized by DE-Nocil's Managing Director.

8. None of the payments that were ultimately made to the CIB Official were properly recorded in DE-Nocil's books. The payments resulted in the expedited registration of three DE-Nocil products: "Pride (NI-25)," "Nurelle-D," and "Dursban 10G," products which used active ingredients that were widely used, and registered by Dow or other pesticide manufacturers, in other countries, including the United States. As a result of the expedited registrations, Dow estimated that DE-Nocil generated $435,000 in direct operating margin from the accelerated sales of these products, 75.7% (or $329,295) of which, based on Dow's ownership interest, went to Dow.

9. DE-Nocil also made improper payments at the state level. DE-Nocil routinely used money from petty cash to pay state officials in order to distribute and sell its products. These payments were transmitted to state officials through DE-Nocil's distributors in the field. Although the payments were in small amounts – well under $100 per payment – the payments were numerous and frequent. Dow estimates that from 1996 to 2001, $87,400 in payments were made to state inspectors and other state officials. None of these payments were properly recorded in DE-Nocil's books.

10. In sum, over a six-year period, DE-Nocil distributed an estimated $200,000 in improper payments through federal and state channels. An independent auditor retained by Dow identified approximately $75,600 of payments and, through a process of extrapolation, estimated an additional $125,000, for a total of approximately $200,000. From this amount, an estimated $39,700 was used by DE-Nocil to register its products and an estimated $87,400 was paid to state level agriculture inspectors. The remainder of improper payments consisted of an estimated: $37,600 for gifts, travel, entertainment and other items; $19,000 to government officials; $11,800 to sales tax officials; $3,700 to excise tax officials; and $1,500 to customs officials. The payments were made without knowledge or approval of any Dow employee.

C. Dow's Internal Investigation

11. Dow conducted an internal investigation of DE-Nocil and, upon its completion, voluntarily approached Commission staff and presented the results. Dow also undertook certain remedial actions relating to the DE-Nocil matter, including employee disciplinary actions. Dow

retained an independent auditor to conduct a forensic audit of the books and records and internal controls at DE-Nocil; reported its internal investigation to the Audit Committee of the Board of Directors; and provided FCPA compliance training to employees at DE-Nocil, as well as to employees at DAS. In addition to the remedial actions relating to DE-Nocil, Dow restructured its global compliance program; improved and expanded FCPA compliance training for employees of Dow and its subsidiaries worldwide; trained its internal auditors to recognize FCPA issues; and joined a non-profit association specializing in anti-bribery due diligence that, among other things, screens potential partners and other third parties that work with multinational corporations and provides FCPA training to them. Dow also hired an independent consultant to review and assess its FCPA compliance program.

D. Violations

12. The FCPA, enacted in 1977, added Exchange Act Section 13(b)(2)(A) to require public companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer, and Section 13(b)(2)(B) of the Exchange Act to require such companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management's general or specific authorization; and (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets.

13. As detailed above, because DE-Nocil did not properly record the payments that it made to Indian government officials in its books, its books, records and accounts did not, in reasonable detail, accurately reflect its transactions and disposition of assets.

14. As a result of the conduct described above, Dow violated Section 13(B)(2)(A) of the Exchange Act.

15. In addition, DE-Nocil failed to take steps to ensure that its employees and consultants complied with the FCPA and to ensure that the payments it made to Indian government officials were accurately reflected on its books and records.

16. As a result of the conduct described above, Dow violated Section 13(b)(2)(B) of the Exchange Act.

Dow's Remedial Efforts

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

IV.

In view of the foregoing, the Commission deems it appropriate to accept the Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that Dow cease and desist from committing or causing any violations and any future violations of Section 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55287 / February 13, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2555 / February 13, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12567

In the Matter of	:	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**
THE DOW CHEMICAL COMPANY,	:	
Respondent.	:	

I.

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

II.

In anticipation of the institution of these proceedings, the Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting

Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934, as set forth below ("Order").[1]

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

Summary

This matter involves Dow's violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA") through numerous improper payments made by DE-Nocil Crop Protection Ltd. ("DE-Nocil"), a fifth-tier subsidiary of Dow, from 1996 to 2001, to Indian government officials to register several agro-chemical products slated for marketing in time for India's growing season. DE-Nocil paid an estimated $200,000 in improper payments and gifts to Indian government officials at the state and federal levels. None of these payments were accurately reflected in Dow's books and records. Additionally, Dow's system of internal accounting controls failed to prevent the payments.

Respondent

1. Dow is a Delaware corporation with corporate headquarters in Midland, Michigan, that manufactures and sells chemicals, plastic materials, agricultural and other specialized products and services. Its common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and is listed on the New York Stock Exchange.

Other Relevant Entities

2. During the time period 1996 to 2001, DE-Nocil, headquartered in Mumbai, India, was a fifth-tier subsidiary of Dow that manufactured and marketed pesticides and other products primarily for use in the Indian agriculture industry. DE-Nocil was established in 1994 as a joint venture when a majority-owned Dow subsidiary, DowElanco, acquired a 51% ownership interest in the agro-chemicals business of a local Indian company, National Organic Chemicals Industry Ltd. ("Nocil") owned by a prominent Indian family. In 1997, DowElanco became a wholly-owned subsidiary of Dow and was re-named Dow AgroSciences LLC ("DAS"), a Delaware limited liability company. As of March 2001, DAS' stake in DE-Nocil was 75.7%. On January

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[1] The Commission has contemporaneously filed a complaint in the United States District Court for the District of Columbia against Dow alleging violations of Section 13(B)(2)(A) and 13(b)(2)(B) of the Securities Exchange Act of 1934 ("Exchange Act") and seeking a civil penalty. Without admitting or denying the Commission's allegations, Dow has consented to the entry of a final judgment by the Court that requires Dow to pay a $325,000 civil penalty. *See SEC v. The Dow Chemical Company*, Case No. 07CV00336 (D.D.C.) (filed February 13, 2007).

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

13, 2005, Dow attained 100% ownership of DE-Nocil, and on March 31, 2005, DE-Nocil changed its name to Dow AgroSciences India Pvt. Ltd.

Facts

A. The Indian Government Regulatory Framework Affecting DE-Nocil

3. Before it could market its products in India, DE-Nocil was required by Indian law to obtain government registration for its products. This process involved registration both at the federal and state levels. At the federal level, the principal regulator was an agency called the Central Insecticides Board ("CIB"). The CIB was comprised of twenty-nine officials charged with examining safety and health issues related to agricultural chemicals. Within the CIB was a Registration Committee composed of six persons that recommended whether to grant registrations and when they would be granted. A key member of the Registration Committee (the "CIB Official") held considerable influence within the Committee. He was able to determine if and when a company's agricultural chemical product would be registered and, in fact, the CIB Official would refuse or delay registrations unless he received financial payments. This individual left the CIB in 2000. Dow is not aware of any similar requests made by CIB officials after the CIB Official left.

4. In addition to the CIB, there were a number of state government officials in India that had some regulatory and enforcement authority regarding agro-chemical businesses like DE-Nocil. These included "licensing officers" in each state, whose approval was necessary for producing, warehousing and selling product in a particular state. The state officials also included inspectors, 30,000 to 40,000 in number, who could prevent the sale of a product by drawing samples and falsely claiming that the samples were misbranded or mislabeled. Misbranding or mislabeling carried significant potential penalties. Companies could challenge accusations of misbranding or mislabeling in court. However, rather than face a suspension in sales of products caused by the false accusations, companies would make petty cash payments to state inspectors.

B. DE-Nocil's Improper Payment Practice and Improper Accounting

5. DE-Nocil's commercial vice-president, who later became a consultant to DE-Nocil, and DE-Nocil's technical development leader, developed an improper payment practice to facilitate the registration of DE-Nocil's products to the CIB. The practice involved directing improper payments to the CIB Official through the use of consultants and unrelated companies.

6. Beginning in 1996, DE-Nocil personnel began accumulating funds off DE-Nocil's books to be available to pay the CIB Official contemporaneously with DE-Nocil's product registration applications. DE-Nocil personnel enlisted one of DE-Nocil's contractors, an Indian product formulator that mixed and packaged products for DE-Nocil, to accumulate funds on DE-Nocil's behalf. The contractor, through agreement with DE-Nocil, added fictitious charges called "incidental charges" on its bills to DE-Nocil. The contractor agreed to accumulate and

segregate the funds representing these "incidental charges" and to disburse these funds as directed by DE-Nocil. When needed, DE-Nocil contacted the contractor and asked it to disburse funds to third party "consultants" who delivered the funds to the CIB Official. DE-Nocil made approximately $20,000 in improper payments to the CIB Official through this contractor.

7. DE-Nocil also made an improper payment to the CIB Official through a second contractor, which was also one of DE-Nocil's product formulators. In this case, the second contractor, through an agreement with DE-Nocil, issued DE-Nocil a false invoice for $12,000 in capital equipment. DE-Nocil paid the contractor the $12,000, which was then delivered to the CIB Official. The payment was authorized by DE-Nocil's Managing Director.

8. None of the payments that were ultimately made to the CIB Official were properly recorded in DE-Nocil's books. The payments resulted in the expedited registration of three DE-Nocil products: "Pride (NI-25)," "Nurelle-D," and "Dursban 10G," products which used active ingredients that were widely used, and registered by Dow or other pesticide manufacturers, in other countries, including the United States. As a result of the expedited registrations, Dow estimated that DE-Nocil generated $435,000 in direct operating margin from the accelerated sales of these products, 75.7% (or $329,295) of which, based on Dow's ownership interest, went to Dow.

9. DE-Nocil also made improper payments at the state level. DE-Nocil routinely used money from petty cash to pay state officials in order to distribute and sell its products. These payments were transmitted to state officials through DE-Nocil's distributors in the field. Although the payments were in small amounts – well under $100 per payment – the payments were numerous and frequent. Dow estimates that from 1996 to 2001, $87,400 in payments were made to state inspectors and other state officials. None of these payments were properly recorded in DE-Nocil's books.

10. In sum, over a six-year period, DE-Nocil distributed an estimated $200,000 in improper payments through federal and state channels. An independent auditor retained by Dow identified approximately $75,600 of payments and, through a process of extrapolation, estimated an additional $125,000, for a total of approximately $200,000. From this amount, an estimated $39,700 was used by DE-Nocil to register its products and an estimated $87,400 was paid to state level agriculture inspectors. The remainder of improper payments consisted of an estimated: $37,600 for gifts, travel, entertainment and other items; $19,000 to government officials; $11,800 to sales tax officials; $3,700 to excise tax officials; and $1,500 to customs officials. The payments were made without knowledge or approval of any Dow employee.

C. Dow's Internal Investigation

11. Dow conducted an internal investigation of DE-Nocil and, upon its completion, voluntarily approached Commission staff and presented the results. Dow also undertook certain remedial actions relating to the DE-Nocil matter, including employee disciplinary actions. Dow

retained an independent auditor to conduct a forensic audit of the books and records and internal controls at DE-Nocil; reported its internal investigation to the Audit Committee of the Board of Directors; and provided FCPA compliance training to employees at DE-Nocil, as well as to employees at DAS. In addition to the remedial actions relating to DE-Nocil, Dow restructured its global compliance program; improved and expanded FCPA compliance training for employees of Dow and its subsidiaries worldwide; trained its internal auditors to recognize FCPA issues; and joined a non-profit association specializing in anti-bribery due diligence that, among other things, screens potential partners and other third parties that work with multinational corporations and provides FCPA training to them. Dow also hired an independent consultant to review and assess its FCPA compliance program.

D. Violations

12. The FCPA, enacted in 1977, added Exchange Act Section 13(b)(2)(A) to require public companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer, and Section 13(b)(2)(B) of the Exchange Act to require such companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that: (i) transactions are executed in accordance with management's general or specific authorization; and (ii) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and to maintain accountability for assets.

13. As detailed above, because DE-Nocil did not properly record the payments that it made to Indian government officials in its books, its books, records and accounts did not, in reasonable detail, accurately reflect its transactions and disposition of assets.

14. As a result of the conduct described above, Dow violated Section 13(B)(2)(A) of the Exchange Act.

15. In addition, DE-Nocil failed to take steps to ensure that its employees and consultants complied with the FCPA and to ensure that the payments it made to Indian government officials were accurately reflected on its books and records.

16. As a result of the conduct described above, Dow violated Section 13(b)(2)(B) of the Exchange Act.

Dow's Remedial Efforts

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

IV.

In view of the foregoing, the Commission deems it appropriate to accept the Respondent's Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that Dow cease and desist from committing or causing any violations and any future violations of Section 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55293; File No. SR-NYSE-2006-120)

February 14, 2007

Self-Regulatory Organizations; New York Stock Exchange LLC; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Regarding the Proposed Combination Between NYSE Group, Inc. and Euronext N.V.

I. Introduction

On December 29, 2006, New York Stock Exchange LLC ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended, ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change regarding the proposed business combination ("Combination") between NYSE Group, Inc. ("NYSE Group") and Euronext N.V. ("Euronext"). The proposed rule change was published for comment in the Federal Register on January 8, 2007.[3] The Commission has received two comments on the proposal.[4] The Exchange filed a response to comments on February 14, 2007.[5]

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1 15 U.S.C. 78s(b)(l).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 55026 (December 29, 2006), 72 FR 814 ("Notice").

4 See letter from Andrew Rothlein, to Nancy Morris, Secretary, Commission, dated January 17, 2007 ("OTR Investors Letter"); and letter from Professor J. Robert Brown, Jr., University of Denver Sturm College of Law, to Nancy Morris, Secretary, Commission, received by the Commission, February 13, 2007 ("Brown Letter").

5 See letter from Mary Yeager, Assistant Secretary, NYSE, to Nancy M. Morris, Secretary, Commission, dated February 14, 2007 ("NYSE Response to Comments").

On February 13, 2007, the Exchange filed Amendment No. 1 to the proposed rule change.[6] This order approves the proposed rule change, grants accelerated approval to Amendment No. 1, and solicits comments from interested persons on Amendment No. 1.

The Commission has reviewed carefully the proposed rule change, the comment letters, and the NYSE Response to Comments, and finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.[7] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b) of the Exchange Act,[8] which, among other things, requires a national securities exchange to be so organized and have the capacity to be able to carry out the purposes of the Exchange Act and to enforce compliance by its members and persons associated with its members with the provisions of the Exchange Act, the rules and regulations thereunder, and the rules of the exchange, and assure the fair representation of its members in the selection of its directors and administration of its affairs, and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer. Section 6(b) of the Exchange Act[9] also requires that the rules of the exchange be designed to promote just and equitable principles of trade, to remove impediments to and

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6 See Partial Amendment dated February 13, 2007 ("Amendment No. 1"). The text of Amendment No. 1 and Exhibits 5C, 5D, 5F, 5G, 5H, 5I, 5J, and 5M, which set forth certain governing documents as proposed to be amended, are available on the Commission's Web site (http://www.sec.gov/rules/sro.shtml), at the Commission's Public Reference Room, at the NYSE, and on the NYSE's Web site (http://www.nyse.com).

7 In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

8 15 U.S.C. 78f(b).

9 Id.

perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

A. Accelerated Approval of Amendment No. 1

As set forth below, the Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after publishing notice of Amendment No. 1 in the Federal Register pursuant to Section 19(b)(2) of the Exchange Act.[10]

In Amendment No. 1, NYSE made changes to the Purpose Section of Form 19b-4 to (1) provide an explanation of the purpose of the proposed change from the current independence policy of NYSE Group to no longer provide as a categorical matter that a person fails to be independent if he or she is a director of an affiliate of a member organization; (2) specify that the Exchange has proposed to make a change to the ownership limitation in the NYSE Group Certificate of Incorporation to match the voting limitation, and add that the board of directors must determine that share ownership in excess of the concentration limitation will not impair the ability of NYSE Group to discharge its responsibilities under the Exchange Act and the rules and regulations thereunder; (3) clarify the process for nominating directors for the NYSE Euronext ("NYSE Euronext") board of directors; (4) clarify that it is requesting that the Commission allow NYSE Euronext alone to wholly own and vote all of the outstanding common stock of NYSE Group; and (5) clarify that the organizational documents of the Exchange, NYSE Market, Inc. ("NYSE Market"), and NYSE Regulation, Inc. ("NYSE Regulation") provide that any person not meeting the board qualifications in the relevant organizational documents will not be

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10 15 U.S.C. 78s(b)(2). Pursuant to Section 19(b)(2) of the Exchange Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing.

qualified to serve, and therefore will not be eligible to serve as a director. The Exchange made a corresponding clarifying change to the proposed Second Amended and Restated Operating Agreement of the Exchange ("proposed NYSE Operating Agreement") and the proposed Amended and Restated Bylaws of NYSE Market ("proposed NYSE Market Bylaws"). Additionally, the Exchange made a change to the proposed Second Amended and Restated Bylaws of NYSE Regulation ("proposed NYSE Regulation Bylaws") to add that any person who is not elected or appointed in accordance with the qualifications set forth in Section 1(A) of Article III of the proposed NYSE Regulation Bylaws shall not be qualified to serve as a director and therefore shall not be elected to serve as a director. This proposed change was described in the Notice,[11] but was inadvertently omitted from the proposed NYSE Regulation Bylaws. The Exchange also made technical revisions to proposed Article VII, Section 2 of the proposed Amended and Restated Certificate of Incorporation of NYSE Group ("proposed NYSE Group Certificate of Incorporation") relating to quorum requirements for each meeting of stockholders.[12] The Exchange also is amending the Trust Agreement (as defined below) to specify that the shares of Archipelago Holdings, Inc. ("Archipelago") may also be held directly by the Trust (as defined below). These changes are necessary to clarify the proposal. The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the Federal Register because they clarify the Exchange's rules, which should facilitate the Exchange's compliance with its rules and the Commission's ability to ensure

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11 See Notice, supra note 3, at 831.

12 In the Notice, the Exchange mistakenly showed proposed deletions to the current quorum requirements. The Exchange is not proposing to change the quorum requirements that exist in the current NYSE Group Certificate of Incorporation.

compliance with such rules, and assist members and investors in understanding the application and scope of the rules.

In addition, the Exchange made certain clarifying, conforming, technical, non-material, and non-substantive changes to the Purpose Section of Form 19b-4, the Independence Policy of the NYSE Euronext Board of Directors ("Independence Policy"), the proposed NYSE Group Certificate of Incorporation, the proposed Second Amended and Restated Certificate of Incorporation of NYSE Market ("proposed NYSE Market Certificate of Incorporation"), the proposed Restated Certificate of Incorporation of NYSE Regulation[13] ("proposed NYSE Regulation Certificate of Incorporation"), and the Trust Agreement, which raise no new or novel issues. These changes are non-substantive and technical in nature and are necessary to reflect the changes from the current rules of the Exchange and clarify the proposal. The Commission finds good cause exists to accelerate approval of these changes prior to the thirtieth day after publication in the Federal Register because they clarify the Exchange's rules, which should facilitate the Exchange's compliance with its rules, the Commission's ability to ensure compliance with such rules, and assist members and investors in understanding the application and scope of the rules.

The Commission finds that the changes proposed in Amendment No. 1 are consistent with the Exchange Act and therefore finds good cause to accelerate approval of Amendment No. 1, pursuant to Section 19(b)(2) of the Exchange Act.[14]

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13 In Amendment No. 1, the Exchange proposed to change the name of this document to conform to New York State law. See Amendment No. 1, supra note 6.

14 15 U.S.C. 78s(b)(2).

B. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSE-2006-120 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSE-2006-120. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro-shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of NYSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to

make available publicly. All submissions should refer to Amendment No. 1 of File Number SR-NYSE-2006-120 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

II. Discussion

The Exchange has submitted the proposed rule change in connection with the Combination of NYSE Group with Euronext. As a result of the Combination, the businesses of NYSE Group (including the businesses of the Exchange and NYSE Arca , Inc. (a Delaware corporation, registered national securities exchange and self-regulatory organization ("NYSE Arca")), and Euronext will be held under a single, publicly traded holding company named NYSE Euronext, a Delaware corporation. Following the Combination, each of NYSE Group and Euronext will be a separate subsidiary of NYSE Euronext, and their respective businesses and assets will continue to be held as they are currently held (subject to any post-closing corporate reorganization of Euronext). The proposed rule change is necessary to effectuate the consummation of the Combination and will not be operative until the consummation of the Combination.

A. Corporate Structure

After the Combination, the Exchange will remain a wholly owned subsidiary of NYSE Group. NYSE Market, a Delaware corporation, will remain a wholly owned subsidiary of the Exchange and conduct the Exchange's business. NYSE Regulation, a New York Type A not-for-profit corporation, will remain a wholly owned subsidiary of the Exchange, and continue to perform the regulatory responsibilities for the Exchange pursuant to a delegation agreement with the Exchange and many of the regulatory functions of NYSE Arca pursuant to a services agreement with NYSE Arca.

Archipelago, a Delaware corporation, will remain a wholly owned subsidiary of NYSE Group. NYSE Arca Holdings, Inc., a Delaware corporation ("NYSE Arca Holdings"), and NYSE Arca L.L.C., a Delaware limited liability company ("NYSE Arca LLC"), will remain wholly owned subsidiaries of Archipelago. NYSE Arca will remain a wholly owned subsidiary of NYSE Arca Holdings, and NYSE Arca Equities, Inc. ("NYSE Arca Equities"), a Delaware corporation formerly known as PCX Equities, Inc., will remain a wholly owned subsidiary of NYSE Arca. NYSE Arca will continue to maintain its status as a registered national securities exchange and self-regulatory organization. Archipelago's businesses and assets will continue to be held by it and its subsidiaries. Pursuant to a regulatory services agreement, NYSE Regulation will continue to perform many of the regulatory functions of NYSE Arca. The governing documents of Archipelago will remain unchanged other than amendments to the Certificate of Incorporation of Archipelago to allow the Trust (as defined below) to exceed the voting limitation and ownership concentration limitation as provided for in the Trust Agreement.[15]

The Exchange represents that the Combination will have no effect on the ability of any party to trade securities on NYSE Market, NYSE Arca, or NYSE Arca Equities. Euronext and its subsidiaries will continue to operate their business and operations in substantially the same

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15 These amendments are the subject of a proposed rule change filed by NYSE Arca, which proposed rule change the Commission is approving today. See Securities Exchange Act Release No. 55294 (February 14, 2007) (approval order). See also Securities Exchange Act Release No. 55109 (January 16, 2007), 72 FR 2578 (January 19, 2007) (notice of proposed rule change of NYSE Arca). The Combination involves certain modifications to the organizational documents of NYSE Group and of NYSE Euronext, which upon consummation of the Combination will be the new indirect parent company of NYSE Arca. The organizational documents and independence policies of NYSE Group and NYSE Euronext and the Trust Agreement constitute rules of NYSE Arca. The resolutions of the board of directors of NYSE Group are also rules of NYSE Arca requiring Commission approval. Accordingly, NYSE Arca has submitted a proposed rule change to reflect the rule changes to be implemented in connection with the Combination.

manner as they are conducted currently, with any changes subject to the approval of the European Regulators to the extent required.

A core aspect of the structure of the Combination is local regulation of the marketplace, members, and issuers. Therefore, securities exchanges, members, and issuers of NYSE Group and Euronext will continue to be regulated in the same manner as they are currently regulated. The Commission notes that this conclusion (i.e., that securities exchanges, members, and issuers of NYSE Group and Euronext will continue to be regulated in the same manner as they are currently regulated) is based on the structure of the Combination as described in this proposal.

1. NYSE Euronext

Following the Combination, NYSE Euronext will be a for-profit, publicly traded stock corporation and will act as a holding company for the businesses of the NYSE Group and Euronext. NYSE Euronext will own all of the equity interests in NYSE Group and its subsidiaries, including the Exchange and NYSE Arca, and a majority (if not all) of the equity interests in Euronext and its respective subsidiaries. Section 19(b) of the Exchange Act and Rule 19b-4 thereunder require a self-regulatory organization ("SRO") to file proposed rule changes with the Commission. Although NYSE Euronext is not an SRO, certain provisions of its proposed Amended and Restated Certificate of Incorporation ("proposed NYSE Euronext Certificate of Incorporation") and proposed Amended and Restated Bylaws ("proposed NYSE Euronext Bylaws") are rules of an exchange[16] if they are stated policies, practices, or

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16 See Section 3(a)(27) of the Exchange Act, 15 U.S.C. 78c(a)(27). If NYSE Euronext decides to change its Certificate of Incorporation or Bylaws, NYSE Euronext must submit such change to the board of directors of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca, and NYSE Arca Equities, and if any or all of such board of directors shall determine that such amendment or repeal must be filed with or filed with and approved by the Commission pursuant to Section 19 of the Exchange Act and the

interpretations, as defined in Rule 19b-4 under the Exchange Act, of the exchange, and must be filed with the Commission pursuant to Section 19(b)(4) of the Exchange Act and Rule 19b-4 thereunder. Accordingly, the Exchange has filed the proposed NYSE Euronext Certificate of Incorporation and the proposed NYSE Euronext Bylaws with the Commission.

a. Board of Directors

Because directors of NYSE Euronext will also serve on the boards of the Exchange, NYSE Market, and NYSE Regulation, the composition of, and selection process for, the NYSE Euronext's board of directors is described below. It is currently contemplated that immediately after the Combination, the NYSE Euronext board of directors will consist of twenty-two directors. The initial NYSE Euronext board of directors will have an equal number of U.S. Persons[17] and European Persons.[18] Eleven directors will be the directors of NYSE Group as of immediately prior to the consummation of the Combination (including the chief executive officer and chairman of the board of NYSE Group). Nine directors will be members of the supervisory

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rules thereunder, such change shall not be effective until filed with or filed with and approved by the Commission, as applicable. See proposed NYSE Euronext Certificate of Incorporation, Article X and proposed NYSE Euronext Bylaws, Article X, Section 10.10(C).

17 A "U.S. Person" shall mean, as of the date of his or her most recent election or appointment as a director, any person whose domicile as of such date is and for the immediately preceding 24 months shall have been the United States. See proposed NYSE Euronext Bylaws, Article III, Section 3.2(A).

18 A "European Person" shall mean, as of the date of his or her most recent election or appointment as a director, any person whose domicile as of such date is and for the immediately preceding 24 months shall have been a country in Europe. See proposed NYSE Euronext Bylaws, Article III, Section 3.2(A).

board of Euronext[19] as of immediately prior to the consummation of the Combination (including the chairman of the Euronext supervisory board). One director will be the chief executive officer of Euronext as of immediately prior to the consummation of the Combination, and the remaining director will be a European Person approved by both the NYSE Group board of directors and the Euronext supervisory board. The term of the initial directors of NYSE Euronext will end with the first annual meeting of stockholders to be held by NYSE Euronext, at which meeting the existing directors of NYSE Euronext will be nominated as directors of NYSE Euronext by the nominating and governance committee of the NYSE Euronext board of directors. Thereafter, the directors elected will serve one-year terms.

Beginning with the first annual meeting of stockholders,[20] nominees to the NYSE Euronext board of directors will be nominated by the nominating and governance committee of the NYSE Euronext board of directors, which committee shall be comprised of an equal number of European Persons and U.S. Persons. The proposed NYSE Euronext Bylaws provide that in any election of directors, the nominees who shall be elected to the NYSE Euronext board of directors shall be nominees who receive the highest number of votes such that, immediately after such election: (1) U.S. Persons as of such election shall constitute at least half of, but no more than the smallest number of directors, that will constitute a majority of the directors on the NYSE Euronext board of directors; and (2) European Persons as of such election shall constitute the remainder of the directors on the NYSE Euronext board of directors.[21]

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19 The supervisory board of a Dutch company such as Euronext, is the functional equivalent of a board of directors of a U.S. company but is not permitted to include members of management.

20 See Amendment No. 1, supra note 6.

21 See proposed NYSE Euronext Bylaws, Article III, Section 3.2(A).

The proposed NYSE Euronext Bylaws also provide that either the chairman of the board shall be a U.S. Person and the chief executive officer shall be a European Person, or the chairman of the board shall be a European Person and the chief executive officer shall be a U.S. Person.[22] The chief executive officer and deputy chief executive officer may be, but are not required to be, members of the board of directors of NYSE Euronext.

Each member of the NYSE Euronext board of directors (other than the chief executive officer and deputy chief executive officer of NYSE Euronext if they are members of the board of directors) must satisfy the independence requirements set forth in the Independence Policy, as amended from time to time.[23]

The NYSE Euronext board of directors may create one or more committees. It is expected that upon consummation of the Combination, the NYSE Euronext board of directors will have an audit committee, a human resource and compensation committee, and a nominating and governance committee. Each of the audit committee, human resource and compensation

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22 See proposed NYSE Euronext Bylaws, Article III, Section 3.3.

23 The chief executive officer and deputy chief executive officer, if they are members of the board of directors, will be recused from any act of the board of directors, whether it is acting as the board of directors or as a committee of the board, with respect to any act of any board committee that is required to be comprised solely of independent directors. See proposed NYSE Euronext Bylaws, Article III, Section 3.4. To clarify and continue NYSE Group board's current practice of soliciting the input of NYSE Group management for certain board and committee matters, the Exchange proposes to use the word "acts" instead of the word "deliberations" and "acts" instead of the word "activities" in the proposed NYSE Euronext Bylaws (See Amendment No. 1, supra note 6), each of which are currently used in the Amended and Restated Bylaws of NYSE Group ("current NYSE Group Bylaws") but will be deleted as part of the proposed changes to the Amended and Restated Certificate of Incorporation of NYSE Group ("current NYSE Group Certificate of Incorporation"). (See Amendment No. 1, supra note 6.) This same clarification to board practice will also be made to the Bylaws of NYSE Market ("current NYSE Market Bylaws") and the Amended and Restated Bylaws of NYSE Regulation ("current NYSE Regulation Bylaws").

committee, and nominating and governance committee of the NYSE Euronext board of directors will consist solely of directors meeting the independence requirements of NYSE Euronext. These committees also will perform relevant functions for NYSE Group, the Exchange, NYSE Market, NYSE Regulation, Archipelago, NYSE Arca, and NYSE Arca Equities, as well as other subsidiaries of NYSE Euronext, except that the board of directors of NYSE Regulation will continue to have its own compensation committee and nominating and governance committee.

b. Voting and Ownership Limitations; Changes in Control of the Exchange

The proposed NYSE Euronext Certificate of Incorporation includes restrictions on the ability to vote and own shares of stock of NYSE Euronext. Under the proposed NYSE Euronext Certificate of Incorporation, no person (either alone or together with its related persons)[24] will be entitled to vote or cause the voting of shares of stock of NYSE Euronext beneficially owned by such person or its related persons, in person or by proxy or through any voting agreement or other arrangement, to the extent that such shares represent in the aggregate more than 10% of the then outstanding votes entitled to be cast on such matter. No person (either alone or together with its related persons) may acquire the ability to vote more than 10% of the then outstanding votes entitled to be cast on any such matter by virtue of agreements or arrangements entered into with other persons not to vote shares of NYSE Euronext's outstanding capital stock. NYSE Euronext shall disregard any such votes purported to be cast in excess of these limitations.[25]

In addition, no person (either alone or together with its related persons) may at any time beneficially own shares of stock of NYSE Euronext representing in the aggregate more than 20%

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24 See proposed NYSE Euronext Certificate of Incorporation, Article V, Section 1(L) and note 19 of the Notice for the definition of "related person."

25 See proposed NYSE Euronext Certificate of Incorporation, Article V, Section 1(A).

of the then outstanding votes entitled to be cast on any matter.[26] In the event that a person, either alone or together with its related persons, beneficially owns shares of stock of NYSE Euronext in excess of the 20% threshold, such person and its related persons will be obligated to sell promptly, and NYSE Euronext will be obligated to purchase promptly, to the extent that funds are legally available for such purchase, that number of shares necessary to reduce the ownership level of such person and its related persons to below the permitted threshold, after taking into account that such repurchased shares will become treasury shares and will no longer be deemed to be outstanding.[27]

NYSE also has proposed to permit the NYSE Euronext board of directors to require any stockholder that the NYSE Euronext board of directors reasonably believes to be subject to the voting or ownership limitations summarized above, and any person (either alone or together with its related persons) that at any time beneficially owns 5% or more of NYSE Euronext's outstanding capital stock (which ownership has not been reported to NYSE Euronext), to provide to NYSE Euronext information regarding such ownership upon the request of the NYSE Euronext board of directors.[28] This requirement will allow NYSE Euronext to monitor potential changes in control to ensure that none of the limits are reached.

The NYSE Euronext board of directors may waive the provisions regarding voting and ownership limits, subject to a determination by the NYSE Euronext board of directors that the exercise of such voting rights (or the entering into of a voting agreement) or ownership, as applicable:

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26 See proposed NYSE Euronext Certificate of Incorporation, Article V, Section 2(A).

27 See proposed NYSE Euronext Certificate of Incorporation, Article V, Section 2(D).

28 See proposed NYSE Euronext Certificate of Incorporation, Article V, Section 4.

- will not impair the ability of any of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca LLC, NYSE Arca, and NYSE Arca Equities (each a "U.S. Regulated Subsidiary" and together, "U.S. Regulated Subsidiaries"), NYSE Euronext or NYSE Group to discharge their respective responsibilities under the Exchange Act and the rules and regulations thereunder;
- will not impair the ability of any of the European Market Subsidiaries or NYSE Euronext or Euronext to discharge their respective responsibilities under the European Exchange Regulations;[29]
- is otherwise in the best interest of NYSE Euronext, its stockholders, the U.S. Regulated Subsidiaries and the European Market Subsidiaries; and
- will not impair the Commission's ability to enforce the Exchange Act or the European Regulators' ability to enforce the European Exchange Regulations.

Such resolution expressly permitting such voting or ownership must be filed with and approved by the Commission under Section 19 of the Exchange Act[30] and filed with and approved by each European Regulator having appropriate jurisdiction and authority.

In addition, for so long as NYSE Euronext directly or indirectly controls the Exchange or NYSE Market, the NYSE Euronext board of directors cannot waive the voting and ownership limits above the 20% threshold for any person if such person or its related persons is a "member" or "member organization" of the Exchange (as defined in Exchange Rules). In addition, for so long as NYSE Euronext directly or indirectly controls NYSE Arca, NYSE Arca Equities, or any

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29 See proposed NYSE Euronext Bylaws, Article VII, Section 7.3(A), (B), and (E) and note 23 of the Notice for the definitions of "European Exchange Regulations," "European Market Subsidiary," and "Euronext College of Regulators."

30 15 U.S.C. 78s

facility of NYSE Arca, the NYSE Euronext board of directors cannot waive the voting and ownership limits above the 20% threshold if such person or its related persons is an ETP Holder of NYSE Arca Equities, or an OTP Holder or an OTP Firm of NYSE Arca.[31] Further, the NYSE Euronext board of directors also cannot waive the voting and ownership limits above the 20% threshold if such person or its related persons is subject to any statutory disqualification (as defined in Section 3(a)(39) of the Exchange Act) (a "U.S. Disqualified Person") or has been determined by a European Regulator to be in violation of laws or regulations adopted in accordance with the European Directive on Markets in Financial Instruments applicable to any European Market Subsidiary requiring such person to act fairly, honestly and professionally (a "European Disqualified Person").

Members that trade on an exchange traditionally have ownership interests in such exchange. As the Commission has noted in the past, however, a member's interest in an exchange could become so large as to cast doubt on whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.[32] A member that is a controlling shareholder of an exchange might be tempted to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently

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31 ETP Holder is defined in the NYSE Arca Equities rules of NYSE Arca. OTP Holder and OTP Firm are defined in the rules of NYSE Arca.

32 See Securities Exchange Act Release Nos. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (order approving merger of New York Stock Exchange, Inc. and Archipelago, and demutualization of New York Stock Exchange, Inc. ("NYSE Inc.-Archipelago Merger Order")); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (SR-CHX-2004-26); 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (SR-PCX-2004-08); 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-Phlx-2003-73); and 49067 (January 13, 2004), 69 FR 2761 (January 20, 2004) (SR-BSE-2003-19).

monitor and surveil the member's conduct or diligently enforce its rules and the federal securities laws with respect to conduct by the member that violates such provisions.

The Commission finds the ownership and voting restrictions in the proposed NYSE Euronext Certificate of Incorporation are consistent with the Exchange Act. These requirements should minimize the potential that a person could improperly interfere with or restrict the ability of the Commission, the Exchange, or its subsidiaries to effectively carry out their regulatory oversight responsibilities under the Exchange Act.

2. NYSE Group

Following the Combination, NYSE Group will merge with a wholly owned subsidiary of NYSE Euronext and the surviving corporation will be a wholly owned subsidiary of NYSE Euronext.[33] Section 19(b) of the Exchange Act and Rule 19b-4 thereunder require an SRO to file proposed rule changes with the Commission. Although NYSE Group is not an SRO, certain provisions of the current NYSE Group Certificate of Incorporation and current NYSE Group Bylaws are rules of an exchange[34] if they are stated policies, practices, or interpretations, as

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33 NYSE proposes to amend certain provisions of NYSE Group's organizational documents to reflect that, after the Combination, NYSE Group will be an intermediate holding company. The number of authorized shares of NYSE Group will be decreased. Provisions requiring a supermajority vote of shareholders to amend or repeal certain sections of the NYSE Group certificate of incorporation will be deleted. Also, provisions prohibiting NYSE Group shareholders from calling shareholder meetings, taking shareholder action by written consent and postponing shareholder meetings will be deleted. Provisions requiring advance notice from shareholders of shareholder director nominations or shareholder proposals will be eliminated. Finally, provisions relating to the mechanics of shareholders' meetings, such as the appointment of an inspector of elections, inspection of shareholder lists and opening and closing of polls will be deleted.

34 See Section 3(a)(27) of the Exchange Act, 15 U.S.C. 78c(a)(27). As under the current NYSE Group Certificate of Incorporation and current NYSE Group Bylaws, under the proposed NYSE Group Certificate of Incorporation and proposed NYSE Group Bylaws, if NYSE Group decides to change the proposed NYSE Group Certificate of Incorporation

defined in Rule 19b-4 of the Exchange Act, of the exchange, and must be filed with the Commission pursuant to Section 19(b)(4) of the Exchange Act and Rule 19b-4 thereunder. Accordingly, the Exchange has filed the proposed NYSE Group Certificate of Incorporation and proposed NYSE Group Bylaws with the Commission.

The Exchange has proposed to change the voting and ownership limitations of NYSE Group to include a statement that such limitations will not be applicable so long as NYSE Euronext and the Trust collectively own all of the capital stock of NYSE Group. Instead, while NYSE Group is a wholly owned subsidiary of NYSE Euronext, or as provided for in the Trust Agreement, there shall be no transfer of the shares of NYSE Group held by NYSE Euronext without the approval of the Commission.[35] If NYSE Group ceases to be wholly owned by NYSE Euronext or the Trust, the current voting and ownership limitations will apply.[36]

In addition, pursuant to the proposed NYSE Operating Agreement, except as otherwise provided for in the Trust Agreement, NYSE Group may not transfer or assign its interest in the

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or proposed NYSE Group Bylaws, NYSE Group must submit such change to the board of directors of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca, and NYSE Arca Equities, and if any or all of such board of directors shall determine that such amendment or repeal is required by law or regulation to be filed with or filed with and approved by the Commission pursuant to Section 19 of the Exchange Act and the rules thereunder, such change shall not be effective until filed with or filed with and approved by the Commission, as applicable. See current NYSE Group Certificate of Incorporation, Article XIII, current NYSE Group Bylaws, Article VIII, Section 7.9(b), proposed NYSE Group Certificate of Incorporation, Article XII, and proposed NYSE Group Bylaws, Article VII, Section 7.9(b).

35 See proposed NYSE Group Certificate of Incorporation, Article IV, Section 4(a).

36 See proposed NYSE Group Certificate of Incorporation, Article IV, Section 4(b). The Exchange also proposed to eliminate transfer restrictions on the common stock of NYSE Group issued to persons in connection with the merger of New York Stock Exchange, Inc. and Archipelago that exist in the current NYSE Group Certificate of Incorporation, as unnecessary, since upon the consummation of the Combination, all common stock will be wholly owned by NYSE Euronext.

Exchange, in whole or part, to any person or entity, unless such transfer or assignment is filed with and approved by the Commission under Section 19 of the Exchange Act.[37]

The Commission finds the changes to the ownership and voting restrictions in the proposed NYSE Group Certificate of Incorporation and the change in control provisions in the proposed NYSE Operating Agreement are consistent with the Exchange Act. These requirements should minimize the potential that a person could improperly interfere with or restrict the ability of the Commission, the Exchange, or its subsidiaries to effectively carry out their regulatory oversight responsibilities under the Exchange Act.

In addition, to allow NYSE Euronext to wholly own and vote all of NYSE Group stock upon consummation of the Combination, NYSE Euronext delivered a written notice to the board of directors of NYSE Group pursuant to the procedures set forth in the current NYSE Group Certificate of Incorporation requesting approval of its ownership and voting of NYSE Group stock in excess of the NYSE Group ownership limitation and NYSE Group voting limitation.[38] The board of directors of NYSE Group must resolve to expressly permit ownership or voting in excess of the NYSE Group ownership limitation and NYSE Group voting limitation. Such resolution of the NYSE Group board of directors must be filed with and approved by the Commission under Section 19(b) of the Exchange Act, and become effective thereunder. Further, the board of directors may not approve any voting or ownership in excess of the limitations unless it determines that such ownership or exercise of voting rights will not impair

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37 See proposed NYSE Operating Agreement, Article III, Section 3.03.

38 Prior to permitting any person to exceed the ownership limitation and voting limitation, such person must deliver notice of such person's intention to own or vote shares in excess of the ownership limitation or voting limitation to the NYSE Group board of directors. See current NYSE Group Certificate of Incorporation, Article V, Sections 1(A) and 2(B).

the ability of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca LLC, NYSE Arca, or NYSE Arca Equities to discharge their respective responsibilities under the Exchange Act and the rules and regulations thereunder and is otherwise in the best interests of NYSE Group, its stockholders, and the U.S. Regulated Subsidiaries, and will not impair the Commission's ability to enforce the Exchange Act.[39] For so long as NYSE Group directly or indirectly controls the Exchange or NYSE Market, the NYSE Group board of directors cannot waive the voting and ownership limits above the 20% threshold if such person or its related persons is a "member" or "member organization" of the Exchange (as defined in Exchange Rules).[40] In addition, for so long as NYSE Group directly or indirectly controls NYSE Arca, NYSE Arca Equities, or any facility of NYSE Arca, the NYSE Group board of directors cannot waive the voting and ownership limits above the 20% threshold if such person or its related persons is an ETP Holder of NYSE Arca Equities, or an OTP Holder or an OTP Firm of NYSE Arca.[41] Further, the NYSE Group board of directors cannot waive the voting and ownership limits above the 20% threshold if such person or its related persons is a U.S. Disqualified Person.

The notice from NYSE Euronext included representations of NYSE Euronext that neither it, nor any of its related persons, are: (1) ETP Holders of NYSE Arca Equities, OTP Holders or OTP Firms of NYSE Arca: (2) members or member organizations of the Exchange; or (3) subject to any statutory disqualification (as defined in Section 3(a)(39) of the Exchange Act). The NYSE Group board of directors adopted a resolution approving NYSE Euronext's request that it be permitted, either alone or with its related persons, to exceed the NYSE Group

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39 See current NYSE Group Certificate of Incorporation, Article V, Section 1(A)(x).

40 See current NYSE Group Certificate of Incorporation, Article V, Section 1(A)(y).

41 Id.

ownership limitation and the NYSE Group voting limitation.[42] The Exchange proposed that NYSE Euronext wholly own and vote all of the outstanding common stock of NYSE Group upon the consummation of the Combination.[43]

The Commission believes it is consistent with the Exchange Act to allow NYSE Euronext to wholly own and vote all of the outstanding common stock of NYSE Group. The Commission notes that NYSE Euronext and the Exchange represents that neither NYSE Euronext nor any of its related persons is subject to any statutory disqualification (as defined in Section 3(a)(39) of the Exchange Act), or is an ETP Holder of NYSE Arca Equities, OTP Holder or OTP Firm of NYSE Arca or member or member organization of the Exchange. Moreover, NYSE Euronext has comparable voting and ownership limitations to NYSE Group.[44] NYSE Euronext has also included in its corporate documents certain provisions designed to maintain the independence of the U.S. Regulated Subsidiaries' self-regulatory functions from NYSE Euronext and NYSE Group.[45] Accordingly, the Commission believes that the acquisition of ownership and exercise of voting rights of NYSE Group common stock by NYSE Euronext will not impair the ability of the Commission or any of the U.S. Regulated Subsidiaries to discharge their respective responsibilities under the Exchange Act.

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42 Such resolutions of the NYSE Group board of directors were filed as part of the proposed rule change. See Exhibit K to the Notice, which exhibit is available on the Commission's Web site (http://www.sec.gov/rules/sro.shtml), at the Commission's Public Reference Room, at the NYSE, and on the NYSE's Web site (http://www.nyse.com).

43 See Amendment No. 1, supra note 6.

44 See supra notes 24-32 and accompanying text.

45 See infra notes 65-85 and accompanying text.

3. The Exchange, NYSE Market and NYSE Regulation

Following the Combination, the Exchange, which is registered as a national securities exchange and is an SRO, will remain a wholly owned subsidiary of NYSE Group.[46] NYSE Market will remain a wholly owned subsidiary of the Exchange and conduct the Exchange's business. The Combination will have no effect on the ability of any party to trade securities on NYSE Market. NYSE Regulation will remain a wholly owned subsidiary of the Exchange, and will continue to perform the regulatory responsibilities for the Exchange pursuant to a delegation agreement with the Exchange and many of the regulatory functions of NYSE Arca pursuant to a regulatory services agreement with NYSE Arca.

Currently, directors of NYSE Group serve on the boards of the Exchange, NYSE Market, and NYSE Regulation, and the organizational documents of these entities refer to the independence requirements of NYSE Group. The Exchange has proposed to amend the organizational documents of the Exchange, NYSE Market, and NYSE Regulation to replace all references to NYSE Group with NYSE Euronext. Thus, a majority of the directors of each of the Exchange and NYSE Market must be U.S. Persons who are directors of NYSE Euronext that satisfy the independence requirements of the board of directors of NYSE Euronext. In addition, the Exchange's non-affiliated directors[47] must qualify as independent under the Independence Policy. All of the directors of NYSE Regulation (other than the chief executive officer of NYSE

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46 The Exchange proposes to amend various rules to delete all references to "NYSE Group, Inc." or "NYSE Group" in the Exchange Rules and replace those references with "NYSE Euronext," which will be the indirect parent company of the Exchange following the Combination.

47 The Exchange's non-affiliated directors are persons who are not members of the board of directors of NYSE Euronext, but qualify as independent under the independence policy of the board of directors of NYSE Euronext. See proposed NYSE Operating Agreement, Article II, Section 2.03.

Regulation) must satisfy the independence requirements of the board of directors of NYSE Euronext. For this reason, the independence requirements of the board of directors of NYSE Euronext are relevant to the Commission's consideration of whether the boards of directors of the Exchange, NYSE Market, and NYSE Regulation are consistent with the Exchange Act.

Under the Independence Policy, the NYSE Euronext board of directors must make a determination that each director, other than the chief executive officer and deputy chief executive office of NYSE Euronext, does not have any material relationships with NYSE Euronext and its subsidiaries.[48] In addition, the Independence Policy requires each member of the NYSE Euronext board of directors, other than the chief executive officer and deputy chief executive officer of NYSE Euronext, to be independent from: (1) NYSE Euronext and its subsidiaries (including NYSE Group, Euronext and their respective subsidiaries); (2) any member or member organization of the Exchange, NYSE Arca, or NYSE Arca Equities;[49] (3) any non-member broker-dealer that is registered under the Exchange Act and engages in business involving substantial direct contact with securities customers; and (4) any issuer of securities listed on the

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48 The Commission also notes that as a company listed on the Exchange, NYSE Euronext's board of directors must also meet the independence requirements applicable to a listed company's board of directors, as contained in Section 303A of the Exchange's Listed Company Manual.

49 This will include members, allied members (each as defined in the Exchange Rules) and allied persons (as defined in the NYSE Arca and NYSE Arca Equities Rules), member organizations of the Exchange, OTP Firms and OTP Holders of NYSE Arca (each as defined in the Exchange Rules and the rules of NYSE Arca, respectively, as may be in effect from time to time) and ETP Holders of NYSE Arca Equities (as defined in the rules of NYSE Arca Equities, as may be in effect from time to time).

Exchange or NYSE Arca, unless such issuer is a "foreign private issuer" as defined under Rule 3b-4 promulgated under the Exchange Act.[50]

In contrast to the current independence policy of NYSE Group, the Independence Policy will not provide that a person fails to be independent: (1) if he or she is an executive officer of a foreign private issuer of securities listed on the Exchange or NYSE Arca; (2) is a director of an affiliate of a member organization of the Exchange, NYSE Arca, or NYSE Arca Equities;[51] or (3) is a European Person on the board of directors of NYSE Euronext prior to the annual meeting of NYSE Euronext stockholders in 2008. However, the Independence Policy states an executive officer of an issuer whose securities are listed on the Exchange or NYSE Arca (regardless of whether such issuer is a foreign private issuer) and a director of an affiliate of a member organization of the Exchange, NYSE Arca, or NYSE Arca Equities cannot qualify as an independent director of the Exchange, NYSE Market, or NYSE Regulation. In addition, a European Person on the NYSE Euronext board of directors who would not satisfy the independence requirements in the Independence Policy, but for the transition period, cannot qualify as an independent director of the Exchange, NYSE Market, or NYSE Regulation. The prohibition on these persons serving as independent directors of the Exchange, NYSE Market, and NYSE Regulation should help assure that the boards of directors of the Exchange, NYSE

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50 17 CFR 240.3b-4. The Exchange also has proposed that there be a transition period so that the Independence Policy will not apply to the European Persons on the NYSE Euronext board of directors until the annual meeting of NYSE Euronext stockholders in 2008.

51 NYSE further proposes to amend Exchange Rule 2B to clarify that, if a director of an affiliate of a member organization serves as a director of NYSE Euronext, this fact shall not cause such member organization to be an affiliate of the Exchange, or an affiliate of an affiliate of the Exchange. The Commission finds that the Exchange Rule 2B as proposed to be changed, is consistent with the Exchange Act.

Market, and NYSE Regulation are controlled by persons not subject to potential conflicts of interest, and thereby further the goals of Section 6(b)(1) of the Exchange Act.[52]

One commenter[53] expressed concerns that the Independence Policy reflected a weaker independence standard than the current independence policy of NYSE Group. The commenter notes the transition period for European Persons on the NYSE Euronext board of directors as an example of such weakening, among other things. Further, the commenter asserts that the changes will impact the board of directors of NYSE Regulation. In its response to the comments, the Exchange notes that the Independence Policy specifically prohibits: (1) an executive officer of an issuer whose securities are listed on the Exchange or NYSE Arca (regardless of whether such issuer is a foreign private issuer); (2) a European Person on the NYSE Euronext board of directors who would not satisfy the independence requirements in the independence policy but for the transition period; or (3) any director of an affiliate of a member organization from qualifying as an independent director of the Exchange, NYSE Market, or NYSE Regulation.[54] The Exchange also notes that the modifications to the current independence policy of NYSE Group relate only to categorical prohibitions; the NYSE Euronext board of directors will still be required to determine that such persons do not have any material relationship with NYSE Euronext and its subsidiaries in order for them to qualify as independent directors.[55] Further, the Exchange notes that the Independence Policy does not change the

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52 15 U.S.C. 78f(b)(1).

53 See Brown Letter, supra note 4.

54 See NYSE Response to Comments, supra note 5.

55 Id.

independence requirements for NYSE Regulation directors.[56] The Exchange also notes that the Independence Policy was drafted to ensure that it still adequately ensures the independence of the directors of a company controlling U.S. securities exchanges. The Commission believes that the Independence Policy maintains a level of independence that should help to minimize conflicts of interest at the Exchange, NYSE Market, and NYSE Regulation. The Commission finds that these proposals, taken together, are consistent with the Exchange Act, particularly with Section 6(b)(1),[57] which requires an exchange to be so organized and have the capacity to carry out the purposes of the Exchange Act.

The organizational documents of the Exchange, NYSE Market, and NYSE Regulation will be modified to require that a majority of the directors of the boards of each of the Exchange, NYSE Market, and NYSE Regulation be U.S. Persons and any vacancies on such boards created by the departure of a U.S. Person must be filled with a U.S. Person. Additionally, the organizational documents of the Exchange, NYSE Market and NYSE Regulation[58] will be amended to state that any person not meeting the board qualifications of the relevant organizational documents will not be qualified to serve, and therefore will not be eligible to serve, as a director.[59] The Nominating and Governance Committee of NYSE Euronext will be responsible for nominating the candidates to the boards of directors of the Exchange and NYSE Market, and for determining the eligibility of such candidates to serve on such boards (including whether such person qualifies as independent under the Independence Policy, and whether such

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56 Id.

57 15 U.S.C. 78f(b)(1).

58 See supra note 11 and related text.

59 See proposed NYSE Operating Agreement, Article II, Section 2.03, and proposed NYSE Market Bylaws, Article III, Section 1.

person is not a U.S. Disqualified Person). The Commission finds that these proposals, taken together, are consistent with the Exchange Act, particularly Section 6(b)(1),[60] which requires an exchange to be so organized and have the capacity to carry out the purposes of the Exchange Act.

Immediately following the consummation of the Combination, none of the directors of the Exchange, NYSE Market or NYSE Regulation who will serve on such boards will have been elected or appointed by the Nominating and Governance Committee of NYSE Euronext as prescribed in the proposed governing documents of the Exchange, NYSE Market, and NYSE Regulation. However, the Exchange represented that the board members of the Exchange, NYSE Market, and NYSE Regulation immediately preceding the consummation of the Combination – including the directors selected to meet the fair representation requirements of the Exchange Act[61] ("fair representation" directors or candidates) – will be qualified to serve on, and will remain on, the boards of each of the Exchange, NYSE Market, and NYSE Regulation, respectively, following the consummation of the Combination. In light of these circumstances, the Commission believes that the composition of the boards of directors of the Exchange, NYSE Market, and NYSE Regulation is consistent with the Exchange Act.

The NYSE Market Bylaws will be amended to delete the requirement that the chief executive officer of NYSE Group be the chief executive officer of NYSE Market, and to require instead that the chief executive officer of NYSE Market be a U.S. Person.

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60 15 U.S.C. 78f(b)(1).

61 See proposed NYSE Operating Agreement, Article II, Section 2.03, proposed NYSE Market Bylaws, Article III, Section 1, and proposed NYSE Regulation Bylaws, Article III, Section 1.

The amended organizational documents of the Exchange, NYSE Market, and NYSE Regulation will change the time period for member organizations to vote for "fair representation" candidates to 20 calendar days. Currently, if the number of "fair representation" candidates nominated for election to the boards of directors of each of the Exchange, NYSE Market and NYSE Regulation exceeds the number of available "fair representation" positions on such boards, member organizations of the Exchange have 20 business days to submit their votes for the "fair representation" candidates.[62] The Commission believes that the proposed amendment is consistent with Section 6(b)(3) of the Exchange Act,[63] which requires that the rules of an exchange assure fair representation of its members in the selection of its directors and administration of its affairs. Reducing the period for submission of votes from 20 business days to 20 calendar days should still afford members adequate time to consider and submit their votes. The Commission finds that these proposals, taken together, are consistent with the Exchange Act, particularly with Section 6(b)(1),[64] which requires an exchange to be so organized and have the capacity to carry out the purposes of the Exchange Act.

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62 The Commission notes that other than the changes specified in this Section IIA3, the Exchange is not proposing to change any of the provisions relating to (i) assure the fair representation of the members of the Exchange in the selection of its directors and administration of its affairs or (ii) one or more directors of the exchange being representative of issuers and investors and not being associated with a member of the exchange or with a broker dealer, each as required under Section 6(b)(3) of the Exchange Act. 15 U.S.C. 78f(b)(3).

63 15 U.S.C. 78f(b)(3).

64 15 U.S.C. 78f(b)(1).

B. Relationship of NYSE Euronext, NYSE Group, and the U.S. Regulated Subsidiaries; Jurisdiction over NYSE Euronext

Although NYSE Euronext itself will not carry out regulatory functions, its activities with respect to the operation of any of the U.S. Regulated Subsidiaries must be consistent with, and not interfere with, the U.S. Regulated Subsidiaries' self-regulatory obligations. The proposed NYSE Euronext corporate documents include certain provisions that are designed to maintain the independence of the U.S. Regulated Subsidiaries' self-regulatory functions from NYSE Euronext and NYSE Group, enable the U.S. Regulated Subsidiaries to operate in a manner that complies with the U.S. federal securities laws, including the objectives and requirements of Sections 6(b) and 19(g) of the Exchange Act,[65] and facilitate the ability of the U.S. Regulated Subsidiaries and the Commission to fulfill their regulatory and oversight obligations under the Exchange Act.[66]

For example, under the proposed NYSE Euronext Bylaws, NYSE Euronext shall comply with the U.S. federal securities laws, the European Exchange Regulations, and the respective rules and regulations thereunder; shall cooperate with the Commission, the European Regulators, and the U.S. Regulated Subsidiaries.[67] Also, each director, officer, and employee of NYSE Euronext, in discharging his or her responsibilities shall comply with the U.S. federal securities laws and the rules and regulations thereunder, cooperate with the Commission, and cooperate with the U.S. Regulated Subsidiaries.[68] In addition, in discharging his or her responsibilities as a member of the board, each director of NYSE Euronext must, to the fullest extent permitted by

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65 15 U.S.C. 78f(b) and 15 U.S.C. 78s(g).

66 See proposed NYSE Euronext Certificate of Incorporation, Article XIII, and proposed NYSE Euronext Bylaws, Article III, Section 3.15, Article VII, Article VIII, Article IX, and Article X, Section 10.10.

67 See proposed NYSE Euronext Bylaws, Article IX, Sections 9.1 and 9.2.

68 See proposed NYSE Euronext Bylaws, Article III, Section 3.15.

applicable law, take into consideration the effect that NYSE Euronext's actions would have on the ability of the U.S. Regulated Subsidiaries to carry out their responsibilities under the Exchange Act, on the ability of the European Market Subsidiaries to carry out their responsibilities under the European Exchange Regulations as operators of European Regulated Markets, and on the ability of NYSE Group and NYSE Euronext to carry out their responsibilities under the Exchange Act.[69] NYSE Euronext, its directors, officers and employees shall give due regard to the preservation of the independence of the self-regulatory function of the U.S. Regulated Subsidiaries (to the extent of each U.S. Regulated Subsidiary's self-regulatory function) and the European Market Subsidiaries (to the extent of each European Market Subsidiaries' self-regulatory function).[70] Further, NYSE Euronext agrees to keep confidential, to the fullest extent permitted by applicable law, all confidential information pertaining to: (1) the self-regulatory function of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca and NYSE Arca Equities (including but not limited to disciplinary matters, trading data, trading practices and audit information) contained in the books and records of any of the U.S. Regulated Subsidiaries; and (2) the self-regulatory function of the European Market Subsidiaries under the European Exchange Regulations as operator of a European Regulated Market (including but not limited to disciplinary matters, trading data, trading practices and audit information) contained in the books and records of the European Market Subsidiaries, and not use such information for any commercial[71] purposes.[72]

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69 See proposed NYSE Euronext Bylaws, Article III, Section 3.15.

70 See proposed NYSE Euronext Bylaws, Article IX, Sections 9.4 and 9.5.

71 The Commission believes that any non-regulatory use of such information would be for a commercial purpose.

In addition, NYSE Euronext's books and records shall be subject at all times to inspection and copying by the Commission, the European Regulators, any U.S. Regulated Subsidiary (provided that such books and records are related to the operation or administration of such U.S. Regulated Subsidiary or any other U.S. Regulated Subsidiary over which such U.S. Regulated Subsidiary has regulatory authority or oversight) and any European Market Subsidiary (provided that such books and records are related to the operation or administration of such European Market Subsidiary or any European Regulated Market over which such European Market Subsidiary has regulatory authority or oversight).[73] NYSE Euronext's books and records related to U.S. Regulated Subsidiaries shall be maintained within the United States, and NYSE Euronext's books and records related to European Market Subsidiaries shall be maintained in the home jurisdiction of one or more of the European Market Subsidiaries.[74] To the extent that any of NYSE Euronext's books and records relate to both the U.S. Regulated Subsidiaries and the European Market Subsidiaries (each such book and record, an "Overlapping Record"), NYSE Euronext shall be entitled to maintain such books and records in either the United States or the home jurisdiction of one or more of the European Market Subsidiaries.[75] To facilitate compliance with the requirements of Rule 17a-1(b) under the Exchange Act, NYSE Euronext shall maintain in the United States originals or copies of Overlapping Records covered by Rule 17a-1(b) promptly after creation of such Overlapping Records. The Commission notes that NYSE Euronext is liable for any books and records it is required to produce for inspection and

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72 See proposed NYSE Euronext Bylaws, Article VIII, Section 8.1.

73 See proposed NYSE Euronext Bylaws, Article VIII, Section 8.3.

74 See proposed NYSE Euronext Bylaws, Article VIII, Sections 8.4 and 8.5.

75 See proposed NYSE Euronext Bylaws, Article VIII, Section 8.6.

copying by the Commission that are created outside the United States and where the law of a foreign jurisdiction prohibits NYSE Euronext from providing such books and records to the Commission for inspection and copying.

In addition, for so long as NYSE Euronext directly or indirectly controls any U.S. Regulated Subsidiary, the books, records, premises, officers, directors, and employees of NYSE Euronext shall be deemed to be the books, records, premises, officers, directors, and employees of the U.S. Regulated Subsidiaries for purposes of and subject to oversight pursuant to the Exchange Act, and for so long as NYSE Euronext directly or indirectly controls any European Market Subsidiary, the books, records, premises, officers, directors, and employees of NYSE Euronext shall be deemed to be the books, records, premises, officers, directors, and employees of such European Market Subsidiaries for purposes of and subject to oversight pursuant to the European Exchange Regulations.[76]

NYSE Euronext, its directors and officers, and those of its employees whose principal place of business and residence is outside of the United States irrevocably submit to the jurisdiction of the U.S. federal courts and the Commission with respect to activities relating to the U.S. Regulated Subsidiaries, and to the jurisdiction of the European Regulators and European courts with respect to activities relating to the European Market Subsidiaries.[77]

Each of NYSE Euronext, NYSE Group, the Exchange and NYSE Market acknowledges that it is responsible for referring possible rule violations to NYSE Regulation. In addition, there will be an explicit agreement among NYSE Euronext, NYSE Group, the Exchange, NYSE

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76 See proposed NYSE Euronext Bylaws, Article VIII, Sections 8.4 and 8.5.

77 See proposed NYSE Euronext Bylaws, Article VII, Sections 7.1 and 7.2.

Market and NYSE Regulation to provide adequate funding for NYSE Regulation, as is currently the case among the NYSE Group entities.

Finally, the proposed NYSE Euronext Certificate of Incorporation and proposed NYSE Euronext Bylaws require that, for so long as NYSE Euronext controls, directly or indirectly, any of the U.S. Regulated Subsidiaries, any changes to the proposed NYSE Euronext Certificate of Incorporation and proposed NYSE Euronext Bylaws be submitted to the board of directors of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca, and NYSE Arca Equities, and if any such boards of directors determines that such amendment is required to be filed with or filed with and approved by the Commission pursuant to Section 19 of the Exchange Act[78] and the rules thereunder, such change shall not be effective until filed with or filed with and approved by, the Commission.[79]

The Commission finds that these provisions are consistent with the Exchange Act, and that they are intended to assist the Exchange in fulfilling its self-regulatory obligations and in administering and complying with the requirements of the Exchange Act. With respect to the maintenance of books and records of NYSE Euronext, the Commission notes that while NYSE Euronext has the discretion to maintain Overlapping Records in either the United States or the home jurisdiction of one or more of the European Market Subsidiaries, NYSE Euronext has represented to the Commission that it will maintain in the United States originals or copies of Overlapping Records covered by Rule 17a-1(b) under the Exchange Act[80] promptly after

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78 15 U.S.C. 78s.

79 See proposed NYSE Group Certificate of Incorporation, Article XII and proposed NYSE Group Bylaws, Article VII, Section 7.9.

80 17 CFR 240.17a-1(b).

creation of such Overlapping Records. The Commission believes that such actions by NYSE Euronext with respect to its books and records are necessary to ensure that the U.S. Regulated Subsidiaries comply with the requirements of Section 17 of the Exchange Act[81] and Rule 17a-1(b) thereunder.[82]

Under Section 20(a) of the Exchange Act,[83] any person with a controlling interest in the Exchange or NYSE Arca shall be jointly and severally liable with and to the same extent that the Exchange and NYSE Arca are liable under any provision of the Exchange Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Exchange Act[84] creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of the Exchange Act or rule thereunder. Further, Section 21C of the Exchange Act[85] authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Exchange Act through an act or omission that the person knew or should have known would contribute to the violation. These provisions are applicable to NYSE Euronext's and NYSE Group's dealings with the U.S. Regulated Subsidiaries.

C. Trust

NYSE Euronext will operate several regulated entities located in the United States and in various jurisdictions in Europe. As described in the Notice, in connection with obtaining

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81 15 U.S.C. 78q.

82 17 CFR 240.17a-1(b).

83 15 U.S.C. 78t(a).

84 15 U.S.C. 78t(e).

85 15 U.S.C. 78u-3.

regulatory approval of the Combination, NYSE Euronext proposed to implement two standby structures, one involving a Delaware trust and one involving a Dutch foundation ("Dutch Foundation"). Pursuant to the terms of the Trust Agreement,[86] the Delaware trust ("Trust") will be empowered to take actions to mitigate the effects of any material adverse change in European law that has an "extraterritorial" impact on the non-European issuers listed on NYSE Group securities exchanges, non-European financial services firms that are members of any NYSE Group securities exchange, or any NYSE Group securities exchange.[87]

Upon the occurrence of a material adverse change of law[88] that continues after the cure periods described below, the Trust may exercise certain remedies that result in a total or partial loss by NYSE Euronext of operating control over some of its securities exchanges. The Trust may require that NYSE Euronext transfer control over a substantial portion of its business and assets to the direction of the Trust. As a result, control of NYSE Group or any NYSE Group securities exchange may be assumed by the Trust. As discussed above, Section 19(b) of the Exchange Act and Rule 19b-4 thereunder require an SRO to file a proposed rule change with the Commission. Although the Trust is not an SRO, certain provisions of the Trust Agreement are

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86 See proposed Trust Agreement, by and among NYSE Euronext, NYSE Group, the Delaware trustee, and the trustees, attached as Exhibit 5M to Amendment No. 1 ("Trust Agreement").

87 The Dutch Foundation will be empowered to take actions intended to mitigate the effects of any material adverse change in U.S. law that has an "extraterritorial" impact on non-U.S. issuers listed on Euronext markets, non-U.S. financial services firms that are members of Euronext markets or holders of exchange licenses with respect to the Euronext markets. The Exchange described the proposed Dutch Foundation in the Notice, supra note 3.

88 What constitutes a material adverse change of law is described in the Notice, supra note 3, at 824-825.

rules of an exchange[89] if they are stated policies, practice, or interpretations, as defined in Rule 19b-4 under the Exchange Act,[90] of the exchange, and must be filed with the Commission pursuant to Section 19(b)(4) of the Exchange Act[91] and Rule 19b-4 thereunder. Accordingly, the Exchange has filed the Trust Agreement with the Commission.

1. Governance of the Trust

The Trust will be administered by a board of three trustees.[92] The initial trustees of the Trust will be selected jointly by NYSE Group and Euronext prior to the Combination, with successor members to be selected by the nominating and governance committee of the NYSE Euronext board of directors.[93]

Pursuant to the Trust Agreement, actions of the Trust will require majority approval of the members of the board of trustees, following reasonable consultation and good-faith

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89 See Section 3(a)(27) of the Exchange Act, 15 U.S.C. 78c(a)(27). If NYSE Euronext decides to change its Amended and Restated Certificate of Incorporation or Amended and Restated Bylaws, NYSE Euronext must submit such change to the board of directors of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca, and NYSE Arca Equities, and if any or all of such board of directors shall determine that such amendment or repeal must be filed with or filed with and approved by the Commission pursuant to Section 19 of the Exchange Act and the rules thereunder, such change shall not be effective until filed with or filed with and approved by the Commission, as applicable. See proposed NYSE Euronext Certificate of Incorporation, Article X and proposed NYSE Euronext Bylaws, Article X, Section 10.10(C).

90 17 CFR 240.19b-4.

91 15 U.S.C. 78s(b).

92 See Trust Agreement, Article III, Section 3.2.

93 See Trust Agreement, Article III, Section 3.4. The initial term of the Trust will be ten years from the date of the consummation of the Combination, renewable for successive one-year terms; provided, however, that any extension that would cause the term of the Trust to continue past the 20th anniversary of the date of the consummation of the Combination shall require the prior written consent of NYSE Euronext. See Trust Agreement, Article II, Section 2.5.

cooperation with NYSE Euronext.[94] In determining whether a material adverse change of law has occurred and the exercise of the remedies, and in exercising its rights and powers during the pendency of a material adverse change of law, the duty of the Trust and its trustees shall be to act in the public interests of the markets operated by NYSE Group and its subsidiaries if and only to the extent necessary to avoid or eliminate the impact or effect of a material adverse change of law. In all other circumstances, the duty of the Trust and its trustees shall be to act in the best interests of NYSE Euronext.[95] In addition, the Trust and trustees shall comply with the U.S. federal securities laws and the rules and regulations thereunder and shall cooperate (and take reasonable steps necessary to cause its agents to cooperate) with the Commission and the U.S. Regulated Subsidiaries pursuant to and to the extent of their respective regulatory authority.[96]

Under the Trust Agreement, if a material adverse change in law occurs with respect to a NYSE Group securities exchange (an "affected subsidiary") and shall continue after the cure periods specified below, the board of trustees of the Trust may exercise several remedies following prior notice to, and, if required under then applicable laws, prior approval by, the Commission.

After a cure period of six months, the board of trustees of the Trust may deliver confidential or public and non-binding or binding advice to NYSE Group and NYSE Euronext with respect to the affected subsidiary relating to decisions regarding: (1) changes to the rules of an affected subsidiary; (2) decisions to enter into (or not enter into) or alter the terms of listing agreements of an affected subsidiary; (3) decisions to enter into (or not enter into) or alter the

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94 See Trust Agreement, Article III, Sections 3.5 and 3.6.

95 See Trust Agreement, Article II, Section 2.3 and Article III, Section 3.6.

96 See Trust Agreement, Article V, Sections 5.2 and 5.3.

terms of contractual arrangements with any non-European financial services firms in relation to an affected subsidiary; (4) changes in information and communications technologies for an affected subsidiary; and (5) changes in clearing and settlement for an affected subsidiary ((1) through (5), together the "Assumed Matters").[97]

After a cure period of six months, the board of trustees of the Trust may assume management responsibilities of NYSE Group or its affected subsidiary with respect to some or all of the Assumed Matters. The board of trustees of the Trust may exercise a call option over priority shares issued by NYSE Group or its affected subsidiary, which priority shares will carry no or a limited economic right or interest and the right to vote on, make proposals with respect to and impose consent requirements to approve actions in relation to, the Assumed Matters.[98]

After a cure period of nine months, the board of trustees of the Trust may exercise a call option over the common stock or voting securities of NYSE Group or its affected subsidiary, in each case, with such common stock, ordinary shares or voting securities being the minimum number necessary, in the reasonable opinion of the trustees of the Trust, to cause all affected subsidiaries to cease to be subject to a material adverse change of law.[99]

Furthermore, subject to any required approval by the Commission, the Trust shall be entitled to give confidential non-binding advice to NYSE Euronext at any time before the end of the above-mentioned cure period and NYSE Euronext shall be entitled, in its sole discretion, to implement any remedy at any time before the end of such cure period. [100]

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97 See Trust Agreement, Article IV, Section 4.1.

98 See Trust Agreement, Article IV, Section 4.1.

99 Id.

100 Id.

Any of the above remedies may be imposed only if and to the extent that such remedy: (1) causes all affected subsidiaries to cease to be subject to a material adverse change of European law; and (2) is the remedy available that causes the least intrusion on the conduct of the business and operations of NYSE Euronext and NYSE Group, and its subsidiaries, including the affected subsidiaries, by their respective governing bodies.[101]

In addition, prior to the exercise of a call option, the board of trustees of the Trust must determine that no other remedy can cause all of the affected subsidiaries to cease to be subject to a material adverse change of law; consult with the NYSE Euronext board of directors; and, in the case of a material adverse change in law with respect to a NYSE Group securities exchange, consult with the NYSE Group board of directors and the Commission to consider the solutions available to address the situation that has arisen and would trigger the right of the Trust to exercise the remedies described above, taking into account any possible adverse consequences for NYSE Euronext or NYSE Group in terms of taxation or accounting treatment.[102]

If and when any of the conditions of a material adverse change of law cease, any and all remedies shall be immediately unwound. NYSE Euronext shall have the right, at any time and regardless of whether a change of law continues to be a material adverse change of law, to request and cause the unwinding of any remedy for the purpose of and to the extent necessary to

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101 Id. In determining whether a remedy causes the least intrusion, negative control by the Trust shall be preferred over affirmative control by the Trust, and authority of the Trust shall be asserted over the fewest and most narrow decisions of NYSE Euronext and its subsidiaries. A remedy covering fewer entities and subsidiary entities shall be preferred over a remedy covering more entities and parent entities. The call option over the priority shares shall be viewed as a remedy of last resort among the remedies that are available after the six-month cure period, and the call option over the common stock, ordinary shares and voting securities shall be viewed as a remedy of last resort among all remedies. See Trust Agreement, Article IV, Section 4.1.

102 See Trust Agreement, Article IV, Section 4.1.

effect a divesture or spin-off of all or part of its interest in NYSE Group or NYSE Euronext, as applicable, or any subsidiary of NYSE Euronext operating an exchange that is affected by a material adverse change of law, as the case may be.[103]

2. Relationship of the Trust, NYSE Group, and the U.S. Regulated Subsidiaries; Jurisdiction Over the Trust

Although the Trust itself will not carry out regulatory functions, its activities with respect to the operation of NYSE Group and any of the U.S. Regulated Subsidiaries must be consistent with, and not interfere with, the U.S. Regulated Subsidiaries' self-regulatory obligations. The Trust Agreement includes certain provisions that are designed to maintain the independence of the U.S. Regulated Subsidiaries' self-regulatory functions from the Trust, enable the U.S. Regulated Subsidiaries to operate in a manner that complies with the U.S. federal securities laws, including the objectives and requirements of Sections 6(b) and 19(g) of the Exchange Act, and facilitate the ability of the U.S. Regulated Subsidiaries and the Commission to fulfill their regulatory and oversight obligations under the Exchange Act.[104]

For example, under the Trust Agreement, the Trust shall comply with the U.S. federal securities laws and the rules and regulations thereunder, and shall cooperate with the Commission and the U.S. Regulated Subsidiaries.[105] Also, each trustee, officer, and employee of the Trust, in discharging his or her responsibilities in such capacity, shall comply with the U.S. federal securities laws and the rules and regulations thereunder, cooperate with the Commission,

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103 See Trust Agreement, Article IV, Section 4.4.

104 See Trust Agreement, Articles V, VI, and VIII.

105 See Trust Agreement, Article V, Section 5.3(a).

and cooperate with the U.S. Regulated Subsidiaries.[106] In addition, in discharging his or her responsibilities as a trustee, each trustee must, to the fullest extent permitted by applicable law, take into consideration the effect that the Trust's actions would have on the ability of the U.S. Regulated Subsidiaries, NYSE Euronext and NYSE Group to discharge their respective responsibilities under the Exchange Act.[107] The Trust, trustees, and the officers and employees of the Trust shall give due regard to the preservation of the independence of the self-regulatory function of the U.S. Regulated Subsidiaries (to the extent of each U.S. Regulated Subsidiary's self-regulatory function) and shall not take any action that would interfere with the effectuation of any decision by the board of directors or managers of the U.S. Regulated Subsidiaries relating to their regulatory responsibilities or that would interfere with the ability of the U.S. Regulated Subsidiaries to carry out their respective responsibilities under the Exchange Act.[108] The Trust, the trustees, and the officers and employees of the Trust whose principal place of business and residence is outside of the United States irrevocably submit to the jurisdiction of the U.S. federal courts and the Commission with respect to activities relating to the U.S. Regulated Subsidiaries.[109]

In addition, the Trust's books and records shall be subject at all times to inspection and copying by the Commission, NYSE Euronext, NYSE Group, and any U.S. Regulated Subsidiary (provided that such books and records are related to the operation or administration of such U.S. Regulated Subsidiary or any other U.S. Regulated Subsidiary over which such U.S. Regulated

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106 See Trust Agreement, Article V, Section 5.2 (a).

107 See Trust Agreement, Article V, Section 5.1(a).

108 See Trust Agreement, Article V, Section 5.1(b).

109 See Trust Agreement, Article V, Section 5.4.

Subsidiary has regulatory authority or oversight).[110] The Trust's books and records related to U.S. Regulated Subsidiaries shall be maintained within the United States.[111]

In addition, for so long as the Trust directly or indirectly controls any U.S. Regulated Subsidiary, the books, records, premises, officers, trustees, and employees of the Trust shall be deemed to be the books, records, premises, officers, trustees, and employees of the U.S. Regulated Subsidiaries for purposes of and subject to oversight pursuant to the Exchange Act.[112] Further, the Trust agrees to keep confidential, to the fullest extent permitted by applicable law, all confidential information pertaining to the self-regulatory function of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca and NYSE Arca Equities (including but not limited to disciplinary matters, trading data, trading practices and audit information) contained in the books and records of any of the U.S. Regulated Subsidiaries and not use such information for any commercial[113] purposes.[114] The Commission notes that the proposed governing documents of NYSE Euronext and NYSE Group contain similar confidentiality provisions regarding information pertaining to the self-regulatory function of the Exchange, NYSE Market, NYSE

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110 See Trust Agreement, Article VI, Section 6.3.

111 See Trust Agreement, Article VI, Section 6.1(b).

112 Id.

113 The Commission believes that any non-regulatory use of such information would be for a commercial purpose.

114 See Trust Agreement, Article VI, Section 6.1. The Trust Agreement states that none of its provisions shall be interpreted so as to limit or impede the rights of the Commission or any of the U.S. Regulated Subsidiaries to have access to and examine such confidential information pursuant to the U.S. federal securities laws and the rules and regulations thereunder, or to limit or impede the ability of any trustees, officers, directors, employees, or agents of NYSE Euronext or the Trust to disclose such confidential information to the Commission or the U.S. Regulated Subsidiaries. See Trust Agreement, Article VI, Section 6.2.

Regulation, NYSE Arca, and NYSE Arca Equities.[115] The Commission believes that confidentiality provisions in the proposed NYSE Euronext Bylaws and proposed NYSE Group Certificate of Incorporation apply to any such confidential information obtained by NYSE Euronext or NYSE Group, including that which comes into their possession through the Trust.

The Trust Agreement provides that in no event shall the Trust sell, transfer, convey, assign, dispose, pledge (or agree to sell, transfer, convey, assign, dispose or pledge) any property of the Trust, except pursuant to the unwinding of the remedies, or in circumstances permitted by the Trust Agreement and pursuant to written instructions from NYSE Euronext approved by the board of directors of NYSE Euronext. In addition to the foregoing, any transfer, conveyance, assignment, disposition or pledge by the Trust or any trustee of any equity interest in, or all or substantially all of the assets of, the Exchange, NYSE Market, NYSE Regulation, NYSE Arca LLC, NYSE Arca, or NYSE Arca Equities (other than any such transfer or disposition to NYSE Euronext or its subsidiaries pursuant to the unwinding of remedies) shall not be effected until filed with the Commission under Section 19 of the Exchange Act.[116]

The Trust Agreement requires that it may only be amended with prior written approval of the Commission, as and to the extent required under the Exchange Act.[117] Further, for so long as NYSE Euronext or the Trust shall control, directly or indirectly, any of the U.S. Regulated

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115 See proposed NYSE Euronext Bylaws, Article VIII and proposed NYSE Group Certificate of Incorporation, Article X.

116 See Trust Agreement, Article IV, Section 4.3. The proposed rule change also includes modifications to the organizational documents of the Exchange, NYSE Market, and NYSE Regulation so that the a transfer of the equity interests of the Exchange, NYSE Market, and NYSE Regulation pursuant to the terms of the Trust Agreement is permitted under such organizational documents.

117 See Trust Agreement, Article VIII, Section 8.2.

Subsidiaries, before any amendment or repeal of any provision of the Trust Agreement shall be effective, such amendment or repeal must be submitted to the boards of directors of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca, and NYSE Arca Equities. If any such boards of directors determines that such amendment or repeal is required to be filed with or filed with and approved by the Commission pursuant to Section 19 of the Exchange Act[118] and the rules thereunder, such change shall not be effective until filed with or filed with and approved by the Commission.[119]

The Commission finds that the Trust Agreement's provisions are designed to enable the U.S. Regulated Subsidiaries to operate in a manner that complies with the federal securities laws, including the objectives and requirements of Sections 6(b) and 19(g) of the Exchange Act,[120] facilitate the ability of the U.S. Regulated Subsidiaries and the Commission to fulfill their regulatory and oversight obligations under the Exchange Act,[121] and are consistent with the provisions other entities that directly or indirectly own or control an SRO have instituted and that have been approved by the Commission.[122] The Commission finds that the Trust's provisions are consistent with the Exchange Act, and that they are intended to assist the Exchange in fulfilling its self-regulatory obligations and in administering and complying with the requirements of the Exchange Act.

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118 15 U.S.C. 78s.

119 See Trust Agreement, Article VIII, Section 8.2.

120 15 U.S.C. 78f(b) and 15 U.S.C. 78s(g).

121 See Trust Agreement, Articles V, VI, and VIII.

122 See, e.g., NYSE Inc.-Archipelago Merger Order, supra note 32.

Under Section 20(a) of the Exchange Act,[123] any person with a controlling interest in the Exchange or NYSE Arca shall be jointly and severally liable with and to the same extent that the Exchange and NYSE Arca are liable under any provision of the Exchange Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Exchange Act[124] creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of the Exchange Act or rule thereunder. Further, Section 21C of the Exchange Act[125] authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Exchange Act through an act or omission that the person knew or should have known would contribute to the violation. These provisions are applicable to the Trust and all other entities controlling the U.S. Regulated Subsidiaries.

D. Automatic Suspension and Repeal of Certain Provisions in the NYSE Euronext Organizational Documents

Under the organizational documents of NYSE Euronext, immediately following the exercise of a call option over a substantial portion of Euronext's business (a "Euronext call option"), whereby the priority shares or ordinary shares of Euronext are transferred from NYSE Euronext to the Dutch Foundation, and for so long as the Dutch Foundation shall continue to hold any priority shares or ordinary shares of Euronext, or the voting securities of one or more of

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123 15 U.S.C. 78t(a).

124 15 U.S.C. 78t(e).

125 15 U.S.C. 78u-3.

the subsidiaries of Euronext that, taken together, represent a substantial portion of Euronext's business, then certain provisions of the proposed NYSE Euronext Bylaws shall be suspended.[126]

In addition, if after a period of six months following the exercise of a Euronext call option, the Dutch Foundation shall continue to hold any ordinary or priority shares of Euronext or any ordinary or priority shares or similar voting securities of one or more subsidiaries of Euronext that, taken together, represent a substantial portion of Euronext's business, or if at any time, NYSE Euronext no longer holds a direct or indirect controlling interest in Euronext or in one or more subsidiaries of Euronext that, taken together, represent a substantial portion of Euronext's business, then certain provisions of the proposed NYSE Euronext Bylaws and the proposed NYSE Euronext Certificate of Incorporation shall be revoked.[127] In addition, any officer or director of NYSE Euronext who is a European Person shall resign or be removed from his or her office.

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126 These include the requirement that European Persons are represented in a certain proportion on the NYSE Euronext board of directors and the nominating and governance committee of the NYSE Euronext board of directors; the requirement of supermajority board or shareholder approval for certain extraordinary transactions; the provisions granting jurisdiction to European regulators over certain actions of NYSE Euronext and the NYSE Euronext board of directors; and references to European regulators, European market subsidiaries and European disqualified persons appearing in the proposed NYSE Euronext Bylaws.

127 These include the provisions of the proposed NYSE Euronext Bylaws subject to suspension; the references in the proposed NYSE Euronext Certificate of Incorporation and proposed NYSE Euronext Bylaws to European regulators, European exchange regulations, European market subsidiaries, European regulated markets, Europe and European disqualified persons; the provisions in the proposed NYSE Euronext Certificate of Incorporation and proposed NYSE Euronext Bylaws requiring that amendments to such certificate of incorporation or bylaws be submitted to the European market subsidiaries and, if applicable, filed with and approved by a European regulator; and the provisions in the proposed NYSE Euronext Bylaws requiring approval of either two-thirds or more of the NYSE Euronext directors or 80% of the votes entitled to be cast by the holders of the then-outstanding shares of capital stock of NYSE Euronext entitled to vote generally in the election of directors to amend certain bylaw provisions.

The Commission finds the suspension or repeal of the above described provisions of the proposed NYSE Euronext Bylaws and the proposed NYSE Euronext Certificate of Incorporation under circumstances in which the Dutch Foundation controls a substantial portion of Euronext's business, is consistent with the Exchange Act.

E. Listing of NYSE Euronext's or an Affiliate's Securities

NYSE Euronext intends to list its shares of common stock for trading on the Exchange, as well as on Euronext Paris. Pursuant to the proposed amendments to NYSE Rule 497, any security of NYSE Euronext and its affiliates shall not be approved for listing on the Exchange unless NYSE Regulation determines that such securities satisfy the Exchange's rules for listing, and such finding is approved by the NYSE Regulation board of directors.[128] The Commission finds that the proposed procedure for the initial listing of NYSE Euronext common stock is consistent with the Exchange Act.

NYSE Regulation will be responsible for all Exchange listing-compliance decisions with respect to NYSE Euronext as an issuer. As in the case of NYSE Group under current Exchange Rule 497, NYSE Regulation will prepare a quarterly report summarizing its monitoring of NYSE Euronext common stock's compliance with such listing standards and its monitoring of trading in such securities. This report will be provided to the NYSE board of directors and to the Commission. Any notification of lack of compliance with any applicable listing standard from NYSE Regulation to NYSE Euronext or an affiliate, and any corresponding plan of compliance, must be reported to the Commission. Once a year, an independent accounting firm will review NYSE Euronext's or any affiliated issuer's compliance with the Exchange's listing standards and

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128 The Exchange proposes to delete Exchange Rule 497T (Transition Rules for the First Listed Security Issued by NYSE Group, Inc.), which is now obsolete.

a copy of this report will be forwarded to the Commission. The Commission believes that the procedures for monitoring of the listing of and trading of NYSE Euronext's or an affiliate's securities are consistent with the Act.

F. Options Trading Rights

The Commission received a comment letter[129] on the proposed rule change regarding certain Option Trading Rights ("OTRs") that were separated from full New York Stock Exchange, Inc. [130] seats ("Separated OTRs"). All New York Stock Exchange seat ownership (with or without OTRs) was extinguished in the 2006 demutualization of New York Stock Exchange, Inc.[131] Although the commenter supports the Combination, it contends that the owners of Separated OTRs retained their Separated OTRs, even after the New York Stock Exchange, Inc. exited the options business in 1997, with the expectation that their ownership of the Separated OTRs would afford them full rights to trade options under the auspices of New York Stock Exchange, Inc. or its successor entity. The commenter contends that such ownership gives a right to trade options on NYSE Market and NYSE Arca, and after the Combination, Euronext. The commenter refers to its comment letters in connection with the demutualization of New York Stock Exchange, Inc. in its merger with Archipelago.[132]

The issue of the rights of owners of Separated OTRs is not before the Commission in the context of this rule filing. Pursuant to Section 19(b)(1) of the Exchange Act,[133] an SRO (such as

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129 See OTR Investors Letter, supra note 4.

130 New York Stock Exchange, Inc. is the predecessor entity to NYSE. See NYSE Inc.-Archipelago Merger Order, supra note 32.

131 See NYSE Inc.-Archipelago Merger Order, supra note 32.

132 See NYSE Inc.-Archipelago Merger Order, supra note 32, at note 6.

133 15 U.S.C. 78s(b)(1).

NYSE) is required to file with the Commission any proposed rule or any proposed change in, addition to, or deletion from the rules of such SRO. Further, pursuant to Section 19(b)(2) of the Exchange Act,[134] the Commission shall approve a proposed rule change filed by an SRO if the Commission finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to the SRO. The NYSE is not proposing in this filing a change in the trading rights on the Exchange.

III. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act[135] that the proposed rule change (SR-NYSE-2006-120) is approved, and Amendment No. 1 is approved on an accelerated basis.

By the Commission.

Nancy M. Morris
Secretary

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134 15 U.S.C. 78s(b)(2).

135 Id.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55294; File No. SR-NYSEArca-2007-05)

February 14, 2007

Self-Regulatory Organizations; NYSE Arca, Inc.; Order Granting Accelerated Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 Regarding a Proposed Combination Between NYSE Group, Inc. and Euronext N.V.

I. Introduction

On January 12, 2007, NYSE Arca, Inc. ("NYSE Arca" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended, ("Exchange Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change regarding the proposed business combination ("Combination") between NYSE Group, Inc. ("NYSE Group") and Euronext N.V. ("Euronext"). The proposed rule change was published for comment in the Federal Register on January 19, 2007.[3] The Commission received no comments on the proposal. On February 13, 2007, the Exchange filed Amendment No. 1 to the proposed rule change.[4] This order grants accelerated approval to the proposed rule change, grants accelerated approval to Amendment No. 1, and solicits comments from interested persons on Amendment No. 1.

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1 15 U.S.C. 78s(b)(l).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 55109 (January 16, 2007), 72 FR 2578 ("Notice").

4 See Partial Amendment dated February 13, 2007 ("Amendment No. 1"). The text of Amendment No. 1 and Exhibits 5C, 5D, 5G, and 5H, which set forth certain governing documents as proposed to be amended, are available on the Commission's Web site (http://www.sec.gov/rules/sro.shtml), at the Commission's Public Reference Room, at the Exchange, and on the Exchange's Web site (http://www.nysearca.com).

The Commission has reviewed carefully the proposed rule change and finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.[5] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b) of the Exchange Act,[6] which, among other things, requires a national securities exchange to be so organized and have the capacity to be able to carry out the purposes of the Exchange Act and to enforce compliance by its members and persons associated with its members with the provisions of the Exchange Act, the rules and regulations thereunder, and the rules of the exchange, and assure the fair representation of its members in the selection of its directors and administration of its affairs, and provide that one or more directors shall be representative of issuers and investors and not be associated with a member of the exchange, broker, or dealer. Section 6(b) of the Exchange Act[7] also requires that the rules of the exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission finds good cause for approving this proposed rule change before the thirtieth day after the publication of notice thereof in the Federal Register. This proposed rule change seeks to make changes to the following documents: the Amended and Restated Certificate of Incorporation of NYSE Euronext ("NYSE Euronext Certificate of Incorporation"); the Amended and Restated Bylaws of NYSE Euronext ("NYSE Euronext Bylaws"); the NYSE

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5 In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

6 15 U.S.C. 78f(b).

7 Id.

Euronext Director Independence Policy ("Independence Policy"), which policy will replace the current NYSE Group Director Independence Policy; the proposed Amended and Restated Certificate of Incorporation of NYSE Group ("NYSE Group Certificate of Incorporation"); the proposed Amended and Restated Bylaws of NYSE Group ("NYSE Group Bylaws"); the resolutions of the board of directors of NYSE Group; and the proposed Trust Agreement for the Delaware Trust ("Trust Agreement"). All of the proposed changes to these documents were published for comment in connection with the proposed rule change submitted by the New York Stock Exchange LLC ("NYSE LLC") in connection with the Combination.[8] In addition to these changes, the Exchange has proposed changes to the proposed Amended and Restated Certificate of Incorporation of Archipelago Holdings, Inc. ("Arca Holdings") to allow for the ownership and voting of shares of Arca Holdings by the Delaware Trust ("Trust").[9] The Commission has received no comment letters on this proposal. The Commission finds good cause to accelerate approval of this proposal to allow the timing of this approval to coincide with the approval of the corresponding filing by the NYSE LLC.[10]

A. Accelerated Approval of Amendment No. 1

The Commission also finds good cause for approving Amendment No. 1 prior to the thirtieth day after publishing notice of Amendment No. 1 in the Federal Register pursuant to

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8 See Securities Exchange Act Release No. 55026 (December 29, 2006), 72 FR 814 (January 8, 2007) ("NYSE LLC Rule Filing").

9 Similar changes have been proposed for NYSE Group. See proposed NYSE Group Certificate of Incorporation, Article IV, Section 4.

10 See Securities Exchange Act Release No. 55293 (February 14, 2007) (approval order for SR-NYSE-2006-120 ("NYSE LLC Approval Order")).

Section 19(b)(2) of the Exchange Act.[11] In Amendment No. 1, the Exchange made technical revisions to proposed Article VII, Section 2 of the proposed NYSE Group Certificate of Incorporation relating to quorum requirements for each meeting of stockholders.[12] These changes are necessary to clarify the proposal. The Commission finds good cause to accelerate approval of these changes prior to the thirtieth day after publication in the Federal Register because they clarify the Exchange's rules, which should facilitate the Exchange's compliance with its rules, and the Commission's ability to ensure compliance with such rules, and assist members and investors in understanding the application and scope of the rules.

In addition, the Exchange made certain clarifying, conforming, technical, non-material, and non-substantive changes to the proposed Amended and Restated Certificate of Incorporation of Arca Holdings ("Arca Holdings Certificate of Incorporation"), the proposed NYSE Group Certificate of Incorporation, the Independence Policy, and the proposed Trust Agreement, which raise no new or novel issues. These changes are non-substantive and technical in nature and are necessary to reflect the changes from the current rules of the Exchange and clarify the proposal. The Commission finds good cause exists to accelerate approval of these changes prior to the thirtieth day after publication in the Federal Register because they clarify the Exchange's rules, which should facilitate the Exchange's compliance with its rules, the Commission's ability to

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11 15 U.S.C. 78s(b)(2). Pursuant to Section 19(b)(2) of the Exchange Act, the Commission may not approve any proposed rule change, or amendment thereto, prior to the thirtieth day after the date of publication of the notice thereof, unless the Commission finds good cause for so doing.

12 In the Notice, the Exchange mistakenly showed proposed deletions to the current quorum requirements. The Exchange is not proposing to change the quorum requirements that exist in the current NYSE Group Certificate of Incorporation.

ensure compliance with such rules, and assist members and investors in understanding the application and scope of the rules.

The Commission finds that the changes proposed in Amendment No. 1 are consistent with the Exchange Act and therefore finds good cause to accelerate approval of Amendment No. 1, pursuant to Section 19(b)(2) of the Exchange Act.[13]

B. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-NYSEArca-2007-05 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-NYSEArca-2007-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro-shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the

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[13] 15 U.S.C. 78s(b)(2).

proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to Amendment No. 1 of File Number SR-NYSEArca-2007-05 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

II. Discussion

The Exchange has submitted the proposed rule change in connection with the Combination of NYSE Group with Euronext. As a result of the Combination, the businesses of NYSE Group (including the businesses of the Exchange and NYSE LLC (a New York limited liability company, registered national securities exchange and self-regulatory organization)), and Euronext will be held under a single, publicly traded holding company named NYSE Euronext, a Delaware corporation ("NYSE Euronext"). Following the Combination, each of NYSE Group and Euronext will be a separate subsidiary of NYSE Euronext, and their respective businesses and assets will continue to be held as they are currently held (subject to any post-closing corporate reorganization of Euronext). The proposed rule change is necessary to effectuate the consummation of the Combination and will not be operative until the consummation of the Combination.

A. Corporate Structure

After the Combination, Arca Holdings, a Delaware corporation, will remain a wholly owned subsidiary of NYSE Group. NYSE Arca Holdings, Inc., a Delaware corporation ("NYSE Arca Holdings"), and NYSE Arca L.L.C., a Delaware limited liability company ("NYSE Arca LLC"), will remain wholly owned subsidiaries of Arca Holdings. NYSE Arca will remain a wholly owned subsidiary of NYSE Arca Holdings, and NYSE Arca Equities, Inc. ("NYSE Arca Equities"), a Delaware corporation formerly known as PCX Equities, Inc., will remain a wholly owned subsidiary of NYSE Arca. NYSE Arca will continue to maintain its status as a registered national securities exchange and self-regulatory organization. Arca Holdings' businesses and assets will continue to be held by it and its subsidiaries. NYSE LLC will remain a wholly owned subsidiary of NYSE Group. NYSE Market, Inc. ("NYSE Market"), a Delaware corporation, and NYSE Regulation, Inc. ("NYSE Regulation"), a New York Type A not-for-profit corporation, will remain wholly owned subsidiaries of NYSE LLC.[14]

The Exchange represents that the Combination will also have no effect on the ability of any party to trade securities on NYSE Arca, NYSE Arca Equities, or NYSE Market. Euronext and it subsidiaries will continue to operate their business and operations in substantially the same

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[14] For a description of the Combination and related rule changes regarding NYSE Euronext, NYSE Group, and the Trust, see the NYSE LLC Approval Order, supra note 10. See also NYSE LLC Rule Filing, supra note 8. The Combination involves certain modifications to the organizational documents of NYSE Group and of NYSE Euronext, which upon consummation of the Combination will be the new indirect parent company of NYSE LLC and of the Exchange. Provisions of the organizational documents of NYSE Group and NYSE Euronext and the Trust Agreement constitute rules of NYSE LLC and of the Exchange. The resolutions of the board of directors of NYSE Group are also rules of NYSE LLC and of the Exchange requiring Commission approval. Accordingly, NYSE LLC and the Exchange have each submitted proposed rule changes to reflect the rule changes to be implemented in connection with the Combination.

manner as they are conducted currently, with any changes subject to the approval of the European Regulators to the extent required.

1. NYSE Euronext

Following the Combination, NYSE Euronext will be a for-profit, publicly traded stock corporation and will act as a holding company for the businesses of NYSE Group and Euronext. NYSE Euronext will own all of the equity interests in NYSE Group and its subsidiaries, including the Exchange and NYSE Arca, and a majority (if not all) of the equity interests in Euronext and its respective subsidiaries. Section 19(b) of the Exchange Act and Rule 19b-4 thereunder require a self-regulatory organization ("SRO") to file proposed rule changes with the Commission. Although NYSE Euronext is not an SRO, certain provisions of the NYSE Euronext Certificate of Incorporation and NYSE Euronext Bylaws are rules of an exchange[15] if they are stated policies, practice, or interpretations, as defined in Rule 19b-4 under the Exchange Act, of the exchange, and must be filed with the Commission pursuant to Section 19(b)(4) of the Exchange Act and Rule 19b-4 thereunder. Accordingly, the Exchange has filed the NYSE Euronext Certificate of Incorporation and NYSE Euronext Bylaws with the Commission.

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15 See Section 3(a)(27) of the Exchange Act, 15 U.S.C. 78c(a)(27). If NYSE Euronext decides to change its Amended and Restated Certificate of Incorporation or Amended and Restated Bylaws, NYSE Euronext must submit such change to the board of directors of NYSE LLC, NYSE Market, NYSE Regulation, NYSE Arca, and NYSE Arca Equities, and if any or all of such board of directors shall determine that such amendment or repeal must be filed with or filed with and approved by the Commission pursuant to Section 19 of the Exchange Act and the rules thereunder, such change shall not be effective until filed with or filed with and approved by the Commission, as applicable. See proposed NYSE Euronext Certificate of Incorporation, Article X and proposed NYSE Euronext Bylaws, Article X, Section 10.10(C).

a. Board of Directors

It is currently contemplated that immediately after the Combination, the NYSE Euronext board of directors will consist of twenty-two directors.[16] Each member of the NYSE Euronext board of directors (other than the chief executive officer and deputy chief executive officer of NYSE Euronext if they are members of the board of directors) must satisfy the independence requirements set forth in the Independence Policy, as amended from time to time. This Independence Policy, however, is not referenced in the organizational documents of the Exchange or NYSE Arca Equities,[17] and is therefore not relevant to the Commission's consideration of whether the boards of directors of the Exchange or NYSE Arca Equities are consistent with the Exchange Act.

b. Voting and Ownership Limitations; Changes in Control of the Exchange

The NYSE Euronext Certificate of Incorporation includes restrictions on the ability to vote and own shares of stock of NYSE Euronext.[18] Members that trade on an exchange traditionally have ownership interests in such exchange. As the Commission has noted in the past, however, a member's interest in an exchange could become so large as to cast doubt on

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16 For a detailed description of the provisions regarding the composition of, and the selection process for, the NYSE Euronext board of directors, see NYSE LLC Approval Order, supra note 10.

17 The organizational documents of the Exchange and NYSE Arca Equities (unlike the organizational documents of NYSE LLC, NYSE Market and NYSE Regulation) do not require that any of the members of the board of directors of the Exchange and NYSE Arca Equities be members of the board of directors of NYSE Euronext. See Bylaws of NYSE Arca, Article III, Section 3.02, and Bylaws of NYSE Arca Equities, Article III, Section 3.02.

18 See NYSE LLC Approval Order, supra note 10, for a detailed description of the provisions regarding restrictions on the ability to vote and own shares of stock of NYSE Euronext.

whether the exchange can fairly and objectively exercise its self-regulatory responsibilities with respect to that member.[19] A member that is a controlling shareholder of an exchange might be tempted to exercise that controlling influence by directing the exchange to refrain from, or the exchange may hesitate to, diligently monitor and surveil the member's conduct or diligently enforce its rules and the federal securities laws with respect to conduct by the member that violates such provisions.

The Commission finds the ownership and voting restrictions in the NYSE Euronext Certificate of Incorporation are consistent with the Exchange Act. These requirements should minimize the potential that a person could improperly interfere with or restrict the ability of the Commission, the Exchange, or its subsidiaries to effectively carry out their regulatory oversight responsibilities under the Exchange Act.

2. NYSE Group

Following the Combination, NYSE Group will merge with a wholly owned subsidiary of NYSE Euronext and the surviving corporation will be a wholly owned subsidiary of NYSE Euronext. Section 19(b) of the Exchange Act and Rule 19b-4 thereunder require an SRO to file proposed rule changes with the Commission. Although NYSE Group is not an SRO, certain provisions of its Amended and Restated Certificate of Incorporation and Amended and Restated

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19 See Securities Exchange Act Release Nos. 53382 (February 27, 2006), 71 FR 11251 (March 6, 2006) (SR-NYSE-2005-77) (order approving merger of New York Stock Exchange, Inc. and Archipelago, and demutualization of New York Stock Exchange, Inc. ("NYSE Inc.-Archipelago Merger Order")); 53128 (January 13, 2006), 71 FR 3550 (January 23, 2006) (File No. 10-131); 51149 (February 8, 2005), 70 FR 7531 (February 14, 2005) (SR-CHX-2004-26); 49718 (May 17, 2004), 69 FR 29611 (May 24, 2004) (SR-PCX-2004-08); 49098 (January 16, 2004), 69 FR 3974 (January 27, 2004) (SR-Phlx-2003-73); and 49067 (January 13, 2004), 69 FR 2761 (January 20, 2004) (SR-BSE-2003-19).

Bylaws are rules of an exchange[20] if they are stated policies, practices, or interpretations, as defined in Rule 19b-4 of the Exchange Act, of the exchange, and must be filed with the Commission pursuant to Section 19(b)(4) of the Exchange Act and Rule 19b-4 thereunder. Accordingly, the Exchange has filed the proposed NYSE Group Certificate of Incorporation and proposed NYSE Group Bylaws with the Commission.

The Exchange has proposed to change the voting and ownership limitations of NYSE Group to include a statement that such limitations will not be applicable so long as NYSE Euronext and the Trust collectively own all of the capital stock of NYSE Group. Instead, while NYSE Group is a wholly owned subsidiary of NYSE Euronext, or as provided for in the Trust Agreement, there shall be no transfer of the shares of NYSE Group held by NYSE Euronext without the approval of the Commission.[21] If NYSE Group ceases to be wholly owned by NYSE Euronext or the Trust, the current voting and ownership limitations will apply.[22]

The Commission finds the changes to the ownership and voting restrictions in the proposed NYSE Group Certificate of Incorporation are consistent with the Exchange Act. These requirements should minimize the potential that a person could improperly interfere with or

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20 See Section 3(a)(27) of the Exchange Act, 15 U.S.C. 78c(a)(27). If NYSE Group decides to change its Amended and Restated Certificate of Incorporation or Amended and Restated Bylaws, NYSE Group must submit such change to the board of directors of NYSE LLC, NYSE Market, NYSE Regulation, NYSE Arca, and NYSE Arca Equities, and if any or all of such board of directors shall determine that such amendment or repeal is required by law or regulation to be filed with or filed with and approved by the Commission pursuant to Section 19 of the Exchange Act and the rules thereunder, such change shall not be effective until filed with or filed with and approved by the Commission, as applicable. See proposed NYSE Group Certificate of Incorporation, Article XII and proposed Amended and Restated Bylaws of NYSE Group ("NYSE Group Bylaws"), Article VII, Section 7.9(b).

21 See proposed NYSE Group Certificate of Incorporation, Article IV, Section 4(a).

22 See proposed NYSE Group Certificate of Incorporation, Article IV, Section 4(b).

restrict the ability of the Commission or the ability of the Exchange, NYSE Market, NYSE Regulation, NYSE Arca LLC, NYSE Arca, and NYSE Arca Equities (together, the "U.S. Regulated Subsidiaries") to effectively carry out their regulatory oversight responsibilities under the Exchange Act.

The Exchange requested that the Commission allow NYSE Euronext to wholly own and vote all of the outstanding common stock of NYSE Group.[23] The Commission believes it is consistent with the Exchange Act to allow NYSE Euronext to wholly own and vote all of the outstanding common stock of NYSE Group.[24] The Commission notes that NYSE Euronext represents that neither NYSE Euronext nor any of its related persons is subject to any statutory disqualification (as defined in Section 3(a)(39) of the Exchange Act), or is an ETP Holder of NYSE Arca Equities, OTP Holder or OTP Firm of NYSE Arca or member or member organization of NYSE LLC. Moreover, NYSE Euronext has comparable voting and ownership limitations to NYSE Group. NYSE Euronext has also included in its corporate documents certain provisions designed to maintain the independence of the U.S. Regulated Subsidiaries' self-regulatory functions from NYSE Euronext and NYSE Group. Accordingly, the Commission believes that the acquisition of ownership and exercise of voting rights of NYSE Group common stock by NYSE Euronext will not impair the ability of the Commission or any of the U.S. Regulated Subsidiaries to discharge their respective responsibilities under the Exchange Act.

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23 The Exchanged clarified in Amendment No. 1 that NYSE Euronext alone be permitted to wholly own and vote such shares. See Amendment No. 1 supra note 4.

24 See NYSE LLC Approval Order, supra note 10, for a description of the proposal that NYSE Euronext wholly own and vote all of the outstanding stock of NYSE Group upon the consummation of the Combination.

3. The Exchange and NYSE Arca Equities

Following the Combination, NYSE Arca, which is registered as a national securities exchange and is an SRO, will remain a wholly owned subsidiary of NYSE Arca Holdings, and NYSE Arca Equities will remain a wholly owned subsidiary of NYSE Arca. The Combination will have no effect on the ability of any party to trade securities on NYSE Arca or NYSE Arca Equities. Pursuant to a regulatory services agreement, NYSE Regulation will continue to perform many of the regulatory functions of NYSE Arca.

There will be no change to the current manner of election or appointment of the directors and officers of Arca Holdings, NYSE Arca Holdings, NYSE Arca LLC, NYSE Arca, or NYSE Arca Equities as a result of the Combination.

Article Fourth of the proposed Arca Holdings Certificate of Incorporation will be amended to provide for voting or ownership of the shares of stock of Arca Holdings by the Trust pursuant to the terms and conditions of the Trust Agreement by and among NYSE Euronext, Inc., NYSE Group, Inc. and the trustees and Delaware trustee thereto.[25] The Commission finds that these changes to the ownership and voting restrictions in the proposed Arca Holdings Certificate of Incorporation are consistent with the Exchange Act. These requirements should minimize the potential that a person could improperly interfere with or restrict the ability of the Commission or the U.S. Regulated Subsidiaries to effectively carry out their regulatory oversight responsibilities under the Exchange Act.

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25 See proposed Arca Holdings Certificate of Incorporation, Article Fourth (C)(1) and (D)(1).

B. Relationship of NYSE Euronext, NYSE Group, and the U.S. Regulated Subsidiaries; Jurisdiction over NYSE Euronext

Although NYSE Euronext itself will not carry out regulatory functions, its activities with respect to the operation of any of the U.S. Regulated Subsidiaries must be consistent with, and not interfere with, the U.S. Regulated Subsidiaries' self-regulatory obligations. The NYSE Euronext corporate documents include certain provisions that are designed to maintain the independence of the U.S. Regulated Subsidiaries' self-regulatory functions from NYSE Euronext and NYSE Group, enable the U.S. Regulated Subsidiaries to operate in a manner that complies with the federal securities laws, including the objectives of Sections 6(b) and 19(g) of the Exchange Act,[26] and facilitate the ability of the U.S. Regulated Subsidiaries and the Commission to fulfill their regulatory and oversight obligations under the Exchange Act.[27]

The Commission finds that the provisions proposed by the Exchange are consistent with the Exchange Act, and that they will assist the Exchange in fulfilling its self-regulatory obligations and in administering and complying with the requirements of the Exchange Act. With respect to the maintenance of books and records of NYSE Euronext, the Commission notes that while NYSE Euronext has the discretion to maintain books and records that relate to both the U.S. Regulated Subsidiaries and the European Market Subsidiaries (each such book and record, an "Overlapping Record") in either the United States or the home jurisdiction of one or

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26 15 U.S.C. 78f(b) and 15 U.S.C. 78s(g).

27 See NYSE LLC Approval Order, Section II.B., supra note 10, for a detailed discussion of proposed provisions in the NYSE Euronext Bylaws regarding NYSE Euronext compliance with U.S. federal securities laws; NYSE Euronext books and records; jurisdiction of the U.S. federal courts and the Commission; confidential information pertaining to self-regulation; and responsibilities of NYSE Euronext directors with respect to the ability of U.S. Regulated Subsidiaries, NYSE Euronext, and NYSE Group to carry out their responsibilities under the Exchange Act, including referring rule violations and providing funding to NYSE Regulation.

more of the European Market Subsidiaries, NYSE Euronext has represented to the Commission that it will maintain in the United States originals or copies of Overlapping Records covered by Rule 17a-1(b) under the Exchange Act[28] promptly after creation of such Overlapping Records.[29] The Commission believes that such actions by NYSE Euronext with respect to its books and records are necessary to ensure that the U.S. Regulated Subsidiaries comply with the requirements of Section 17 of the Exchange Act[30] and Rule 17a-1(b) thereunder.

Under Section 20(a) of the Exchange Act,[31] any person with a controlling interest in NYSE LLC or NYSE Arca shall be jointly and severally liable with and to the same extent that NYSE LLC and NYSE Arca are liable under any provision of the Exchange Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Exchange Act[32] creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of the Act or rules thereunder. Further, Section 21C of the Exchange Act[33] authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Exchange Act through an act or omission that the person knew or should have known would contribute to the violation. These provisions are applicable to NYSE Euronext's and NYSE Group's dealings with the U.S. Regulated Subsidiaries.

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28 17 CFR 240.17a-1(b).

29 See NYSE LLC Rule Filing, supra note 8, at 822.

30 15 U.S.C. 78q.

31 15 U.S.C. 78t(a).

32 15 U.S.C. 78t(e).

33 15 U.S.C. 78u-3.

C. Trust

NYSE Euronext will operate several regulated entities located in the United States and in various jurisdictions in Europe. In connection with obtaining regulatory approval of the Combination, NYSE Euronext proposed to implement two standby structures, one involving a Delaware trust and one involving a Dutch foundation ("Dutch Foundation").[34] Pursuant to the terms of the Trust Agreement,[35] the Trust will be empowered to take actions to mitigate the effects of any material adverse change in European law that has an "extraterritorial" impact on the non-European issuers listed on NYSE Group securities exchanges, non-European financial services firms that are members of any NYSE Group securities exchange, or any NYSE Group securities exchange.

Upon the occurrence of a material adverse change of law that continues after the designated cure periods, the Trust may exercise certain remedies that result in a total or partial loss by NYSE Euronext of operating control over some of its securities exchanges. The Trust may require that NYSE Euronext transfer control over a substantial portion of its business and assets to the direction of the Trust. As a result, control of NYSE Group of any NYSE Group securities exchange may be assumed by the Trust. As discussed above, Section 19(b) of the Exchange Act and Rule 19b-4 thereunder require an SRO to file a proposed rule change with the Commission. Although the Trust is not an SRO, certain provisions of the Trust Agreement are rules of an exchange[36] if they are stated policies, practices, or interpretations, as defined in

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34 See NYSE LLC Approval Order, supra note 10, for a detailed discussion of the Delaware Trust and Dutch Foundation.

35 See proposed Trust Agreement, by and among NYSE Euronext, NYSE Group, the Delaware trustee and the trustees, attached as Exhibit H to Amendment No. 1.

36 See Section 3(a)(27) of the Exchange Act, 15 U.S.C. 78c(a)(27).

Rule 19b-4 under the Exchange Act,[37] of the exchange, and must be filed with the Commission pursuant to Section 19(b)(4) of the Exchange Act[38] and Rule 19b-4 thereunder. Accordingly, the Exchange has filed the Trust Agreement with the Commission.

The Trust Agreement contains detailed provisions with respect to governance of the Trust; remedies that may be exercised by trustees upon the occurrence of a material adverse change in law; the relationship of the Trust, NYSE Group, and the U.S. Regulated Subsidiaries; and jurisdiction over the Trust.[39] The Commission finds that the Trust Agreement's provisions are designed to enable the U.S. Regulated Subsidiaries to operate in a manner that complies with the federal securities laws, including the objectives and requirements of Sections 6(b) and 19(g) of the Exchange Act,[40] and to facilitate the ability of the U.S. Regulated Subsidiaries and the Commission to fulfill their regulatory and oversight obligations under the Exchange Act,[41] and are consistent with the provisions other entities that directly or indirectly own or control an SRO have instituted and that have been approved by the Commission.[42] The Commission finds that the Trust's provisions are consistent with the Exchange Act, and that they are intended to assist the Exchange in fulfilling its self-regulatory obligations and in administering and complying with the requirements of the Exchange Act.

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37 17 CFR 240.19b-4.

38 15 U.S.C. 78s(b).

39 See NYSE LLC Approval Order, Sections II.C and II.D, supra note 10, for a detailed description of the provisions contained in the Trust Agreement.

40 15 U.S.C. 78f(b) and 15 U.S.C. 78s(g).

41 See Trust Agreement, Articles V, VI, and VIII.

42 See, e.g., NYSE Inc.-Archipelago Merger Order, supra note 19.

Under Section 20(a) of the Exchange Act,[43] any person with a controlling interest in NYSE LLC and NYSE Arca shall be jointly and severally liable with and to the same extent that NYSE LLC and NYSE Arca are liable under any provision of the Exchange Act, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or cause of action. In addition, Section 20(e) of the Exchange Act[44] creates aiding and abetting liability for any person who knowingly provides substantial assistance to another person in violation of any provision of the Exchange Act or rule thereunder. Further, Section 21C of the Exchange Act[45] authorizes the Commission to enter a cease-and-desist order against any person who has been "a cause of" a violation of any provision of the Exchange Act through an act or omission that the person knew or should have known would contribute to the violation. These provisions are applicable to the Trust and all other entities controlling the U.S. Regulated Subsidiaries.

D. Automatic Suspension and Repeal of Certain Provisions in the NYSE Euronext Organizational Documents

Under the organizational documents of NYSE Euronext, immediately following the exercise of a call option over a substantial portion of Euronext's business (a "Euronext call option"), whereby the priority shares or ordinary shares of Euronext are transferred from NYSE Euronext to the Dutch Foundation, and for so long as the Dutch Foundation shall continue to hold any priority shares or ordinary shares of Euronext, or the voting securities of one or more of

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43 15 U.S.C. 78t(a).

44 15 U.S.C. 78t(e).

45 15 U.S.C. 78u-3.

the subsidiaries of Euronext that, taken together, represent a substantial portion of Euronext's business, then certain provisions of the NYSE Euronext Bylaws shall be suspended.[46]

In addition, if after a period of six months following the exercise of a Euronext call option, the Dutch Foundation shall continue to hold any ordinary or priority shares of Euronext or any ordinary or priority shares or similar voting securities of one or more subsidiaries of Euronext that, taken together, represent a substantial portion of Euronext's business, or if at any time, NYSE Euronext no longer holds a direct or indirect controlling interest in Euronext or in one or more subsidiaries of Euronext that, taken together, represent a substantial portion of Euronext's business, then certain provisions of the NYSE Euronext Bylaws and the NYSE Euronext Certificate of Incorporation shall be revoked.[47] In addition, any officer or director of NYSE Euronext who is a European Person shall resign or be removed from his or her office.

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46 These include the requirement that European Persons are represented in a certain proportion on the NYSE Euronext board of directors and the nominating and governance committee of the NYSE Euronext board of directors; the requirement of supermajority board or shareholder approval for certain extraordinary transactions; the provisions granting jurisdiction to European regulators over certain actions of NYSE Euronext and the NYSE Euronext board of directors; and references to European regulators, European market subsidiaries and European disqualified persons appearing in the NYSE Euronext Bylaws.

47 These include the provisions of the NYSE Euronext Bylaws subject to suspension; the references in the NYSE Euronext Certificate of Incorporation and NYSE Euronext Bylaws to European regulators, European exchange regulations, European market subsidiaries, European regulated markets, Europe and European disqualified persons; the provisions in the NYSE Euronext Certificate of Incorporation and NYSE Euronext Bylaws requiring that amendments to such certificate of incorporation or bylaws be submitted to the European market subsidiaries and, if applicable, filed with and approved by a European regulator; and the provisions in the NYSE Euronext Bylaws requiring approval of either two-thirds or more of the NYSE Euronext directors or 80% of the votes entitled to be cast by the holders of the then-outstanding shares of capital stock of NYSE Euronext entitled to vote generally in the election of directors to amend certain bylaw provisions.

The Commission finds the suspension or repeal of the above described provisions of the NYSE Euronext Bylaws and the NYSE Euronext Certificate of Incorporation under circumstances in which the Dutch Foundation controls a substantial portion of Euronext's business, is consistent with the Exchange Act.

III. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Exchange Act and the rules and regulations thereunder applicable to a national securities exchange.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act[48] that the proposed rule change (SR-NYSEArca-2007-05), as amended by Amendment No. 1, is approved on an accelerated basis.

By the Commission.

Nancy M. Morris
Secretary

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48 15 U.S.C. 78s(b)(2).

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55310 / February 16, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2560 / February 16, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12569

In the Matter of RICHARD A. CAUSEY, CPA, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Richard A. Causey ("Respondent" or "Causey") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

Document 14 of 22

herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.3 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Causey, age 47, of The Woodlands, Texas, joined Enron Corp. in 1991. In 1998, Causey became Chief Accounting Officer of Enron and retained that position until he left Enron in 2002. At all relevant times, Causey was a certified public accountant licensed to practice in the State of Texas. Causey signed Enron's annual reports on Form 10-K and its quarterly reports on Form 10-Q filed with the Commission.

2. Enron was, at all relevant times, an Oregon corporation with its principal place of business in Houston, Texas. Until its bankruptcy filing in December 2001, Enron was the seventh largest corporation in the United States based on reported revenue. In the previous ten years, Enron had evolved from a regional natural gas provider to a commodity trader of natural gas, electricity, and other physical commodities with retail operations in energy and other products. At all relevant times, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 ("Exchange Act") and traded on the New York Stock Exchange.

3. On January 22, 2004, the Commission filed a complaint against Causey in Securities and Exchange Commission v. Richard A. Causey, Civil Action No. H-04-0284 (S.D. Tex.). The Commission filed its second amended complaint against Causey on July 8, 2004. On February 8, 2007, the court entered its Final Judgment against Causey, which, among other things, permanently enjoined Causey, by consent, from violating, and aiding and abetting the violation of, Sections 10(b) and 13(b)(5) of the Exchange Act and Exchange Act Rules 10b-5, 13b2-1 and 13b2-2, and from aiding and abetting the violation of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Exchange Act Rules 12b-20, 13a-1 and 13a-13. The court also prohibited Causey from acting as an officer or director of any issuer of securities that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of such Act.

4. The Commission's complaint alleged that Causey, along with others, engaged in a wide-ranging scheme to manipulate Enron's publicly-reported earnings through a variety of devices designed to produce materially false and misleading financial results. As alleged, Causey and others fraudulently manipulated Enron's merchant asset portfolio; improperly used "off-balance-sheet" special purpose entities (SPEs); manipulated Enron's "business segment reporting" to conceal losses at Enron's retail energy business, Enron Energy Services (EES); manipulated expenses to conceal losses at Enron's broadband unit, Enron Broadband Services (EBS); and manipulated reserves in Enron's wholesale energy trading business to conceal earnings

volatility and losses. The complaint also alleged that Causey and others made false and misleading statements concerning Enron's financial results and the performance of its businesses, and that these misrepresentations were reflected in Enron's public filings with the Commission.

5. On December 28, 2005, in a parallel criminal proceeding brought in the United States District Court for the Southern District of Texas, captioned United States v. Richard A. Causey, CR-H-04-25(S-2), Causey pleaded guilty to one count of violating 15 U.S.C. §§ 78j(b) and 78ff, a felony that carries a ten-year maximum sentence, by knowingly and willfully conspiring to commit securities fraud. Under the plea agreement, Causey will forfeit $1.25 million, relinquish any claim he may have to deferred compensation in the Enron bankruptcy,[2] and cooperate with the ongoing investigation being conducted by the Commission and Task Force.[3]

IV.

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

Accordingly, it is hereby ORDERED, effective immediately, that Causey is suspended from appearing or practicing before the Commission as an accountant.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

[2] In return for Causey relinquishing any claim he may have to deferred compensation, the Task Force will credit him with giving up $250,000. This number approximates the value of Causey's claim to deferred compensation from his work at Enron. Thus, with Causey's forfeiture of $1.25 million in other assets, the Task Force is crediting Causey with giving up a total of $1.5 million.

[3] On November 15, 2006, Causey was sentenced to 66 months in prison. Pursuant to the plea agreement, Causey's potential sentence ranged from 60-84 months, subject to the Court's ultimate discretion.

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT COMPANY ACT OF 1940
Release No.27700/ February 16, 2007

In the Matter of

AMERICAN INTERNATIONAL GROUP, INC.
AIG EQUITY SALES CORP.
AIG GLOBAL INVESTMENT CORP.
70 Pine Street
New York, NY 10270

AIG ANNUITY INSURANCE COMPANY
AMERICAN GENERAL DISTRIBUTORS, INC.
THE VARIABLE ANNUITY LIFE INSURANCE COMPANY
2929 Allen Parkway, L4-01
Houston, TX 77019

AIG LIFE INSURANCE COMPANY
One ALICO Plaza
600 King Street
Wilmington, DE 19801

AIG SUNAMERICA ASSET MANAGEMENT CORP.
AIG SUNAMERICA CAPITAL SERVICES, INC.
Harborside Financial Center
3200 Plaza 5
Jersey City, NJ 07311-4992

AIG SUNAMERICA LIFE ASSURANCE COMPANY
1999 Avenue of the Stars
Los Angeles, CA 90067

AMERICAN GENERAL EQUITY SERVICES CORP.
AMERICAN GENERAL LIFE INSURANCE COMPANY
2727 Allen Parkway
Houston, TX 77019

AMERICAN INTERNATIONAL LIFE ASSURANCE COMPANY OF NEW YORK
80 Pine Street
New York, NY 10005

BRAZOS CAPITAL MANAGEMENT, L.P.
5949 Sherry Lane, Suite 1600
Dallas, TX 75225

FIRST SUNAMERICA LIFE INSURANCE COMPANY
733 Third Avenue, 4th Floor
New York, NY 10017

THE UNITED STATES LIFE INSURANCE COMPANY
IN THE CITY OF NEW YORK
830 Third Avenue
New York, NY 10022

(812-13259)

ORDER PURSUANT TO SECTION 9(c) OF THE INVESTMENT COMPANY ACT OF 1940 EXTENDING A TEMPORARY EXEMPTION FROM SECTION 9(a) OF THE ACT

American International Group, Inc. ("AIG"), et al., filed an application on February 10, 2006, requesting temporary and permanent orders under section 9(c) of the Investment Company Act of 1940 ("Act") exempting applicants and any other company of which AIG is or hereafter becomes an affiliated person (together, "Covered Persons") from section 9(a) of the Act solely with respect to a securities-related injunction entered by the U.S. District Court for the Southern District of New York on or about February 21, 2006 (the "AIG Injunction").

On February 21, 2006, the Commission issued a temporary conditional order exempting Covered Persons from section 9(a) of the Act until the Commission took final action on the application for a permanent order or, if earlier, August 21, 2006 (Investment Company Act Release No. 27227). On August 18, 2006 the Commission issued a temporary conditional order exempting Covered Persons from section 9(a) of the Act until the Commission took final action on the application for a permanent order or, if earlier, February 21, 2007 (Investment Company Act Release No. 27446).

The Commission has determined that it requires additional time to consider the issuance of a permanent order under section 9(c) of the Act.

Accordingly,

IT IS ORDERED, under section 9(c) of the Act, that the temporary conditional order is extended until the date on which the Commission takes final action on the application for a permanent order exempting applicants from section 9(a) with respect to the AIG Injunction or, if earlier, August 21, 2007.

By the Commission.

Nancy M. Morris
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

Commissioner Atkins Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 55313 / February 20, 2007

Admin. Proc. File No. 3-12260

In the Matter of the Application of

DONNER CORPORATION INTERNATIONAL,
JEFFERY L. BACLET,
VINCENT M. UBERTI, and
PAUL A. RUNYON

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION -- REVIEW OF DISCIPLINARY PROCEEDING

Violations of Securities Laws and Conduct Rules

Material Misstatements and Omissions of Material Fact

Violations of Public Communications Rules

Conduct Inconsistent With Just and Equitable Principles of Trade

Touting

Failure to Establish Adequate Written Supervisory Procedures

NASD member firm, president of firm, and registered representative of firm made material misstatements and omitted material facts in research reports issued by firm, failed to comply with standards for communications with the public, failed to disclose that firm received compensation for issuing reports, and failed to establish and maintain adequate written supervisory procedures or ensure written approval of reports by a principal of the firm. Held, association's findings of violation sustained and sanctions imposed sustained in part and vacated and remanded in part.

Document 16 of 22

Registered representatives of NASD member firm formed non-member research firm and made material misstatements and omitted material facts in research reports issued by non-member firm. Held, association's findings of violation and sanctions imposed sustained.

APPEARANCES:

Jeffrey L. Baclet, pro se and for Donner Corporation International.

Vincent M. Uberti, pro se.

Paul A. Runyon, pro se.

Marc Menchel, Alan Lawhead, and Carla J. Carloni, for NASD.

Appeal filed: April 12, 2006
Last brief received: June 20, 2006

I.

Donner Corporation International ("Donner"), a former NASD member firm, 1/ Jeffrey L. Baclet, its former president, sole owner, financial and operations principal, and options principal, and Vincent M. Uberti and Paul A. Runyon, former registered representatives of Donner 2/ and subsequently of NASD member firm Lloyd, Scott, and Valenti ("Lloyd"), appeal from NASD disciplinary action. NASD found that Donner, Baclet, and Uberti violated Section 10(b) of the Securities Exchange Act of 1934, 3/ Exchange Act Rule 10b-5, 4/ and NASD Conduct Rules 2120, 2210, and 2110 5/ by preparing and disseminating twenty-five research reports containing

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1/ Donner changed its name to National Capital Securities, Inc. in May 2002. NASD cancelled the firm's membership in November 2002 for failing to pay fees. The firm withdrew its registration as a broker-dealer effective December 21, 2002.

2/ Central Registration Depository states that Uberti was registered with Donner as a general securities principal effective July 2001. Uberti asserts that he left Donner before that date and was never a Donner principal. See infra note 33.

3/ 15 U.S.C. § 78j.

4/ 17 C.F.R. § 240.10b-5.

5/ NASD Rule 2120 prohibits inducing the purchase or sale of a security by means of "any manipulative, deceptive or other fraudulent device or contrivance." Rule 2210 requires that public communications, including research reports, "be based on principles of fair

(continued...)

material misstatements and omissions, 6/ and that Uberti and Runyon violated these provisions by issuing two research reports containing material misstatements and omissions through Lincoln Equity Research, LLC ("Lincoln"), a non-member firm formed by Uberti and Runyon.

NASD found further that Donner, Baclet, and Uberti violated NASD Rule 2110 with respect to research reports covering forty-eight issuers by failing to disclose, in violation of Section 17(b) of the Securities Act of 1933, 7/ that Donner received compensation for writing those reports. 8/ NASD also found that Donner and Baclet violated NASD Rules 3010, 2210, and 2110 by failing to establish and maintain adequate written supervisory procedures and failing to ensure written approval of Donner's research reports by a firm principal.

NASD expelled Donner from NASD membership, barred Baclet and Uberti in all capacities, and suspended Runyon for six months, fined Runyon $20,000, and ordered that Runyon requalify as a general securities principal and representative. We base our findings on an independent review of the record.

II.

A. The Donner Research Reports

Donner issued research reports on companies whose stock traded below $5 per share. Donner identified issuers and offered to write research reports in exchange for compensation. Issuing research reports constituted approximately seventy percent of Donner's business.

5/ (...continued)
dealing and good faith," "be fair and balanced," and "provide a sound basis" for evaluating a security. The rule prohibits making "any false, exaggerated, unwarranted or misleading statement or claim" in a research report or omitting "any material fact or qualification if the omission, in the light of the context of the material presented, would cause the communications to be misleading." Rule 2110 requires members to "observe high standards of commercial honor and just and equitable principles of trade."

6/ NASD found that Uberti was liable for twenty-two of the twenty-five reports. Exhibit A to NASD's complaint listed the twenty-five reports containing alleged material misstatements and omissions and identified the twenty-two reports for which NASD charged Uberti with liability. Exhibit A is reproduced at the end of this opinion.

7/ 15 U.S.C. § 77q(b).

8/ NASD found that Uberti was liable for reports covering forty-four of the forty-eight issuers. Exhibit B to NASD's complaint listed the reports that failed to disclose the compensation received by Donner and identified the forty-four issuers for which NASD charged Uberti with liability. Exhibit B is reproduced at the end of this opinion.

Under a typical agreement between Donner and an issuer, Donner received an initial retainer fee of $2,500, $2,000 per month for services provided, and $2 to $3 for each investor package mailed to potential investors. Some agreements also provided that Donner would receive stock if the company's share price exceeded a certain level after Donner initiated coverage of the company. Uberti testified that, for the companies Baclet gave him "to handle," Uberti received fifty percent of the amounts "generated by [Donner's] relationship with the company."

Between 1999 and 2000, Donner issued research reports on the stock of forty-eight companies that did not disclose the compensation Donner received for its analysis. Most of these reports recommended the company's securities as a "speculative buy," but some reports (usually after Donner initiated coverage on a company with a "speculative buy" and thereafter issued a subsequent report) recommended a "buy" or a "strong buy." These reports stated simply that Donner "may from time to time perform investment banking, corporate finance, provide services for, and solicit investment banking, corporate finance or other business" from the company. Several of these reports added the words "for a fee" after this description of services.

1. The drafting of the reports

Donner recruited Richard Merrell as an independent contractor to prepare research reports. Merrell drafted over 200 of the reports issued by Donner and all but three of the allegedly violative reports at issue in this proceeding. 9/ Merrell was not registered with NASD in any capacity, was not a Donner employee, and did not write research reports as his full-time job. He worked full-time as a quality assurance manager at an orthodontics firm and stated that he wrote reports for Donner as a "part time job that I did nights and weekends just to try to make extra money to feed my family." According to Merrell, Donner paid him $100 per report. 10/

Merrell had no prior experience conducting research or writing reports on publicly-traded companies. He testified that he was "not an expert enough to know what is negative information," did not understand the meaning of a going-concern qualification on financial statements, was "kind of fuzzy on the whole negative information aspect," and did not know enough to form an opinion about the companies.

Donner did not provide Merrell with any training and gave him little guidance in preparing research reports. Initially, Baclet faxed Merrell a template report and asked Merrell to draft reports that followed the template's format. Merrell stated that the template's overall tone was "generally positive." He testified that the template described the company as undervalued or highly undervalued, well-positioned to garner a substantial share of the market, and poised to become a major player or leading provider. Merrell included this language in his subsequent

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9/ Tony Rhee, a Donner research analyst, drafted the remaining allegedly violative reports.

10/ Baclet states that Merrell was paid $150 per report.

reports but admitted that he had no independent knowledge as to whether these statements were in fact true or supported by the material included in the reports. Merrell understood that his reports should be generally positive.

Merrell prepared reports by using information obtained from the company, information obtained from Yahoo Finance's website, and, "as a last resort," information obtained from the company's public filings. He reformatted the information into the template provided him by Baclet. Merrell did not verify any company-generated information with another source. He did not visit the companies, test their products, or speak with any of their customers or competitors. Merrell observed that "for a hundred bucks a report I'm not going to spend a lot of time."

Merrell testified that Uberti was his primary contact at Donner. According to Merrell, Uberti would ask him to draft a report for a specific company. Merrell returned his drafts to Uberti. Uberti checked the accuracy of the financial information on the first page of the report and asked Merrell to make changes such as adding information about recent developments.

Although Uberti acknowledged that he received and reviewed the Donner research reports drafted by Merrell, ensured that the first page of the report contained accurate financial information, and edited the language used by Merrell, he also testified that he did not review the research reports "for compliance," did not determine "what needed to be or didn't need to be disclosed in the research report," and "made no determination [as to] what was material or what wasn't material." At some point, Uberti began reading the reports "in more depth," and made changes to the language used by Merrell. He admitted that he "did look at financial information" and "generally that information either came from a press release from the company or from the 10-K or the 10-Q." He testified further that he "read audited financial statements or going concern opinion statements." Uberti also acknowledged that if a research report contained "something that was not accurate then it would be my obligation to point that out."

In his investigative testimony, Uberti acknowledged that a going concern opinion should "definitely" be disclosed in a research report "so the investor knows the financial status of the company before they make an investment decision." He also stated that a research report should disclose negative earnings, pending lawsuits, and accumulated losses. He stated further that "all negative information, as far as financial, needs to be disclosed." 11/

11/ At the hearing, Uberti tried to downplay this testimony. His investigative testimony, however, was given closer in time to the events at issue, and we therefore give it greater weight. William Edward Daniel, 50 S.E.C. 332, 335 n.7 (1990) (stating that Commission "agree[d] with the NASD" that a witness's "earlier testimony" was more reliable than testimony before NASD's Board of Governors "as it was closer in time to the events in question"); see also Byron G. Borgardt, Securities Act Rel. No. 8274 (Aug. 25, 2003), 80 SEC Docket 3559, 3580 (finding "no reason to depart from [law judge's] assessment" that a witness's 1996 responses to questions posed by the Division of Enforcement during its

(continued...)

2. The misleading reports.

NASD alleged that twenty-five of the Donner research reports contained material misstatements and omissions about the issuers' finances and business prospects. 12/ These reports were issued over Donner's name. Each report recommended the company's stock as a "speculative buy." The first page of the report provided information under categories entitled "Overview," "Earnings Per Share," "Capitalization," and "Revenues." The "Overview" section listed the recent price of the issuer's stock, its trading range for the prior year, trading volume, and the issuer's fiscal year. The "Capitalization" section included, variously, the number of shares outstanding, market capitalization, long-term debt, equity, debt/capital ratio, and working capital. The exact information included in the "Capitalization" section varied by report, and neither Merrell nor Uberti explained the reasons for the choice of information included in this section. The remainder of the report described the company's business. Each report concluded by again recommending the company's stock. Two of the twenty-five reports at issue had a second section containing additional financial information and a hyperlink to the Commission's website where the company's public filings were available.

Baclet acknowledged that Donner was paid to issue positive reports. Tony Rhee, a research analyst, testified that Baclet discouraged Rhee from writing negative reports. Baclet

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11/ (...continued)
investigation "should be accorded more weight" than his 1999 hearing testimony because "the 1996 responses were closer in time to the events in question").

12/ The Donner research reports at issue are (1) Dynamic Web Enterprises (DWEB), issued March 22, 1999; (2) General Automation, Inc. (GAUM), issued June 7, 1999; (3) Medical Science Systems (MSSI), issued June 14, 1999; (4) Imaging Technologies Corporation (ITEC), issued June 23, 1999; (5) Alyn Corporation (ALYN), issued July 7, 1999; (6) Esynch Corporation (ESYN), issued September 27, 1999; (7) Hawaiian Natural Water Co., Inc. (HNWCC), issued October 5, 1999; (8) American Champion Entertainment (ACEI), issued October 18, 1999; (9) StarBase Corporation (SBAS), issued October 12, 1999; (10) Imperial Petroleum (IPTM), issued November 11, 1999; (11) Professional Transportation Group, Ltd. (TRUC) issued January 17, 2000; (12) Dippy Foods, Inc. (DPPI), issued January 31, 2000; (13) Ocean Power Corporation (PWRE), issued February 23, 2000; (14) Ilive.com, Inc. (LIVE), issued March 8, 2000; (15) Itronics, Inc. (ITRO), issued March 20, 2000; (16) Genius Products, Inc. (GNUS), issued April 25, 2000; (17) Insider Street.com (NSDR), issued April 26, 2000; (18) Pen Interconnect, Inc. (PENC), issued May 23, 2000; (19) Advanced Biotherapy Concepts (ADVB), issued August 21, 2000; (20) Far East Ventures, Inc. (FEVI), issued January 10, 2001; (21) SEDONA Corporation (SDNA), issued April 25, 2001; (22) Aethlon Medical, Inc. (AEMD), issued June 12, 2001; (23) Advanced Aerodynamics and Structures, Inc. (AASI), issued June 27, 2001; (24) Vital Living, Inc. (VTLV), issued April 24, 2002; and (25) Xechem International, Inc. (ZKEM), issued May 16, 2002.

testified that Donner sent draft reports to the subject company to ensure that "the company felt good about the report" before Donner issued it to the public. Almost all the reports at issue stated that Donner believed the company's stock was "undervalued" or "highly undervalued." The reports also stated that the company was "well-positioned," "poised," or otherwise ready to grow and become a market leader in its industry. Most reports stated further that there was "superior potential for appreciation of this stock" or "significant upside potential" or that the stock presented a "significant" or "outstanding" investment opportunity.

The companies' public filings did not contain such optimistic assessments. The then most-current financial statements for all twenty-five companies included an auditor's opinion with a going-concern qualification about the company's ability to continue in existence. 13/ The companies' public filings disclosed additional negative financial information, including the nature and extent of net losses 14/ and the sources of the companies' negative earnings, such as significant operating losses, 15/ defaults on payment obligations, 16/ reliance on short-term borrowing and issuance of stock for operating capital, 17/ inadequate working capital, 18/ accumulated deficits, 19/ and/or cash flow deficiencies. 20/ Certain public filings indicated that the companies were unlikely to generate revenues or profits in the near future. 21/

13/ A going-concern opinion indicates substantial doubt about a company's ability to continue in existence for another year without additional capital or funding or other significant operational changes. Rocky Mountain Power Co., 53 S.E.C. 979, 983 n.6 (1998).

14/ DWEB, ITEC, ALYN, ESYN, HNWCC, ACEI, IPTM, TRUC, LIVE, ITRO, PENC, ADVB, FEVI, AASI, and VTLV.

15/ DWEB, GAUM, MSSI, ESYN, SBAS, IPTM, SDNA, AEMD, VTLV, and ZKEM.

16/ ADVB and AASI.

17/ ESYN, HNWCC, ACEI, SBAS, IPTM, TRUC, GNUS, NSDR, PENC, and VTLV.

18/ DWEB, GAUM, ITEC, ALYN, ESYN, IPTM, TRUC, DPPI, PENC, ADVB, VTLV, and ZKEM.

19/ MSSI, ALYN, ESYN, ACEI, SBAS, IPTM, DPPI, PWRE, ITRO, PENC, ADVB, AEMD, and ZKEM.

20/ GAUM, MSSI, ALYN, HNWCC, ACEI, TRUC, PWRE, LIVE, ITRO, GNUS, NSDR, ADVB, AASI, and ZKEM.

21/ DWEB, GAUM, MSSI, ALYN, HNWCC, SBAS, IPTM, NSDR, PENC, ADVB, AASI, and ZKEM. In addition, according to their filings, both GAUM and LIVE were experiencing liquidity problems.

Donner also failed to disclose that several of the issuers had limited operating histories or were development-stage companies. 22/ Some of the companies were dependent on certain key customers for a large percentage of the issuers' revenues 23/ or dependent on key officers or employees, 24/ or faced significant competition in their industries. 25/ Certain issuers had negative cash flow, 26/ and two of the issuers faced material litigation. 27/ Certain issuers also disclosed a lack of potential for future profitability and anticipation of increasing losses. 28/ The Donner research reports failed to disclose any of this information.

Donner's research report on Xechem International, Inc. (ZKEM), issued May 16, 2002, is illustrative. Donner reported that Xechem was "significantly undervalued, considering it is positioning itself as the premier provider of the next generation of nutraceutical and pharmaceutical healthcare products to a global audience." Donner stated that Xechem was "positioned to become a global leader in the development and sale of naturally derived nutraceutical and pharmaceutical products." The report also stated that Donner believed Xechem was "on the verge of tremendous growth and may represent an outstanding investment opportunity for the prudent investor."

Xechem's Form 10-KSB for the year ending December 31, 2001, filed on March 29, 2002, however, included an opinion by Xechem's independent auditor expressing "substantial doubt about [Xechem's] ability to continue as a going concern." The Form 10-KSB disclosed that Xechem was a development-stage company that had "experienced significant operating losses since inception and ha[d] generated minimal revenues from its operations." It stated

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22/ ALYN, DPPI, PWRE, VTLV, and ZKEM. Donner also failed to disclose that LIVE, NSDR, ADVB, and ZKEM were development-stage companies. A development-stage enterprise is defined by Statement of Financial Accounting Standards No. 7 as a business devoting substantially all of its efforts to establishing a new business in which either: (1) planned principal operations have not commenced, or (2) there have been no significant revenues therefrom. Russell Ponce, 54 S.E.C. 804, 806 n.9 (2000), aff'd, 345 F.3d 722 (9th Cir. 2003).

23/ ITEC, TRUC, and NSDR.

24/ IPTM and LIVE.

25/ GAUM, MSSI, ALYN, HNWCC, ACEI, TRUC, PWRE, LIVE, ITRO, GNUS, NSDR, ADVB, AASI, and ZKEM.

26/ DWEB, ITEC, IPTM, PENC, AEMD, AASI, and VTLV.

27/ ITRO and ESYN.

28/ DWEB, MSSI, ITEC, ALYN, HNWCC, SBAS, IPTM, PENC, ADVB, AEMD, AASI, VTLV, and ZKEM.

further that "additional operating losses can be expected." According to Xechem, "[n]o assurance [could] be given that [its] product research and development efforts will be successfully completed, that required regulatory approvals will be obtained, or that any products, if developed and introduced, will be successfully marketed or achieve market acceptance." Xechem also stated that its competitors had "substantially greater capital resources, research and development capabilities, manufacturing and marketing resources, and experience." The Form 10-KSB indicated that Xechem had an accumulated deficit of $36,000,000. None of this negative information was included in the Donner research report.

The remaining twenty-four Donner research reports at issue contained similar statements in the reports and omitted similar information from the company's public filings. For example, the research report on Dynamic Web Enterprises, Inc. (DWEB), issued March 22, 1999, stated that "Dynamic Web's stock is undervalued," that it "possesse[d] the knowledge both scientifically and strategically to make a significant impact on the booming e-commerce market," and that a "large market exist[ed] for the company's products and services, creating superior potential for appreciation of this stock." Dynamic Web's most recent Form 10-KSB, however, contained a going-concern qualification by the company's auditor, stated that Dynamic had "lost money every quarter since" it entered the electronic commerce business, stated that it could not give assurances that it would soon or would ever make a profit, stated that it "expect[ed] to lose substantial amounts of money in the near future," and stated that the electronic commerce industry was "highly competitive." Donner's report did not disclose this negative information.

Donner's research report on eSynch Corporation (ESYN), issued September 27, 1999, stated that eSynch was "undervalued considering the large and growing demand for the company's internet products," "possesse[d] the knowledge both scientifically and strategically to rise to the top of the internet utilities and electronic software distribution industry," and had "large and lucrative markets . . . for the company's products, creating superior potential for appreciation of this stock." The most recent Form 10-KSB for eSynch, however, included a going-concern qualification and stated that the company had incurred a $5 million net loss, had $1,413 in cash on hand, had a deficit in working capital of $2 million, had been relying upon short-term borrowing and the issuance of stock, and faced numerous pending lawsuits. The research report issued by Donner for eSynch did not reflect any of this information.

Donner issued a press release whenever it issued a research report, noting that copies of the report could be obtained from Donner and providing either Donner's telephone number or website address. The reports were available to the public without restriction. Uberti testified that the "research report was posted to the web site and whoever wanted to come in and register and print it and go to their broker and say 'should I buy this' could do it."

Baclet submitted a document during NASD's investigation identifying the persons who worked on each research report. Baclet agreed that he worked on all twenty-five research reports discussed above and wrote that Uberti worked on twenty-two of these reports. 29/

3. The supervision of the reports

Donner's written supervisory procedures designated Baclet as the Donner principal responsible for advertising, which included research reports. 30/ As Baclet admitted, Donner did not have any written procedures providing guidance for the preparation of research reports. Donner's written procedures also did not provide a review process for research reports. 31/ Although Donner's written procedures stated that a designated principal would approve each item of advertising (which, as noted above, included research reports), Baclet admitted that he did not sign or initial the research reports as an indication that the firm had approved the reports for dissemination.

Baclet acknowledged that he bore responsibility if the research reports contained exaggerated or misleading statements or omitted material facts. In his investigative testimony, however, he stated that he rarely reviewed the public filings for the issuers that Donner covered. At the hearing, he stated further that although he would "look at" the final drafts of Donner's research reports, he "wouldn't read them." Baclet testified that he had read only three or four of the allegedly violative reports and ten to fifteen of the 200 reports that Donner issued in total. Baclet conceded that this failure was irresponsible and admitted that he still had not read the allegedly violative reports at the time of the hearing.

Baclet testified that he conducted supervision by hiring competent individuals. Baclet also testified that Donner's legal and compliance department had one or two attorneys, one or two law school graduates, and three to five interns. In 1999, Brett Saddler was in the compliance

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29/ According to Baclet, Uberti had no responsibility for the research reports on MSSI, VTLV, or ZKEM. NASD did not charge Uberti with violations in connection with these reports.

30/ Baclet stated generally that "any responsibilities of [Donner] were ultimately my responsibilities" and that Donner's written supervisory procedures listed him "as having responsibility for basically everything." Uberti and Runyon confirmed that Baclet ran Donner's operations and "usually got involved in most of the supervisory issues."

31/ Uberti testified that he never saw any procedures for the writing and dissemination of research reports or to ensure that the reports did not contain exaggerated or unwarranted statements.

office. 32/ A compliance consultant retained by Donner found Saddler disorganized and unfamiliar with NASD requirements. It appears that in 2001 Rebecca Wilson headed the compliance operation. Neither Saddler nor Wilson was registered with NASD. The record does not establish any role that Saddler or Wilson had in reviewing research reports.

Baclet conceded that "[n]either Ms. Wilson nor any student had any authority to initiate, supplement or conclude positively or negatively any compliance agenda; they were merely extra hands and feet for myself" and other unidentified principals. Baclet also testified that by November 1999, Donner had retained five additional registered principals. However, there is no evidence in the record that these principals had any role in reviewing research reports. Uberti testified that "the licensed person that was responsible for compliance [was] Jeff Baclet."

B. The Lincoln Research Reports

In July 2001, Uberti and Runyon left Donner and formed Lincoln, a non-member firm, and became registered representatives of Lloyd. 33/ Lincoln prepared research reports for distribution over the Internet. Uberti and Runyon each owned fifty percent of Lincoln. They shared responsibilities equally and also shared equally in the firm's profits. Runyon testified that he and Uberti equally shared the responsibility of producing a fair and objective research report. Uberti admitted that the content of the research reports was solely his and Runyon's, and not Lloyd's, responsibility. Uberti also acknowledged that Lloyd "never edited the content of the report other than the disclaimer and the heading."

Uberti contacted Merrell and asked Merrell to write Lincoln's research reports. Merrell drafted approximately seventeen Lincoln research reports, including a report, dated August 30, 2001, on The Majestic Companies, Ltd. ("Majestic"), and one, dated October 31, 2001, on Dtomi, Inc. ("Dtomi"), the two Lincoln research reports at issue here. Merrell followed the same format as the Donner reports. Lincoln's reports recommended Majestic and Dtomi as "speculative buys."

Lincoln represented that Majestic had "significant upside potential," was "well-positioned for growth," and was "quickly becoming a recognized leader in its field" of school bus safety devices. The company's public filings, however, did not support such positive statements. Its most recent financial statements included a going-concern qualification. The most recent Form 10-KSB also stated that Majestic was a "development stage company," that its "business units

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32/ At some points in the record, Saddler was identified as the compliance director. Baclet states in his brief that Saddler was never the director.

33/ According to CRD, Uberti's and Runyon's association with Donner terminated as of July 31, 2001. Both Uberti and Runyon contend that they resigned from Donner on July 6, 2001. Donner did not file a Form U-5 "Uniform Termination Notice for Securities Industry Registration" for either Uberti or Runyon until May 2002.

[had] not generated sufficient earnings to cover the cost of operations," that its "management team [had] no direct operating experience" in its industry prior to 1998, that its industry was "a highly competitive field," and that "[a]ll of [Majestic's] competitors ha[d] capital and other resources greater than [Majestic's]." The Form 10-KSB also disclosed that Majestic incurred a net loss of $5,815,893 during 2000 and a net loss of $4,123,634 during 1999, that its current liabilities exceeded its current assets by $1,449,524 as of December 31, 2000, and that a substantial portion of its assets were illiquid. In its most recent Form 10-QSB, Majestic disclosed further that it had an accumulated deficit of $14,091,989 and was named as a defendant in litigation seeking over $700,000 in damages. Lincoln's research report for Majestic disclosed none of these facts. 34/

The Lincoln report on Dtomi stated that the company was "well-positioned for growth," had "positioned itself to significantly impact the $4 billion market intelligence industry," and was "poised" to become a "leading provider" and "leading developer" in that industry. The Lincoln report noted that Dtomi had "entered into an agreement to acquire privately held International Manufacturers Gateway, Inc. (IMG)," that the merger was "expected to close by November 15, 2001," and that the merger was "expected to generate immediate revenues and significantly enhance shareholder value." Lincoln's report disclosed that Dtomi reported no revenues and a net loss of $94,794 since its inception. However, according to the report, Dtomi "expected to generate $800,000 in the first twelve months of operations," and its "primary objective" was to "generate $2.7 million in gross sales and gain 1,500 customers between November 1, 2001 and November 1, 2002." As noted, the report, however, was issued two weeks before the anticipated merger and did not disclose the risk that the merger might not occur. In fact, the merger did not occur until two months after the report's issuance.

Audited financial statements did not exist for either Dtomi or IMG. Only Copper Valley Minerals, Ltd. ("Copper Valley"), Dtomi's predecessor, had audited financial statements. Copper Valley's most recent financial statements included a going-concern qualification. According to its most recent Form 10-KSB, Copper Valley "had a limited operating history," had "not achieved any revenues or earnings from operations," and had "no significant assets or financial resources." The Form 10-KSB also stated that, unless the company acquired a new business opportunity, the company would likely "sustain operating expenses without corresponding revenues," incur "a net operating loss that will increase continuously," and be unable to "generate revenues that will be sufficient to cover [its] expenses." The most recent Form 10-QSB filed by Copper Valley listed the company's cash on hand as $365. The Dtomi report did not disclose this information.

Uberti testified specifically that he reviewed Majestic's two most recent 10-K reports and all the intervening 10-Q reports and knew about the going-concern qualification. He also testified that he read Copper Valley's 10-K report in preparation for writing the Dtomi report. In

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34/ The Majestic report included a hyperlink to the Commission's website where the company's public filings were available.

his investigative testimony, Runyon admitted that he reviewed Majestic's most recent 10-K and 10-Q reports and that he "probably" read the most recent 10-Q report filed by Copper Valley.

Lincoln disseminated these reports to the public by posting the reports on its website and issuing a press release. Any member of the public could access Lincoln research reports by registering on the website and receiving a password.

III.

A. Antifraud and Public Communications Violations

Exchange Act Section 10(b), Exchange Act Rule 10b-5, and NASD Rule 2120 each prohibit fraudulent and deceptive acts in connection with the purchase or sale of a security. A violation of these provisions "may be established by a showing that persons acting with scienter misrepresented or omitted material facts in connection with securities transactions." 35/ NASD

35/ Alvin W. Gebhart, Jr. and Donna T. Gebhart, Exchange Act Rel. No. 53136 (Jan. 18, 2006), 87 SEC Docket 437, 462 n.80 (citing Basic Inc. v. Levinson, 485 U.S. 224, 239 n.17 (1988)), appeal pending, No. 06-71021 (9th Cir.). We find, and Applicants do not dispute, that Applicants made statements in connection with securities transactions. For purposes of establishing the "in connection with" requirement, a "misrepresentation need not be made with respect to a particular sales transaction but should be applied generally." SEC v. C. Jones & Co., 312 F. Supp. 2d 1375, 1381 (D. Col. 2004). "Where the fraud alleged involves public dissemination in a document such as a press release, annual report, investment prospectus or other such document on which an investor would presumably rely, the 'in connection with' requirement is generally met by proof of the means of dissemination and the materiality of the misrepresentation or omission." SEC v. Rana Research, Inc., 8 F.3d 1358, 1362 (9th Cir. 1993). The requirement is also satisfied when a statement is made "in a manner reasonably calculated to influence the investing public." Orlando Joseph Jett, Securities Act Rel. No. 8395 (Mar. 5, 2004), 82 SEC Docket 1211, 1250-51 n.37 (citing SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 862 (2d Cir. 1968)). Here, both Donner and Lincoln wrote research reports to "create exposure" for the subject companies and intended the reports for investors who could purchase the companies' stock. The reports were posted on Donner's or Lincoln's website, and each firm issued a press release whenever it issued a report. The reports included positive statements about the company's stock and recommended the stock as an investment. Cf. SEC v. Gebben, 225 F. Supp. 2d 921, 927 (C.D. Ill. 2002) (finding that internet postings on a web site "intended to provide information to investors about stocks" which included "positive recommendations about Issuers' stocks and encouraged readers to buy Issuers' stocks" and "disputed negative comments about Issuer stock" sufficiently influenced investors to establish the "in connection with" requirement).

Rule 2210 prohibits, in any communication with the public, 36/ "exaggerated, unwarranted, or misleading statements or claims" or the omission of "any material fact or qualification" that would render statements misleading. 37/ The rule also requires that public communications "be based on principles of fair dealing and good faith," "be fair and balanced," and "provide a sound basis" for evaluating a security. Misrepresentations and omissions are also inconsistent with just and equitable principles of trade and violate NASD Rule 2110. 38/

1. Reports' Material Misstatements and Omissions.

The Donner and Lincoln research reports contained both material misrepresentations and omissions. A fact is material if there is a substantial likelihood that a reasonable investor would have considered the fact important in making an investment decision, and disclosure of the omitted fact would have significantly altered the total mix of information available. 39/ Both the Donner and Lincoln research reports contained statements asserting that the subject stock was "undervalued" or "highly undervalued," that the company was "well-positioned," "poised," or otherwise ready to grow and become a market leader, and that there was "superior potential for appreciation of this stock," "significant upside potential," or a "significant" or "outstanding" "investment opportunity." The research reports, however, failed to disclose the going-concern opinions or the net losses, inadequate working capital, default on payment obligations, accumulated deficits, cash-flow deficiencies, and reliance on short-term borrowing that triggered these opinions, and therefore omitted material facts. "[T]he materiality of information relating to financial condition, solvency and profitability is not subject to serious challenge." 40/

Both the Donner and Lincoln research reports also failed to disclose the dim prospects and significant competition faced by the respective companies, and such failures constituted material omissions. "Material facts include . . . those facts which affect the probable future of a company and which may affect the desires of investors to buy, sell, or hold the company's

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36/ Under Rule 2210(a)(2), "communications with the public" include "research reports."

37/ Davrey Financial Services, Inc. and Pravin R. Davrey, Exchange Act Rel. No 51780 (June 2, 2005), 85 SEC Docket 2057, 2063.

38/ Gebhart, 87 SEC Docket at 463 n.86 (citing Robert Tretiak, Exchange Act Rel. No. 47534 (Mar. 19, 2003), 79 SEC Docket 3166, 3180).

39/ Basic Inc. v. Levinson, 485 U.S. 224, 231-32 (1988); TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

40/ SEC v. Murphy, 626 F.2d 633, 653 (9th Cir. 1980).

securities." 41/ Various of the public filings disclosed that, for example, the companies were unlikely to generate revenues or profits in the near future; that the companies faced significant competition in their industries; had limited operating histories; relied on a few key customers for a significant portion of their revenue; and/or faced potentially significant lawsuits.

Baclet concedes that financial statements are material but argues that Donner was not required to include the financial statements in the body of the research reports. Donner's research reports, however, disclosed some financial information and coupled this limited disclosure with glowing descriptions of the issuer's prospects and position in its industry. The antifraud provisions "give rise to a duty to disclose any information necessary to make an individual's voluntary statements not misleading." 42/ "It is a well-settled principle that once disclosures are made, there is a duty to disclose all material information . . . . ." 43/ NASD Rule 2210(d)(1)(A), moreover, required Donner to issue fair and balanced research reports that provided a sound basis for evaluating the security.

We therefore reject Baclet's assertion that the recommendation of the securities as a "speculative buy" was sufficient to put potential investors on notice that the companies had issues with respect to their finances or operations. The reports did not explain what Donner meant by the term "speculative buy," and that recommendation was surrounded with highly positive information about the issuer that omitted material negative information.

We also reject Applicants' argument that the research reports did not need to disclose the omitted facts because they believed a reasonable investor would read the company's public filings and obtain the information from those filings and because some reports provided a hyperlink to the Commission's website where those filings were available. 44/ The research reports themselves needed to convey a complete and accurate picture and could not depend on other

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41/ SEC v. Hasho, 784 F. Supp. 1059, 1108 (S.D.N.Y. 1992) (quoting SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, 849 (2d Cir. 1968)); see also Tretiak, 79 SEC Docket at 3176.

42/ SEC v. Druffner, 353 F. Supp. 2d 141, 148 (D. Mass. 2005); see also SEC v. Fehn, 97 F.3d 1276, 1290 n.12 (9th Cir. 1996) (stating that the federal securities laws "impose[] a duty to disclose material facts that are necessary to make disclosed statements, whether mandatory or volunteered, not misleading"); John J. Kenny and Nicholson/Kenny Capital Mgmt., Inc., Securities Act Rel. No. 8234 (May 14, 2003), 80 SEC Docket 564, 576 (finding respondent, once he undertook to speak, "was obligated to do so truthfully and in a way that was not misleading"), aff'd, 87 Fed. Appx. 608 (8th Cir. 2004).

43/ United States v. Cannistrano, 800 F. Supp. 30, 81 (D.N.J. 1992) (citing Greenfield v. Heublein, 742 F.2d 751, 756, 758 (3d Cir. 1984) (citing SEC v. Texas Gulf Sulphur Corp., 401 F.2d 833, 862 (2d Cir. 1968) (cert. denials omitted))).

44/ Only a few of the violative research reports had such hyperlinks. See supra Section II.A.2.

information available to investors. "When a securities recommendation is made to a customer, it is necessary that full disclosure be made of all material facts. A broker may not satisfy that obligation by pointing to bits and pieces of information that appeared in the media or elsewhere and were never brought to the customer's attention." 45/ "A reasonable investor would want to know of any risks or potential harms associated with his or her investment." 46/

We find inapposite the cases cited by Uberti in support of his argument that Donner did not need to disclose any information available to the public. Although the court in Whirlpool Fin. Corp. v. GN Holdings, Inc. 47/ stated, as noted by Uberti, that a "reasonable investor is presumed to have information available in the public domain," the court made this statement in finding that the availability of the information in the public domain placed the plaintiff on inquiry notice of his potential fraud claim for purposes of "start[ing] the [statute of] limitations clock." The court did not find that the public availability of the information obviated a duty to disclose information necessary to make statements not misleading. Johnson v. Wiggs 48/ held that the public availability of the information meant that a stock seller did not have inside information unavailable to the buyer. The seller made no representations to the buyer rendered misleading by his failure to disclose any material information. In Panter v. Marshall Field & Co., 49/ the court found that the defendant did not omit a material fact in its press release because the plaintiff had included that fact in its own press release and the defendant had no obligation to reemphasize the fact. The court did not find that the defendant had no obligation to disclose facts necessary to render its statements not misleading because such facts were publicly available. Here, however, respondents omitted facts necessary to make their representations in the research reports not misleading, and the public availability of those facts does not cure these omissions.

Applicants argue that the existence of a going-concern qualification is an opinion, and not a fact, and therefore does not require disclosure. However, a going concern opinion is "a most serious qualification on a financial statement because it generally indicates the auditor's opinion that a company is faced with a serious risk of bankruptcy." 50/ Conditions or events that suggest the need for a going-concern opinion include recurring operating losses, working capital

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45/ Richmark Capital Corp., Exchange Act Rel. No. 48758 (Nov. 7, 2003), 81 SEC Docket 2205, 2215-16, aff'd, 86 Fed. Appx. 744 (5th Cir. 2004).

46/ SEC v. Treadway, 430 F. Supp. 2d 293, 330 (S.D.N.Y. 2006).

47/ 67 F.3d 605 (7th Cir. 1995).

48/ 443 F.2d 803 (5th Cir. 1971).

49/ 646 F.2d 271 (7th Cir. 1981).

50/ Copy Data Sys., Inc. v. Toshiba America, Inc., 755 F.2d 293, 299 (2d Cir. 1985).

deficiencies, negative cash flows from operating activities, and adverse key financial ratios. 51/ Accordingly, both the existence of an opinion by a company's auditor expressing substantial doubt about the company's ability to continue in existence and the negative financial information providing the basis for such an opinion constitute material facts. 52/

Uberti and Runyon argue that, because Dtomi anticipated merging with IMG, they did not need to disclose information relating to Dtomi's predecessor, Copper Valley. Uberti acknowledged that the Dtomi research report contained no indication that this merger might not occur even though the merger was not expected to close until at least two weeks after the issuance of the report and in fact did not close for another two months. Uberti admitted that investors buying Dtomi on the day the research report was issued would only be buying the company that had entered into, but not yet consummated, a merger. Copper Valley's limited assets and lack of operations were facts material to assessing an investment in Dtomi as it existed at the time and in assessing the potential success of the projected merger.

Baclet asserts that the Donner research reports did not violate the antifraud provisions because Donner "declined to represent about 100 out of about 250 businesses that solicited

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51/ CODIFICATION OF STATEMENTS ON AUDITING STANDARDS, The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern, AU § 341 (American Inst. of Certified Pub. Accountants 1994).

52/ Baclet argues that failing to disclose the going concern qualification was not material because most of the issuers that were the subject of Donner research reports were still in business and their stock had risen in price at the time of the NASD hearing. It is unclear to which issuers Baclet refers. Moreover, that an issuer continues in business or becomes profitable at some point after its auditor gives a going-concern qualification to its opinion does not render the omission of the opinion's existence at the time of its issuance immaterial. See General Aeromation, Inc., 41 S.E.C. 219, 223-24 n.2 (1962) ("That somewhat favorable developments may have occurred subsequently cannot remedy the prior misstatements and failures to state adverse material facts.").

Uberti and Runyon argue that the going-concern opinion is not material because "no 8-K filing is required upon receipt of the Going Concern Opinion." A going-concern qualification need not be disclosed in a Form 8-K, however, because such a qualification is generated by the need to have audited financial statements in a Form 10-K. Form 8-K specifies that "[i]f the registrant previously has reported substantially the same information as required by this form, the registrant need not make an additional report of the information on this form." See General Instructions to Form 8-K, Federal Securities Laws (CCH) ¶ 33,211. The going-concern qualifications at issue here were disclosed in the issuers' annual reports on Forms 10-KSB. That certain specific events require filing a Form 8-K, moreover, does not mean that other facts are not material; the events for filing a Form 8-K do not define the universe of material facts for disclosure.

[Donner's] services," because Donner refused to write research reports on companies that offered to pay Donner but did not want full disclosure, and because Donner included going-concern opinions in other research reports. Donner's compliance with the law in some instances does not excuse its dissemination of these violative research reports. 53/

2. Participation in Reports' Creation and Dissemination.

The record establishes that Baclet was responsible for the Donner research reports and acted with scienter. Scienter is the "intent to deceive, manipulate, or defraud." 54/ It may be established by a showing of recklessness, 55/ which involves an "'extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the [actor] or is so obvious that the actor must have been aware of it.'" 56/

Baclet admits that he had ultimate responsibility for the Donner research reports and, based on the record before us, we conclude that he was the only Donner principal with responsibility for the reports. 57/ Baclet contracted with Merrell, a person with no prior

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53/ Cf. Rooms v. SEC, 444 F.3d 1208, 1214 (10th Cir. 2006) (stating that respondent, a general securities representative and principal of a former NASD member firm, "was required to comply with the NASD's high standards of conduct at all times); Robert Fitzpatrick, 55 S.E.C. 419, 433 (2001) (finding that NASD "correctly ruled that prompt compliance with some requests for information does not excuse dilatory compliance with other requests"); Robert Dermot French, 36 S.E.C. 603, 606 (1955) (finding that compliance with the net capital requirement in applicant's last inspection of his books "would not cure or excuse the repeated prior violations").

54/ Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976).

55/ See, e.g., Robert M. Fuller, Securities Act Rel. No. 8273 (Aug. 25, 2003), 80 SEC Docket 3539, 3546 n.20, petition denied, 95 Fed. Appx. 361 (D.C. Cir. 2004).

56/ The Rockies Fund, Inc. v. SEC, 428 F.3d 1088, 1093 (D.C. Cir. 2005) (citing SEC v. Steadman, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (quoting Sundstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1044-45 (7th Cir. 1977))).

57/ Although Baclet contends that "not even [Donner] could ultimately be responsible for the accuracy of information directly depicting the company itself but only the company authorities and representatives themselves," the research reports were issued under Donner's name, and Donner therefore bears responsibility for accurately portraying information from company filings and for the misleading content of the research reports. See SEC v. Current Financial Servs., Inc., 100 F. Supp. 2d 1, 7 (D.D.C. 2000) ("'Securities dealers cannot recommend securities without a reasonable basis for the

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experience, to draft the bulk of Donner's reports and provided Merrell little guidance in preparing the reports. Although he claims that he relied on his legal and compliance department, he staffed that department with unregistered, unqualified, and inexperienced persons. 58/ As noted above, the record does not establish any role that these individuals had in reviewing the reports. In spite of Baclet's admitted responsibility for the reports, Baclet did not review the publicly available information about the companies. He knew that, for the companies Donner covered, "the financials were always a concern," yet he did not include negative financial information about the companies in his reports. Instead, Baclet conceded that he "was paid to come out with a positive report." Baclet also acknowledged that he did not read the final reports issued by Donner and that such conduct was "irresponsible." 59/ Baclet had no basis to believe that the reports conveyed an accurate picture of the risks associated with the issuers. 60/ Under these circumstances, Baclet's conduct represented an extreme departure from the standards of ordinary care, which presented an obvious danger of misleading buyers or sellers.

The record establishes that Uberti also acted with scienter with respect to the twenty-two Donner research reports charged against him. Uberti knew that the companies' public filings contained material negative financial information because he "look[ed] at financial information," which "generally . . . either came from a press release from the company or from the 10-K or the

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57/ (...continued)
recommendation[.]'") (quoting SEC v. Kenyon Capital, Ltd., 69 F. Supp. 2d 1, 9, (D.D.C. 1998)); see also Sheen Fin. Res., Inc., 52 S.E.C. 185, 191 n.25 (1995) ("While some of these documents may have been prepared by entities other than Applicants, Applicants endorsed the contents of these documents when they affixed the Firm's logo and Sheen's name and business address to each document, compiled the materials as part of their seminar packet, and distributed the packet to seminar attendees.").

58/ Baclet also retained responsibility as president of the firm. As we have stated, the president of a broker-dealer

> is responsible for the firm's compliance with all applicable requirements unless and until he or she reasonably delegates a particular function to another person in the firm, and neither knows nor has reason to know that such person is not properly performing his or her duties.

Harry Gliksman, 54 S.E.C. 471, 482 (1999) (quoting Rita H. Malm, 52 S.E.C. 64, 69 (1994)), aff'd, 24 Fed. Appx. 702 (9th Cir. 2001) (Unpublished).

59/ Baclet testified that he still had not read most of the reports at the time of the hearing.

60/ Although Baclet contends that the issuers "signed off on the accuracy of the report as it pertained to the company," a "salesman may not rely blindly on the issuer for information concerning a company." Hanly v. SEC, 415 F.2d 589, 597 (2d Cir. 1969).

10-Q" and he "read [the] audited financial statements or going-concern opinion statements." In his investigatory testimony, Uberti acknowledged that negative financial information should be disclosed in a research report. He admitted further that, if a research report contained "something that was not accurate[,] then it would be my obligation to point that out." Uberti knew, however, that the Donner research reports did not disclose the material negative information contained in the companies' public filings because he reviewed the reports. He acknowledged at the hearing that he received and reviewed the Donner research reports from Merrell, ensured that the first page of the report contained accurate financial information, and edited the language used by Merrell. Uberti stated in his investigative testimony that he was the individual who added any financial information about each company to the research reports. 61/ Uberti acted recklessly because his failure to include negative financial information likely important to investors in the research reports, despite knowing that the companies' public filings contained such negative information, involved an extreme departure from the standards of ordinary care which presented an obvious danger of misleading buyers or sellers.

We reject Uberti's argument that he did not act with scienter because he relied on "Baclet, Compliance and Legal Department directives." Uberti acted recklessly because he himself read the reports that contained positive statements about the issuers, reviewed the public filings pertaining to the issuers that included negative financial information, and knew that this negative information was not included in the reports. Uberti did not believe that the individuals on whom he purportedly relied were investigating financial information beyond the companies' public filings. Although Uberti testified that the Donner research reports "went through a compliance and through a legal department," he stated that "[w]hat they did specifically I don't know." Uberti did not reasonably rely on Baclet or the compliance or legal department to correct the material misstatements and omissions that he recklessly disregarded. 62/

61/ Uberti now seeks to distance himself from his investigative testimony by claiming that he acted in "an administrative capacity" and "wasn't analyzing the financial information" or determining "what needed to be or didn't need to be disclosed in the research report" or "what was or wasn't material." We agree with NASD that the record supports the conclusion that Uberti had substantive responsibility for the reports. Uberti's testimony is consistent with that of other witnesses. Runyon stated in his investigative testimony that Uberti "probably had his hands on the Research Reports more than anyone else in the compilation and coordination of putting the report together." Baclet stated in his investigative testimony that "if a Research Report was put together, it would go through Mike Uberti before it was published" and that Uberti "oversaw the research reports" and "read the Research Reports before they went out."

62/ Cf. Dane S. Faber, Exchange Act Rel. No. 49216 (Feb. 10, 2004), 82 SEC Docket 530, 542 (rejecting applicant's claim "that he cannot have scienter because he properly relied on [his firm's] research on Interbet" because applicant "in fact read Interbet's business plan, which contained much of the material information he failed to disclose").

Uberti and Runyon also are responsible for the Lincoln research reports. According to Uberti, they "both reviewed the reports," "went through the financials and put in the financial information," and "added in the financial information that [they] believe[d] needed to be in the research report." Uberti and Runyon also both reviewed the companies' public filings. As noted above, Uberti testified that he reviewed Majestic's two most recent 10-K reports and all the intervening 10-Q reports as well as Copper Valley's 10-K report. Runyon testified that he reviewed Majestic's most recent 10-K and 10-Q reports and "probably" read the most recent 10-Q report filed by Copper Valley. Reviewing the companies' public filings and failing to notice the significant negative information contained therein or concluding that such information need not be included in the research reports involved an extreme departure from the standards of ordinary care, which presented an obvious danger of misleading buyers or sellers. Uberti and Runyon thus acted recklessly by failing to disclose the material negative financial information in their reports.

Uberti's and Runyon's investigative testimony further underscores their scienter. As noted above, Uberti conceded in his investigative testimony the importance of disclosing negative information. Runyon stated in his investigative testimony that a research report that failed to disclose the existence of a going-concern opinion would not be fair and accurate and that such an opinion needs to be disclosed "[b]ecause if the company does not get additional money from somewhere, they are going to be out of business." 63/ He testified further that he read the auditor's going-concern opinion in Majestic's public filings and that the Majestic research report should have disclosed this opinion. In this testimony, Runyon also stated that research reports should disclose accumulated deficits, pending lawsuits, and significant competition. 64/ We find that Donner and Baclet violated Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5 and NASD Rules 2120, 2210, and 2110 with respect to twenty-five of the research reports issued by Donner, that Uberti violated these provisions with respect to twenty-two of these twenty-five

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63/ At the hearing, Runyon, when asked to explain his statements regarding the necessity of including a going-concern opinion in the research reports, stated that he "was harboring a great deal of resentment towards Donner Corporation and Jeff Baclet" and that he "may have slanted [his] testimony regarding how or what [he] would say should be included in the Donner report" in an "effort to strike back at Donner." We reject this self-serving explanation. According to Baclet, Runyon's statement demonstrates that Runyon's "testimony against [Baclet] was a lie." We have not relied on Runyon's testimony in making findings against Baclet except for facts that are not disputed by Baclet.

64/ Uberti testified further that the research reports were "not for the average investor" but were "for speculative investors that can lose all their money and are willing to take that gamble." The reports, however, were freely available on Lincoln's website and access to them was not restricted in any manner. "Nor do the facts that customers . . . are sophisticated or aware of speculative risks justify making misstatements to them." James E. Cavallo, 49 S.E.C. 1099, 1102 (1989); see also Stephen E. Muth, Exchange Act Rel. No. 52551 (Oct. 3, 2005), 86 SEC Docket 1217, 1237-38 n.56 (and cases cited therein).

Donner reports, and that Uberti and Runyon violated these provisions with respect to the Lincoln research reports issued on Majestic and Dtomi.

B. Touting Violations

The record establishes that Donner and Baclet violated NASD Rule 2110 with respect to research reports covering forty-eight issuers, and that Uberti violated Rule 2110 with respect to reports covering forty-three of these issuers, 65/ by failing to disclose the compensation received by Donner in violation of Securities Act Section 17(b). 66/ "In order to violate Section 17(b), a person must (1) publish or otherwise circulate (using a means of interstate commerce), (2) a notice or type of communication (which describes a security), (3) for consideration received (past, currently, or prospectively, directly or indirectly), (4) without full disclosure of the consideration received and the full amount." 67/ A violation of Section 17(b) does not require a finding of scienter. 68/ "Section 17(b) was designed to protect the public from publications that

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65/ As noted above, Uberti was charged, based on a document prepared by Baclet, with the failure to disclose compensation in reports covering forty-four of these issuers. NASD's exhibit charging Uberti with liability, however, lists Uberti as liable for the Discovery Laboratories, Inc. report, and Baclet did not identify Uberti as having worked on this report. Accordingly, we set aside NASD's finding that Uberti violated NASD Rule 2110 with respect to this research report.

66/ As a result of this finding, we do not need to consider whether the failure to disclose the compensation received in exchange for writing the reports also violated Exchange Act Section 10(b), Rule 10b-5 thereunder, or NASD Rules 2120, 2210, and 2110.

67/ SEC v. Gorsek, 222 F. Supp. 2d 1099, 1105 (C.D. Ill. 2001); see also Donald R. Lehl, 55 S.E.C. 843, 866 (2002) (stating that "Securities Act Section 17(b) makes it unlawful for any person to use the mails or other means of interstate commerce to publish or circulate any communication, including circulars, advertisements, and articles, 'which, though not purporting to offer a security for sale, describes such security for a consideration received or to be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof'") (citing Securities Act Section 17(b), 15 U.S.C. § 77q(b)).

68/ Lehl, 55 S.E.C. at 867.

'purport to give an unbiased opinion but which opinions in reality are bought and paid for.'" 69/ "[A] violation of the securities laws . . . is a violation of Conduct Rule 2110." 70/

Baclet acknowledged that Donner "was paid to come out with a positive report"; however, Donner did not disclose that it received compensation for issuing the reports or the amount of the compensation received. Donner posted the reports on its website, 71/ and described the issuer, analyzed the issuer's prospects, and recommended the issuer's stock in these reports. 72/ Donner sent its new clients an investment banking agreement and an invoice for $2,500 and drafted the research report after receiving the company's check. Baclet acknowledged that he "was paid in stock or cash and/or both," and Uberti testified that, for the companies he oversaw, he "would get fifty percent of the revenues or income that was generated from [Donner's] relationship with that company."

The Donner research reports, however, stated only that Donner "may from time to time perform investment banking, corporate finance, [or] provide services for" the issuer, sometimes adding that Donner might perform these services "for a fee." They did not disclose that Donner in fact received compensation in exchange for writing and making public the research reports or the type of consideration or the amount of compensation received. Thus, Donner failed to make the requisite disclosure. 73/

69/ Gorsek, 222 F. Supp. 2d at 1105 (quoting United States v. Amick, 439 F.2d 351, 365 (7th Cir. 1971)); see also Lehl, 55 S.E.C. at 867 (quoting Amick).

70/ Paul Joseph Benz, Exchange Act Rel. No. 51046 (Jan. 14, 2005), 84 SEC Docket 2631, 2636 n.15; see also Gebhart, 87 SEC Docket at 460 n.75 (finding that respondents' sales in violation of Securities Act Section 5 also constituted a violation of NASD Rule 2110); Sorrell v. SEC, 679 F.2d 1323, 1326 (9th Cir. 1982) (stating that an obvious violation of the securities laws such as selling unregistered securities also would violate the requirement that NASD members observe just and equitable principles of trade).

71/ See SEC v. Phoenix Telecom, LLC, 239 F. Supp. 2d 1292, 1298 (N.D. Ga. 2000) (finding that the means of interstate commerce include an internet web site).

72/ See Gorsek, 222 F. Supp. 2d at 1105 (finding that defendants published a communication describing a security by "produc[ing] 'profiles' on behalf of its issuer-clients" which "recommended the stock of the issuer and appeared to be an independent analysis").

73/ See Gorsek, 222 F. Supp. 2d at 1106-07 ("Here, Section 17(b) calls for the disclosure of the receipt of compensation and the amount. It is undisputed that the Defendants did not disclose the amount of compensation in their written or verbal communications concerning their issuer-clients . . . . [Defendant's disclosure] fail[s], as previously noted, to list the amount of compensation; [it] also fail[s] to disclose the type of consideration

(continued...)

Although Uberti contends that he "was not responsible for the disclaimer" regarding Donner's compensation, he e-mailed Merrell the disclaimer for inclusion in the research reports and admitted in his brief that he "checked to make sure the disclaimer was in fact included on the last page of the report." He knew that "Donner had some sort of agreement with the various companies" to receive compensation for issuing the reports, and he received, as noted above, fifty percent of Donner's revenue generated by the research reports that he worked on. Uberti acknowledged that after NASD issued the complaint he "went and looked at the regulations and the regulations says [sic] you have to disclaim what you were paid and the amount thereof." 74/

We sustain NASD's finding that Donner, Baclet, and Uberti violated NASD Rule 2110 by failing to disclose in violation of Securities Act Section 17(b) the compensation received by Donner in exchange for issuing the research reports. 75/

C. Supervisory Violations

NASD Rule 2210(b)(1) provides that a "registered principal of the member must approve by signature or initial and date each advertisement, item of sales literature and independently prepared reprint." The record establishes that Donner and Baclet violated NASD Rule 2210(b)(1) by failing to have a Donner principal approve and sign Donner's research reports. Donner's written supervisory procedures listed Baclet as having primary responsibility for the firm's advertising and sales literature. The written procedures stated that the designated principal would approve each item of advertising and sales literature, and defined sales literature as including research reports. However, those procedures did not set forth how the principal's approval was to be obtained. Uberti testified he was unaware of a procedure to obtain such approval. None of the Donner research reports contained the signature or initials of Baclet or any

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73/ (...continued)
(e.g., stock, cash, or combination of cash and stock). Therefore, the Court finds there is no genuine issue of material fact disputing that [Defendants] violated Section 17(b)."); see also Lehl, 55 S.E.C. at 867-68 (finding that the "disclosure that persons . . . 'may' receive compensation or may receive securities is misleading and inadequate when they in fact received or contracted to receive compensation").

74/ Uberti testified further that the disclaimer used by Donner was the "industry standard" and that "if all the broker/dealers were using that, that must be accepted by the NASD even though the rule says you have to put the very specific amount of compensation in the disclaimer." "The courts and the Commission have repeatedly held that a practice may be prevalent in the industry and still be fraudulent." IFG Network Secs., Exchange Act Rel. No. 54127 (July 11, 2006), 88 SEC Docket 1374, 1380 (citing cases).

75/ We reject Baclet's contention that NASD alleged that he "broke disclosure rules during 1999 and 2000 that didn't exist until July 2001." Both NASD Rule 2110 and Section 17(b) of the Securities Act were in effect at the time Donner issued its research reports.

other registered principal. Baclet admitted that he did not approve the reports in writing. He admitted further in his reply brief that he was "unintentionally wrong by not having a principal sign off on the reports." We thus sustain NASD's finding that Donner and Baclet violated Rule 2210(b)(1). 76/

NASD Rule 3010 provides that a member firm shall "establish, maintain, and enforce written procedures to supervise the types of business in which it engages and to supervise the activities of registered representatives, registered principals, and other associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of NASD." We have held that "supervisory procedures must establish mechanisms for ensuring compliance and detecting violations." 77/

Donner's written supervisory procedures did not include any guidance with respect to the preparation and review of research reports. Uberti testified that he never saw any written supervisory procedures for the writing and dissemination of research reports or to ensure that the reports did not contain exaggerated or unwarranted statements. Baclet admitted that he failed to review the majority of the research reports and that such failure was "irresponsible."

We reject Applicants' suggestion that a "worksheet" used by Donner fulfilled the requirements of either NASD Rules 3010 or 2210(b)(1). Baclet testified that the worksheet was "just kind of a check sheet that would allow you to correspond with the company all the way down to the end." Although Baclet added that "as time progressed it evolved into different things, like is the due diligence done [or] is the corporate director's questionnaire completed," the only worksheet in the record consisted of a chronology of communications between Donner and the issuer. It was entitled "Donner Corp. Billing Sheet." The top of the worksheet listed the name of the company and its contact information, and the body of the document listed notations such as "faxed invoice," "mailed check," and "draft," with a date next to each. Although Uberti suggested that Donner's worksheet could be considered part of Donner's procedures and could contain a principal's signature, he acknowledged that he did not know whether anyone actually signed the worksheet or otherwise indicated on the worksheet that the report was approved for

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76/ Baclet contends that he "was not made aware of this necessity" of having a principal of the firm sign or initial the research reports and that he would have signed the reports himself had he "known the reports had to be signed off on." We have held repeatedly that "ignorance of NASD rules does not excuse an associated person from compliance with those rules." Guang Lu, Exchange Act Rel. No. 51047 (Jan. 14, 2005), 84 SEC Docket 2639, 2646 n.16 (citing Gilbert M. Hair, 51 S.E.C. 374, 378 (1993)), aff'd, 179 Fed. Appx. 702 (D.C. Cir. 2006).

77/ John A. Chepak, 54 S.E.C. 502, 506 (2000).

dissemination to the public. The worksheet in the record did not document any compliance review by a Donner principal or written approval of the report's dissemination. 78/

IV.

Applicants raise a series of procedural objections. For the reasons set forth below, we reject these challenges.

A. Baclet, Uberti, and Runyon each argue that NASD did not provide them with adequate notice of the charges against them. Baclet contends that NASD "would not disclose to [him] the specific reports and supposed problems with those reports until the hearing thereby denying [him] a reasonable time to prepare a fair defense." NASD, however, identified the allegedly violative reports in its complaint filed on October 21, 2002, and provided Baclet with a chart detailing each alleged misstatement and omission in each report on March 13, 2003, six months before the hearing began on September 15, 2003. 79/

With respect to Uberti and Runyon, NASD's complaint alleged that Lincoln's issuance of the Majestic and Dtomi research reports resulted in violations of Section 10(b) of the Exchange Act, Exchange Act Rule 10b-5, and NASD Rules 2120, 2210, and 2110. The complaint alleged that Uberti and Runyon "intentionally or recklessly" failed to disclose "going concern opinions," the "underlying basis" for those opinions, and the "true financial condition of the companies." NASD also provided Uberti and Runyon with a summary exhibit detailing each alleged misstatement and omission in both reports on March 28, 2003, five-and-a-half months before the

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78/ Baclet attached to his reply brief a document entitled "The Formulation of Donner Analyst Report." Although the document lists ten steps for preparing a research report, Baclet did not introduce it at the hearing, and it is not part of the record in this proceeding. Baclet has not demonstrated the materiality of the exhibit or reasonable grounds for his failure to adduce this document previously. See Commission Rule of Practice 452, 17 C.F.R. § 201.452 (stating that a motion to adduce additional evidence "shall show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously"). Baclet acknowledged at the hearing that Donner's written supervisory procedures did not discuss the preparation and issuance of research reports in its description of the nature of Donner's business. The document attached to the reply brief does not indicate when it was written or to whom it was distributed. For these reasons, we do not attach any weight to the new document.

79/ NASD filed an amended list of the violative reports and an amended chart of the misstatements and omissions on July 17, 2003, in order to "cure minor oversights."

hearing. We find that NASD adequately informed Baclet, Uberti, and Runyon of the nature of the charges against them. 80/

B. Baclet contends further that NASD based its allegations on draft research reports rather than the final research reports issued by Donner. The senior manager conducting NASD's investigation, however, testified that he asked Baclet for a final copy of each research report, that Baclet allowed NASD staff to copy the research reports off his computer onto a disk, and that NASD staff printed these reports off that disk for use as exhibits at the hearing. He added that Applicants had not produced any other research reports which they claimed to be final reports. Although Baclet continues to maintain that NASD reviewed only draft reports, he also states in his reply brief that he "decisively apologize[s] for insisting [NASD] didn't have final reports."

C. Baclet also contends that he "had 12 years in the business having passed all evaluations and examinations in which a number of the same reports were cleared." The only examination documented by Baclet, however, found "deficiencies and/or violations of law." It stated, moreover, that Donner "should not assume that [its] activities not discussed in this letter are in full compliance with the federal securities laws or other applicable rules and regulations." In any event, as noted above, a broker-dealer cannot shift its responsibility for compliance with applicable requirements to the NASD. "A regulatory authority's failure to take early action neither operates as an estoppel against later action nor cures a violation." 81/

D. Baclet asserts that NASD staff exhibited prejudice against him. He claims that the NASD staff attorney conducting his on-the-record interview "was offended at [his] request to pray" before that interview. No evidence exists that NASD staff treated Baclet unfairly or not impartially as a result of Baclet's request. 82/ "Moreover, it is the NASD, not the staff, that makes decisions. Even if a member of the staff were biased, that would not mean that the NASD

80/ See, e.g., Toney L. Reed, 51 S.E.C. 1009, 1013 n.14 (1994) (rejecting applicant's claim "that the NASD did not give him adequate notice of the specific charges against him" where we "reviewed the NASD's complaint" and were "satisfied that [he] had sufficient notice of the charges against him and an adequate opportunity to defend himself").

81/ William H. Gerhauser, 53 S.E.C. 933, 940 (1998) (finding applicants liable "even had there been an NASD audit that found no violations"); Rita H. Malm, 52 S.E.C. 64, 75 n.40 (1994) (rejecting applicant's "contention that, because the NASD noted no markup, pricing or other 'exceptions' during its audit . . . NASD was subsequently precluded from bringing markup or supervisory charges").

82/ Cf. Michael Lubin, 55 S.E.C. 511, 533 (2002) (rejecting applicant's contention that the staff of the Chicago Board Options Exchange was "biased" because there was "no indication in the record that CBOE staff was unfair or not impartial in any way").

decision is biased." 83/ We also note that "our de novo review dissipates even the possibility of unfairness." 84/

E. Baclet also alleges that NASD "denied [him] due process." Although "self-regulatory organizations need not provide the same level of procedural due process as government agencies, Exchange Act Section 15A(b)(8) requires that they provide 'fair procedures' for disciplining members." 85/

Baclet claims that the Hearing Panel "all but totally obstructed Mr. Baclet from having defense witnesses." The Hearing Panel, however, repeatedly extended the deadline for Baclet to submit his proposed witness list. Moreover, the record indicates that the Hearing Panel provided Baclet every opportunity to present witnesses as part of his defense. For example, when Baclet still did not know, in the middle of the hearing, which, if any, of his proposed witnesses would be able to testify, the panel offered to change the order of testimony to accommodate Baclet. The Hearing Officer stated that "after Mr. Uberti then we would have expected to hear your witnesses and then we would have expected to hear from you. And what I'm saying is instead of after Mr. Uberti we hear your witnesses, we hear you first to give your witnesses the opportunity to sign the affidavits and get them in. I'm saying that would that be helpful to you."

We similarly reject Baclet's contention that NASD "monopolized two and a half of the three day hearing endlessly presenting the technicalities of how they gathered their information and only the last half of the last day on the supposed facts against [him] thereby not permitting [him] a fair response or even a comprehensive preparation for response; not even one night." Baclet had almost a year between the filing of the complaint and the start of the hearing to prepare his defense. NASD provided him access to its investigative files. The panel also provided him with the opportunity to testify, adduce evidence, and cross-examine witnesses. 86/

83/ Maximo Justo Guevara, 54 S.E.C. 655, 665 n.21 (2000)(quoting Frank J. Custable, Jr., 51 S.E.C. 855, 862 n.22 (1993)), petition denied, 47 Fed. Appx. 198 (3d Cir. 2002) (Table).

84/ Tretiak, 79 SEC Docket at 3184.

85/ Fitzpatrick, 55 S.E.C. at 427 (citing Larry Ira Klein, 52 S.E.C. 1030, 1039 n.36 (1996)).

86/ Cf. E. Magnus Oppenheim & Co., Exchange Act Rel. No. 51479 (Apr. 6, 2005), 85 SEC Docket 475, 480 (rejecting claim that NASD denied due process where "NASD conducted a hearing on the record at which Applicant was given the opportunity to confront and cross-examine adverse witnesses and to present Applicant's own case and witnesses"). Baclet attached forty-three exhibits to his reply brief. Several of these documents were not introduced at the hearing. Baclet has not demonstrated the materiality of these exhibits or reasonable grounds for his failure to adduce such exhibits previously. See Commission Rule of Practice 452, 17 C.F.R. § 201.452 (stating that a

(continued...)

F. Uberti and Runyon argue that they were "prejudiced" by NASD's denial of their motions to sever the proceeding. Before the hearing, they both filed motions to sever the allegations against Lincoln from the allegations against Donner. Although NASD denied the severance motion, it divided the hearing into two phases, with evidence pertaining to the Lincoln reports presented in phase one and evidence pertaining to the Donner reports presented in phase two.

NASD Rule 9214(d) provides that, in determining whether to sever a proceeding, the factors to be considered are: (1) whether the same or similar evidence reasonably would be expected to be offered at each of the possible hearings; (2) whether the severance would conserve the time and resources of the parties; and (3) whether any unfair prejudice would be suffered by one or more parties if the severance is (not) ordered. As noted by NASD, both Uberti and Runyon worked at Donner before forming Lincoln. The Lincoln research reports followed the same format as the Donner research reports, and Uberti and Runyon retained Merrell to write their research reports as he had done at Donner. Both Uberti and Runyon offered testimony relevant to both the allegations related to the Donner research reports and the allegations related to the Lincoln research reports. Neither Uberti nor Runyon demonstrate any prejudice from NASD's denial of the motion to sever. We find that NASD judged each Applicant solely on the record evidence pertaining to that Applicant. Under these circumstances, we agree with NASD that the same or similar evidence reasonably would be expected to be offered at each of the possible hearings, that severance would not have conserved the time or resources of the parties, and that the denial of a severance would not, and did not, prejudice any party.

V.

Under Exchange Act Section 19(e)(2), we may reduce or set aside sanctions imposed by NASD if we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive or oppressive or impose an unnecessary burden on competition. 87/ The NASD Sanction Guideline for intentional or reckless misrepresentations or omissions of material fact recommends suspending an individual or firm for between ten business days and

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86/ (...continued)
motion to adduce additional evidence "shall show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously"). Although Baclet explains this failure as a result of "not having a history of legal instances" and "not being a lawyer," he introduced several exhibits at the hearing. We therefore grant NASD's motion to strike the additional evidence appended to Baclet's reply brief with respect to those exhibits not previously adduced at the hearing.

87/ 15 U.S.C. § 78s(e)(2). Applicants do not claim, and the record does not show, that NASD's action imposed an undue burden on competition.

two years, or, in egregious cases, barring the individual or expelling the firm. 88/ The guideline for intentional or reckless use of misleading communications with the public recommends suspending the individual or firm for up to two years, or, in the case of numerous acts of intentional or reckless misconduct over an extended period of time, barring the individual or expelling the firm. 89/

Using these guidelines, NASD expelled Donner and barred Baclet and Uberti. NASD did not impose additional sanctions on Donner and Baclet for their failure to maintain adequate written supervisory procedures or obtain written approval for dissemination of the research reports by a firm principal. NASD also suspended Runyon for six months, imposed on him a $20,000 fine, and ordered that he requalify as a general securities representative and principal. NASD also found these sanctions appropriate for Uberti's misconduct related to the Lincoln research reports, but did not impose these additional sanctions on Uberti in light of its imposition of the bar for his misconduct at Donner.

Applicants violated the antifraud provisions of the federal securities laws and the rules and regulations thereunder. "[C]onduct that violate[s] the antifraud provisions of the federal securities laws is especially serious and subject to the severest of sanctions." 90/ Donner and Baclet issued twenty-five research reports that violated the antifraud provisions. As NASD notes, these violations spanned a period of several years, and Donner and Baclet made the violative reports accessible to all members of the public. The reports omitted material negative financial information about the recommended companies and misleadingly portrayed the companies as undervalued, poised for growth, and having significant potential for appreciation. Donner and Baclet also issued the reports in exchange for compensation. We reject Baclet's contention that such misconduct deserves "[c]orrections, warnings, [or] small to moderate fines." Under the circumstances, we find the sanctions imposed by NASD on Donner and Baclet neither excessive nor oppressive.

We also find the sanctions that NASD deemed appropriate for Uberti and Runyon's misconduct regarding the Lincoln research reports neither excessive nor oppressive. Uberti and Runyon, through Lincoln, issued two research reports that violated the antifraud provisions of the federal securities laws. As did the Donner reports, these reports omitted negative financial information and contained exaggerated and unsubstantiated claims about the company's prospects. NASD considered the dissemination of these reports to all members of the public on Lincoln's website an aggravating factor. The six-month suspension, $20,000 fine, and

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88/ NASD Sanction Guidelines 96 (2001 ed.).

89/ Id. at 89.

90/ Gebhart, 87 SEC Docket at 469.

requalification requirement are well within the range of sanctions recommended by the guidelines. 91/

We cannot determine, however, whether the bar imposed for Uberti's misconduct with respect to the Donner research reports is excessive or oppressive. The record suggests that Uberti had less responsibility for the Donner research reports than Baclet. Nonetheless, NASD's National Adjudicatory Council (the "NAC") increased Uberti's sanction to a bar, the same sanction as it imposed on Baclet, after the Hearing Panel imposed on Uberti a two-year suspension and a $20,000 fine. The Hearing Panel found "as a mitigating factor that Uberti relied on Baclet's final review of the research report for conformity with the securities laws and NASD rules" and found Uberti's reliance on Baclet reasonable. According to the Hearing Panel, moreover, "Uberti also believed that Donner had previously cleared the format of the research reports . . . with the regulatory authorities." The Hearing Panel also found "credible" Uberti's expressions of remorse and testimony "that he would not make the same mistakes in the future." Although the NAC determined that Uberti's "continuance in the securities industry could pose a risk to the investing public," it did not discuss any of the mitigating factors identified by the Hearing Panel. Under the circumstances, we find it appropriate to remand the matter to NASD

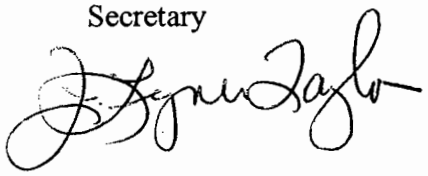
91/ Uberti and Runyon argue that "there are no customer complaints and no evidence that anyone was harmed by the two reports." Although we cannot determine whether the reports caused harm, the reports recommended that investors purchase the issuers' stock while misrepresenting the issuers' financial condition. We do not believe any reduction in sanction is warranted. Cf. Coastline Financial, Inc., 54 S.E.C. 388, 396 (1999) (finding expulsion of firm and permanent bar of president neither excessive nor oppressive because, "[a]lthough, as the NASD noted, there was no evidence of customer harm, Respondents raised hundreds of thousands of dollars by selling securities through outright falsehoods to forty-eight investors"); Barr Financial Group, Inc., Investment Advisers Act Rel. No. 2179 (Oct. 2, 2003), 81 SEC Docket 828, 844 (finding cease-and-desist order, bar, and revocation of registration "amply warranted" where, "[a]lthough there is no evidence that any customer lost money as a result of respondents' violations, their actions clearly posed a threat to the investing public" because the "untrue assertions made by respondents in [their] Commission filings misled investors regarding [respondent's] qualifications and the willingness of others to trust respondents with their assets").

so that it can consider whether a bar is excessive or oppressive in light of this evidence. Although, as noted, NASD did not impose the sanctions for the Lincoln violations on Uberti in light of the bar it imposed for the Donner violations, on remand NASD should consider whether imposing such sanctions on him is warranted.

An appropriate order will issue. 92/

By the Commission (Chairman COX and Commissioners CAMPOS, NAZARETH, and CASEY); Commissioner ATKINS not participating.

Nancy M. Morris
Secretary



By: J. Lynn Taylor
Assistant Secretary

92/ We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 55313 / February 20, 2007

Admin. Proc. File No. 3-12260

In the Matter of the Application of

DONNER CORPORATION INTERNATIONAL,
JEFFREY L. BACLET,
VINCENT M. UBERTI, and
PAUL A. RUNYON

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING FINDINGS OF VIOLATION AND SUSTAINING IN PART AND VACATING AND REMANDING IN PART SANCTIONS IMPOSED BY REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the findings of violation made by NASD against Donner Corporation International, Jeffrey L. Baclet, Vincent M. Uberti, and Paul A. Runyon be, and they hereby are, sustained; and it is further

ORDERED that the sanctions imposed on Donner Corporation International, Jeffrey L. Baclet, and Paul A. Runyon be, and they hereby are, sustained; and it is further

ORDERED that the sanctions imposed on Vincent M. Uberti be, and they hereby are, vacated and remanded to NASD for further proceedings in accordance with this opinion.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

NASD v. Donner Corporation International, et al.

Amended Exhibit A

	Issuer/Symbol/Market/Date/Recommendation	Reports Alleged Against Uberti
1	Dynamic Web Enterprises ("DWEB")/OTCBB 03/22/99: Speculative Buy	Yes
2	General Automation, Inc. (GA Express) ("GUAM")/OTCBB 06/07/99: Speculative Buy	Yes
3	Medical Science Systems ("MSSI")/Nasdaq 06/14/99: Speculative Buy	No
4	Imaging Technologies Corporation ("ITEC")/OTCBB 06/23/99: Speculative Buy	Yes
5	ALYN Corporation ("ALYN")/Nasdaq 07/07/99: Speculative Buy	Yes
6	Esynch Corporation ("ESYN")/OTCBB 09/27/99: Speculative Buy	Yes
7	Hawaiian Natural Water Co., Inc. ("HNWCC")/Nasdaq Small Cap 10/05/99: Speculative Buy	Yes
8	American Champion Entertainment ("ACEI")/Nasdaq Small Cap 10/18/99: Speculative Buy	Yes
9	StarBase Corporation ("SBAS")/Nasdaq 10/21/99: Speculative Buy	Yes
10	Imperial Petroleum ("IPTM")/OTCBB 11/11/99: Speculative Buy	Yes
11	Professional Transportation Group, Ltd. ("TRUC")/Nasdaq 01/17/00: Speculative Buy	Yes
12	Dippy Foods, Inc. ("DPPI")/OTCBB 01/31/00: Speculative Buy	Yes

13	Ocean Power Corporation ("PWRE")/OTCBB 02/23/00: Speculative Buy	Yes
14	Ilive.com, Inc. ("LIVE")/OTCBB 03/08/00: Speculative Buy	Yes
15	Itronics, Inc. ("ITRO")/OTCBB 03/20/00: Speculative Buy	Yes
16	Genius Products, Inc. ("GNUS")/OTCBB 04/25/00: Speculative Buy	Yes
17	Insider Street.com ("NSDR")/OTCBB 04/26/00: Speculative Buy	Yes
18	Pen Interconnect Inc. ("PENC")/OTCBB 05/23/00: Speculative Buy	Yes
19	Advanced Biotherapy Concepts ("ADVB")/OTCBB 08/21/00: Speculative Buy	Yes
20	Far East Ventures, Inc. ("FEVI")/OTCBB 01/10/01: Speculative Buy	Yes
21	SEDONA Corporation ("SDNA")/Nasdaq Small Cap 04/25/01: Speculative Buy	Yes
22	Aethlon Medical, Inc. ("AEMD")/OTCBB 06/12/01: Speculative Buy	Yes
23	Advanced Aerodynamics and Structures, Inc. ("AASI")/OTCBB 06/27/01	Yes
24	Vital Living, Inc. ("VTLV")/OTCBB 04/24/02: Speculative Buy	No
25	Xechem International Inc ("ZKEM")/OTCBB 05/16/02: Speculative Buy	No

NASD v. Donner Corporation, International, et al.

Amended Exhibit B

Issuer Name	Calendar Year 1999	Calendar Year 2000	Reports Alleged Against Uberti
1. Abaxis, Inc.	May 4		X
2. Alyn Corporation	July 7		X
3. American Champion Entertainment	October 18		X
4. Avcorp Industries	June 7		X
5. B2 Technologies		March 6	X
6. Carbite Golf	September 13		X
7. China Premium Food Corp.		February 8	X
8. Comanche Energy, Inc.	October 27		X
9. Cypros Pharmaceuticals Corp.	April 2 and July 23		
10. Datametrics Corporation	August 23		X
11. Digital Power	July 28		X
12. Dippy Foods		January 31 and March 27	X
13. Discovery Laboratories, Inc.	November 30	April 10	X
14. Diversified Senior Services	December 16		
15. Dynamic Web Enterprises	March 22		X
16. Esynch Corporation	September 27		X
17. General Automation (G/A Express, Inc.)	June 7 and October 8	January 25	X
18. Genetronics	June 16		
19. Geo2 Limited	October 21		X
20. Hawaiian Natural Water Company, Inc.	October 5		X
21. Ilive.com		March 8	X
22. Imaging Technologies Corporation	June 23		X
23. Incubator Capital		February 7	X
24. Integrated Spatial Information Solutions, Inc.		March 6	X

25. Interleukin Genetics */		March 8	
26. InternetStudios.com, Inc.		March 2	X
27. Itronics, Inc.		March 20	X
28. Lancer Orthodontics	April 19		X
29. Longport, Inc.		February 2	X
30. Media Bay, Inc.		March 9	X
31. Medical Science Systems, Inc.	June 14 and July 12		
32. Mustang Software, Inc.	September 21	February 22	X
33. ObjectSoft Corp.	September 13		X
34. Ocean Power Corporation		February 23	X
35. Orlando Predators Entertainment, Inc.		February 22	X
36. Pen Interconnect, Inc.	September 21		X
37. PharmaPrint, Inc.	July 23		X
38. Pioneer Behavioral Health, Inc.	May 5 and June 21		
39. PLC Systems, Inc.**/		April 24	X
40. PriceNet USA, Inc.		March 7	X
41. Retrospettiva, Inc.		February 23	X
42. Starbase Corporation	October 21 and December 16		X
43. SVI Holdings	September 9	February 17	X
44. Titan Pharmaceuticals, Inc.	June 22		
45. Tri-Lite, Inc.	October 19		X
46. Trimedyne, Inc.	July 27	February 28 and April 4	X
47. TrimFast Group, Inc.		March 7	X
48. WaveRider Communications, Inc.		February 8	X
49. Xybernaut Corporation	October 12	January 24	X
50. Zapworld.com		February 23	X

*/ NASD made no findings with respect to the Interleukin Genetics research report.

**/ NASD made no findings with respect to the PLC Systems, Inc. research report.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No . 55318 / February 20, 2007

INVESTMENT ADVISERS ACT OF 1940
Rel. No. 2591 / February 20, 2007

Admin. Proc. File No. 3-12250

In the Matter of GLOBAL CROWN CAPITAL, LLC, J&C GLOBAL SECURITIES INVESTMENTS, LLC, RANI T. JARKAS, and ANTOINE K. CHAYA	ORDER DISMISSING PROCEEDINGS

On March 30, 2006, we instituted administrative proceedings against Global Crown Capital, LLC, J&C Global Securities Investments, LLC, Rani T. Jarkas, and Antoine K. Chaya (collectively, "Respondents"). On October 10, 2006, the Division of Enforcement requested that these proceedings be dismissed and that, pending consideration of the Division's request, they be stayed. On October 16, 2006, we granted the Division's request for a stay.

The Division states that "the motion to dismiss is made in light of the potential impact of the recent decision by the District of Columbia Circuit in Goldstein v. SEC, 451 F.3d 873 (D.C. Cir. 2006), on the validity of claims against these Respondents under Sections 206(1) and 206(2) of the [Investment] Advisers Act [of 1940]." The Division notes that the court, in Goldstein, "vacat[ed] and remand[ed] to the Commission the rule adopted in Registration Under the Advisers Act of Certain Hedge Fund Advisers, 69 Fed. Reg. 72,054 (Dec. 10, 2004), requiring that certain hedge fund advisers register under the Advisers Act." The Division represents that "Respondents have no objection to this motion."

We conclude that, under these circumstances, it is appropriate to grant the Division's motion to dismiss the proceedings. */

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*/ We note that the Division of Enforcement has not moved to amend the Order Instituting Proceedings ("OIP"), as authorized by Commission Rule of Practice 200(d), to allege violations of other provisions of the federal securities laws. We express no view on

(continued...)

Accordingly, IT IS ORDERED that the proceedings instituted on March 30, 2006 against Global Crown Capital, LLC, J&C Global Securities Investments, LLC, Rani T. Jarkas, and Antoine K. Chaya be, and they hereby are, dismissed.

By the Commission.

Nancy M. Morris
Secretary

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*/ (...continued)
whether the facts alleged in the OIP could support findings of violation under other provisions of the federal securities laws. Nothing in this order should be interpreted as precluding any subsequent proceedings against Respondents alleging different violations based on the factual allegations in this proceeding or any other facts.

Chairman Cox
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55324 / February 21, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2564 / February 21, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12571

In the Matter of **ANTHONY L. HURLEY,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Anthony L. Hurley ("Respondent" or "Hurley") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

Document 18 of 22

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

III.

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

1. Hurley, age 36, was a certified public accountant licensed in the State of Massachusetts. He was employed as the assistant controller of Enterasys Networks, Inc. ("Enterasys") from October 1998 through November 2002.[2]

2. Enterasys was headquartered in New Hampshire and engaged in the business of providing telecommunications switches and related products. Its stock was registered with the Commission and listed on the New York Stock Exchange. Accordingly, Enterasys filed periodic reports with the Commission containing consolidated financial statements.[3]

3. On February 6, 2007, in the civil action entitled Securities and Exchange Commission v. Anthony L. Hurley, Civil Action Number 07cv022, in the United States District Court for the District of New Hampshire, a final judgment was entered against Hurley, permanently enjoining him from future violations of Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13b2-1 and 13b2-2 thereunder, and from aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder. Hurley was also ordered to pay $24,498 in disgorgement of ill-gotten gains from his sales of stock and bonuses while participating in the fraud, as well as $7,526 in prejudgment interest.

4. The Commission's complaint alleged that Hurley and others engaged in a fraudulent scheme which resulted in Enterasys reporting inflated revenues for periods in 2000 and 2001. The Commission alleged, among other things, that Enterasys improperly recognized

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[2] Enterasys was a wholly-owned subsidiary of Cabletron Systems, Inc. ("Cabletron") from February 2000 to August 6, 2001, at which time Enterasys merged into, and became successor to, Cabletron. As used in this Order, "Enterasys" refers to Cabletron (prior to the merger) and Enterasys (after the merger).

[3] Enterasys became a private company on March 1, 2006, following its acquisition by two limited liability companies. On the same day, it filed a Form 15 with the Commission terminating the registration of its common stock under Section 12 of the Exchange Act. On March 2, 2006, Enterasys was delisted from the New York Stock Exchange.

revenues from sales tied to investment transactions that lacked economic substance. It contended that Enterasys funded the purchase of its own products by purchasing equity interests in other companies that used the investment proceeds to pay for Enterasys products. The Commission alleged that Hurley knowingly participated in the fraudulent scheme by allowing Enterasys to improperly recognize revenue and by misrepresenting material information to or concealing material information from Enterasys' outside auditors.

IV.

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

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

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

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

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

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

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

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

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

(d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to

comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

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

By the Commission.

Nancy M. Morris
Secretary

By: Jill M. Peterson
Assistant Secretary

Commissioner Campos Dissented and Commissioner Nazareth Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55322 / February 21, 2007

INVESTMENT ADVISERS ACT OF 1940
Release No. 2592 / February 21, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12570

In the Matter of **MICHAEL G. VELASCO,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

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

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.1 and III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Velasco, age 45, is a resident of Basking Ridge, New Jersey. From 2001 through January 2004, Velasco was employed as a registered representative at a branch office of Deutsche Bank Securities, Inc. (DBSI), a registered broker-dealer and investment adviser, located in New York, New York. Velasco was registered with DBSI as a general securities representative. During the relevant period, Velasco was a person associated with a broker or dealer and investment adviser.

2. On January 26, 2007, a final judgment was entered by consent against Velasco, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Michael G. Velasco, Civil Action Number 06-CV-15345 (WHP), in the United States District Court for the Southern District of New York.

3. The Commission's Complaint alleged the following. From approximately March 2003 through September 2003, Velasco engaged in deceptive practices to circumvent mutual funds' restrictions on his market timing customers. For example, various mutual funds identified Velasco's customers as market timers, and then rejected the customers' trades. In response, Velasco opened new accounts for the customers, who then used the new accounts to continue market timing the same mutual funds that had previously rejected the customers' trades. Through this conduct, Velasco concealed the true identity of his customers and misled mutual funds into believing that the subsequent trades were for different DBSI customers whose trading had not been blocked. Velasco executed numerous market timing trades using deceptive means. Mutual funds would have rejected these trades had they known Velasco's customers' true identities or trading strategies.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Velasco be, and hereby is barred from association with any broker or dealer, with the right to reapply for association after 2 years to the appropriate self-regulatory organization, or if there is none, to the Commission;

Pursuant to Section 203(f) of the Advisers Act, that Respondent Velasco be, and hereby is barred from association with any investment adviser, with the right to reapply for association after 2 years to the appropriate self-regulatory organization, or if there is none, to the Commission; and

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

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34-55341; File No. S7-06-07]

RIN 3235-AJ80

Proposed Rule Changes of Self-Regulatory Organizations

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing to require Self-Regulatory Organizations ("SROs") that submit proposed rule changes pursuant to Section 19(b)(7)(A) of the Securities Exchange Act of 1934 ("Act") to file these rule changes electronically. In addition, the Commission is proposing to require SROs to post all such proposed rule changes on their Web sites. Together, the proposed amendments are designed to expand the electronic filing by SROs of proposed rule changes, making it more efficient and cost effective, and to harmonize the process of filings made under Section 19(b)(7)(A) with that already in place for filings made by SROs under Section 19(b)(1) of the Act.

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

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

Electronic Comments:

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

- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-06-07 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper Comments:

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

All submissions should refer to File Number S7-06-07. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/proposed.shtml). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: John Roeser, Assistant Director, at (202) 551-5630, Timothy Fox, Special Counsel, at (202) 551-5543, Michou Nguyen, Special Counsel, at (202) 551-5634, Sherry Moore, Paralegal, at (202) 551-5549, Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION:

I. Background

Under Section 19(b)(7) of the Act and Rule 19b-7 thereunder, securities futures exchanges registered with the Commission under Section 6(g) of the Act and associations registered with the Commission for the limited purpose of regulating activities of members who are registered as broker-dealers in security futures[1] with respect to securities futures products under Section 15A(k) of the Act are required to file certain categories of proposed rule changes with the Commission.[2] These proposed rule changes are published for comment and may take effect: (1) when a written certification has been filed with the Commodity Futures Trading Commission ("CFTC") under Section 5c(c) of the Commodity Exchange Act; (2) when the CFTC determines that review of the proposed rule change is not necessary; or (3) when the CFTC approves the proposed rule change.[3] Rule 19b-7 and Form 19b-7 under the Act set forth the process for SROs to file proposed rule changes under Section 19(b)(7).

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1 See Section 15(b)(11) of the Act. 15 U.S.C. 78o(b)(11).

2 Section 19(b)(7) of the Act. 15 U.S.C. 78s(b)(7). Specifically, under Section 19(b)(7), these SROs submit those proposed rule changes that relate to higher margin levels, fraud or manipulation, recordkeeping, reporting, listing standards, or decimal pricing for security futures products, sales practices for security futures products for persons who effect transactions in security futures products, or rules effectuating the SRO's obligation to enforce the securities laws. Id.

3 Section 19(b)(7)(B) of the Act. 15 U.S.C. 78s(b)(7)(B). Proposed rule changes that relate to margin, except for those that result in higher margin levels, must be filed pursuant to Sections 19(b)(1) of the Act. 15 U.S.C. 78s(b)(1).

Currently, other SROs are required to electronically file proposed rule changes submitted to the Commission under Section 19(b)(1) of the Act.[4] SROs are also required to post such proposed rule changes on their Web sites.[5]

Proposed rule changes submitted by SROs under Section 19(b)(7) of the Act, in contrast, are submitted to the Commission in paper.[6] In addition, SROs are not currently required to post proposed rule changes filed under Section 19(b)(7) on their Web sites. The Commission is now proposing to amend Rule 19b-7 and Form 19b-7 to require electronic filing and Web posting of proposed rule changes filed under Section 19(b)(7) of the Act. These proposed requirements are consistent with the requirements already in place for proposed rule changes filed pursuant to Rule 19b-4 and Form 19b-4.

II. Proposed Amendments

A. Electronic Filing

The Commission is proposing to amend Rule 19b-7 and Form 19b-7 to require that all Forms 19b-7, and any amendments thereto, be submitted electronically to the Commission. The proposal would modernize this rule filing process by expanding the types of proposed rule changes filed electronically with the Commission. Each SRO would have access to a secure Web site, known as the Electronic Form Filing System ("EFFS"), which would enable authorized individuals at the SRO to file with the

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4 17 CFR 240.19b-4. See Securities Exchange Act Release No. 50486 (October 4, 2004), 69 FR 60287 (October 8, 2004) (File No. S7-18-04) ("Electronic 19b-4 Adopting Release").

5 17 CFR 240.19b-4(m).

6 See Securities Exchange Act Release No. 44692 (August 13, 2001), 66 FR 43721 (August 20, 2001) (19b-7 Adopting Release).

Commission an electronic Form 19b-7 on the SRO's behalf.[7] The current requirement in Form 19b-7 that SROs submit multiple, paper copies of proposed rule changes would be eliminated.[8] Under the proposed amendments, a proposed rule change would be deemed filed with the Commission on the business day that it is submitted electronically, so long as the Commission receives it on or before 5:30 p.m., Eastern Standard Time or Eastern Daylight Savings Time, whichever is currently in effect, and it is filed in accordance with the requirements of Rule 19b-7 and Form 19b-7.

The Commission also proposes to amend Form 19b-7 so that SROs would be required to file their proposed rule changes with an electronic signature.[9] Form 19b-7 currently requires a person that is "duly authorized" by an SRO to sign manually all rule filings.[10] Under the proposal, each duly authorized signatory would be required to obtain

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7 The SRO would determine which individuals would be supplied with User IDs and passwords to access the secure Web site. See infra note 11 and accompanying text.

8 Occasionally, an SRO may find it necessary to file documents that cannot be submitted electronically, such as comment letters submitted to the Exchange before filing, or other exhibits. In addition, it may not be appropriate to require proprietary and other information subject to a request for confidential treatment to be filed electronically. Accordingly, the proposed amendments to Rule 19b-7 and Form 19b-7 would retain the flexibility to permit portions of a rule filing to be made in paper form under limited circumstances. For example, the Commission would permit SROs to file materials for which confidential treatment is requested in paper format.

9 The Commission notes that the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. 7001, et seq. does not apply in this regard.

10 The signature requirement of Form 19b-7 currently states that "pursuant to the requirements of the [Act], the [SRO] has duly caused the filing to be signed on its behalf by the undersigned thereunto duly authorized." See 17 CFR 249.822. The Commission proposes to clarify on Form 19b-7 that this individual must be an officer of the SRO, who has been authorized by the SRO's governing body to sign proposed rule changes on behalf of the SRO. The General Instructions to Form 19b-7 currently provide that the "chief executive officer, general counsel, or other officer or director of the SRO that exercises similar authority must manually sign

a "digital ID," which would provide both the Commission and the SRO with assurances of the authenticity and integrity of the electronically-submitted Form 19b-7.[11] In addition, each signatory would be required to manually sign the Form 19b-7, authenticating, acknowledging, or otherwise adopting his or her electronic signature that is attached to or logically associated with the filing. In accordance with Rule 17a-1 under the Act,[12] the SRO would be required to retain that manual signature page of the rule filing, authenticating the signatory's electronic signature, for not less than five years after the Form 19b-7 is filed with the Commission and, upon request, furnish a copy of it to the Commission or its staff.[13]

Based on the Commission's experience receiving electronic Rule 19b-4 filings from SROs for nearly two years, the Commission believes that requiring SROs to file proposed rule changes on Form 19b-7 electronically would have many benefits. First, the Commission believes electronic filing would reduce the amount of time required by

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at least one copy of the completed Form 19b-7." Therefore, the proposed clarification would not impose a new obligation for SRO officers.

11 A digital ID, sometimes called a "digital certificate," is a file on the computer that identifies the user. Computers can use a digital ID to create a digital signature that verifies both that the message originated from a specific person and that the message has not been altered either intentionally or accidentally. The user obtains a digital ID from a "Certificate Authority" ("CA") for a modest sum (currently approximately $20 per year). When the SRO electronically sends the Form 19b-7 to the Commission, the digital ID will encrypt the data through a system that uses "key pairs." With key pairs, the SRO's software application uses one key to encrypt the document. When the Commission receives the SRO's electronic document, the Commission's software will use a matching key to decrypt the document.

12 17 CFR 240.17a-1.

13 See Proposed Rule 19b-7(d). These requirements are substantially consistent with the requirements for Form 19b-4 filings, which were adapted from Section 232.302 of Regulation S-T, 17 CFR 232.302 for EDGAR filers.

SROs to submit SRO rule filings by eliminating paper delivery, photocopying, and distribution. Under the current system, SROs send paper copies of proposed rule changes filed under Rule 19b-7 to the Commission via messenger, overnight delivery, or U.S. mail. Electronic filing would reduce costs for the SROs[14] because the SROs would no longer incur costs for delivery of paper filings or for the SRO staff time currently devoted to preparing filing packages. The Commission also would benefit from reducing the personnel time currently associated with manually processing paper filings.

Second, electronic filing would allow for a more efficient use of Commission resources by integrating the SRO electronic filing technology with SRO Rule Tracking System ("SRTS"), the internal Commission database that tracks these filings, the proposal would enable Commission staff to more easily monitor and process proposed rule changes. Pertinent information regarding proposed rule changes, as well as amendments, would be captured automatically by SRTS. As a result, Commission staff would be able to monitor electronically the progress of proposed rule changes filed on Form 19b-7 from initial receipt through final disposition and thereby enhance its management of the rule filing process.

B. Posting of Rule 19b-7 Proposed Rule Changes on SRO Web sites

The Commission also is proposing to amend Rule 19b-7 to require each SRO to post proposed rule changes filed pursuant to that Rule, and any amendments thereto, on its public Web site no later than two business days after filing with the Commission.[15] This requirement would provide interested persons with quick access to the proposed rule

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14 See infra notes 42-44 and accompanying text.

15 Rule 19b-4 requires SROs to post proposed rule changes filed under Section 19(b)(1), and any amendments thereto, on their Web site within two business days after the filing of the proposed rule change. 17 CFR 240.19b-4(l).

change, while at the same time providing SROs with sufficient time to comply with this posting requirement. The complete proposed rule change would be available in the Commission's Public Reference Room in electronic format. The Commission believes that Web site accessibility of SRO proposed rule changes filed under Section 19(b)(7) of the Act would (1) provide interested persons with faster access to proposed rule changes; (2) facilitate the ability of interested persons to comment on the proposals; and (3) save SRO resources currently used to monitor the Commission's Public Reference Room for competitors' proposed rule changes.

The Commission is also proposing to require an SRO to remove a proposed rule change from its Web site within two business days of Commission notification to the SRO that such proposed rule change was not properly filed,[16] or of the SRO's withdrawal of such proposed rule change.

C. Requirement to Update Rule Text on SRO Web Sites

Currently, Rule 19b-4(m) under the Act[17] requires all SROs to post and maintain on their Web sites a complete and accurate copy of their rules. This requirement currently applies to SROs that file proposed rule changes under Section 19(b)(7) of the Act. The Commission is not proposing to change this requirement. All SROs would continue to be required to post and maintain a complete and accurate copy of their rules. The Commission is proposing to add paragraph (g) to Rule 19b-7 to clarify that an SRO would be required (1) to post and maintain a current and complete version of its rules on its Web site and (2) to update the rules posted on its Web site within two days after a rule

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16 A screen within EFFS, the Web-based electronic rule filing system, would indicate that a rule filing has not been properly filed and has been returned to the SRO.

17 17 CFR 240.19b-4(m).

change becomes effective. The Commission believes that this proposal clarifies when an SRO must update the rules posted on its Web site to reflect proposed rule changes filed under Rule 19b-7.

D. Form 19b-7 Amendments

1. Form 19b-7 Amendments

The Instructions to Form 19b-7 would be amended to eliminate the required submission of nine paper copies and instead require electronic filing of Form 19b-7.[18] To access the secure Internet site for Web-based filing of the Form 19b-7, the SRO would submit to the Commission an External Application User Authentication Form ("EAUF")[19] to register each individual at the SRO who will be submitting Forms 19b-7 on behalf of the SRO. Upon receipt and verification of the information in the EAUF process, the Commission would issue each such person a User ID and Password to permit access to the Commission's secure Web site. As Form 19b-7 would be electronic, initially the authorized user at an SRO would access a screen containing a filing template, referenced as Page 1, in which it could identify the SRO, enter a brief description of the proposed rule change, and enter a brief description of the SRO governing body action approval.[20] The SRO would provide contact information and place the electronic signature of a duly authorized officer on this Page 1 initial screen.[21] Only a duly

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18 The proposed amendments to Form 19b-7 are attached as Appendix A.

19 This Commission Web-based application currently exists and allows authorized external users to access select Commission systems.

20 The authorized user also would be able to indicate if there would be a separate filing of any hard copy exhibits that are unable to be submitted electronically.

21 As noted supra notes 9-11, and accompanying text, a person that is a "duly authorized officer" at the SRO would be required to place his or her "electronic

authorized officer of the SRO would be authorized to affix his or her digital signature to the Form 19b-7. The second screen of the electronic Form 19b-7 would provide the SRO with a means to attach the proposed rule change and related exhibits in Microsoft Word format.[22] EAUF users would have electronic access to the general instructions for using the Form, as adapted for electronic filing.[23] Finally, the SRO would use the electronic Form 19b-7 to amend or withdraw a rule filing pending with the Commission.

The Commission is also proposing a number of changes to Form 19b-7, unrelated to electronic filing, that are modeled after certain provisions in Form 19b-4, which the Commission preliminarily believes would facilitate an SRO's proper filing of Form 19b-7. For example, the format of the Instructions to Form 19b-7 would be organized according to the sections used for Form 19b-4 Instructions, instead of the combination of questions and titles that serve as subject heads in the Instructions to Form 19b-7 currently. The proposed Form 19b-7 would require the SRO to describe the purpose of the proposed rule change in sufficient detail to enable the public to provide meaningful public comment. The Form 19b-7 would direct the SRO to relevant sections of the Act that are appropriate for discussion in the Statutory Basis section of the Form 19b-7 and would clarify that a mere assertion that the proposed rule change is consistent with the

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signature" on the Form 19b-7 before it is transmitted electronically to the Commission.

22 Exhibits 2, 3, and 5 may not be available in Microsoft Word and could be submitted in another acceptable electronic format, including Microsoft Excel, Microsoft PowerPoint, Adobe Acrobat, or Corel WordPerfect.

23 For example, the SRO would click separate boxes on the second screen to attach documents containing the various exhibits; notices, written comments, transcripts, other communications; form, report, or questionnaire; proposed rule text; CFTC certification; the completed notice of the proposed rule change for publication in the Federal Register; and, marked copies of amendments if applicable.

Act is not sufficient to describe why the proposed rule change is consistent with the Act. The proposed Form 19b-7 would also provide updated instructions related to the solicitation of comments from interested persons regarding the proposed rule change. These updated instructions would include the new address where commenters may direct comments to Form 19b-7 filings in hard copy and describe the manner in which comments may submitted on the SEC Web site.

The proposed changes to Form 19b-7 would alter the way that the Exhibits are organized and the Instructions to such Exhibits are presented. For example, the proposed Instructions would direct an SRO to include the completed notice of the proposed rule change ("Form 19b-7 Notice" or "Notice") as Exhibit 1, whereas such notice is not assigned to an Exhibit in the existing Form 19b-7. The instructions for the Form 19b-7 Notice would be amended to include more detailed guidance on the current requirement that the Notice must be formatted to comply with the requirements for Federal Register publication. For example, the proposed Instructions would provide guidance regarding Federal Register requirements relating to margin spacing, page numbering, and line spacing.

The subject of existing Exhibit 1, relating to communications with third parties on the subject of the proposed rule change, would move to Exhibit 2. The guidance in the existing Instructions to Exhibit 2 would be replaced, in Exhibit 3, with more detailed guidance as to how the SRO should present forms, reports, and questionnaires that the SRO proposes to use to implement the terms of the proposed rule change. The requirement to include the text of the proposed rule change would remain in Exhibit 4, but the requirement for the SRO to describe the anticipated effect of the proposed rule

change would have on the application of other rules of the SRO would move to Section II(A)(1)(b) of the Form 19b-7 Notice. The requirements relating to Exhibit 5, regarding the effectiveness of the proposed rule change, would remain the same.

The Instructions to Form 19b-7 currently describe circumstances under which an SRO must file an amendment to a proposed rule change and the procedures an SRO must follow when submitting an amendment. The proposed changes to the Instructions to Form 19b-7 would describe the procedures an SRO would follow to submit an amendment electronically.

In addition, the Commission notes that Form 19b-7 will continue to require an SRO to: (1) describe the text of the proposed rule change in a sufficiently detailed and specific manner as to permit interested persons to submit comments; (2) describe the reasons for adopting the proposed rule change, how the proposal will address any problems described in proposed rule change, and the manner in which the proposed rule change will affect various market participants; (3) describe how the filing relates to existing rules of the SRO;[24] and (4) provide an accurate statement of the authority and statutory basis for, and purpose of, the proposed rule change, as well as its impact on competition, if any, and a summary of any written comments received by the SRO.

As noted above, the Commission recognizes that in rare circumstances SROs may be unable to file certain documents electronically with the Commission. Therefore, under these limited circumstances, the Commission would allow SROs to file documents in paper format within five days of the electronic filing of all other required documents.[25]

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24 17 CFR 249.822.

25 This exception from electronic filing would not apply to Page 1 to Form 19b-7 or Exhibits 1 and 4 thereto but would only be applicable to Exhibits 2 and 3, and any

2. Accurate, Consistent, and Complete Forms 19b-7

The Commission firmly believes that, to provide the public with a meaningful opportunity to comment, a proposed rule change must be accurate, consistent, and complete. Form 19b-7 states that the form, including the exhibits, is intended to elicit information necessary for the public to provide meaningful comment on the proposed rule change and for the Commission to determine whether abrogation of the proposal is appropriate because it unduly burdens competition or efficiency, conflicts with the securities laws, or is inconsistent with the public interest and protection of investors.[26] The SRO must provide all the information called for by the form, including the exhibits, and must present the information in a clear and comprehensible manner.

Currently, Commission staff devotes significant time to processing proposed rule changes, reviewing them for accuracy and completeness, and preparing them for publication. SRO staff should ensure that the filings: (1) contain a properly completed Form 19b-7; (2) contain a clear and accurate statement of the authority for, and basis and purpose of, such rule change, including the impact on competition; (3) contain a summary of any written comments received by the SRO; (4) contain the proper certification submitted to the CFTC, any other appropriate determination made by the CFTC that a review of the proposed rule change is not necessary, or an indication that the

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documents filed pursuant to a request for confidential treatment pursuant to the Freedom of Information Act, 5 U.S.C. 552.

26 Section 19(b)(7)(C) of the Act grants to the Commission, after consultation with the CFTC, the authority to summarily abrogate a proposed rule change that has taken effect pursuant to Section 19(b)(7)(B) of the Act if it appears to the Commission that such a rule change unduly burdens competition or efficiency, conflicts with the securities laws, or is inconsistent with the public interest and the protection of investors.

CFTC has approved the proposed rule change; and (5) describe the impact of the proposed rule change on the existing rules of the SRO, including any other rules proposed to be amended. As described in the current Form 19b-7, filings that do not comply with the foregoing are deemed not filed and returned to the SRO. In the future, electronically filed proposed rule changes that do not comply with the foregoing would continue to be returned to the SRO, but in electronic format, and, consistent with current practice, would be deemed not filed with the Commission until all required information has been provided.

E. Rule 19b-4 and Form 19b-4 Conforming Changes

The Commission also is proposing to make certain conforming changes to Rule 19b-4 to account for the proposed amendments to Rule 19b-7. In particular, the Commission proposes to remove a reference in paragraph (m) of Rule 19b-4 relating to the requirement that SROs update their Web sites to reflect proposed rule changes filed pursuant to Section 19(b)(7) of the Act. This requirement is proposed to be incorporated into new paragraph (g) of Rule 19b-7. The Commission is also proposing to make other changes to paragraph (m) of Rule 19b-4 to clarify that the obligation for SROs to update their Web sites to reflect proposed rule changes under this provision applies only to proposed rule changes filed under Section 19(b)(1) of the Act.

The Commission further proposes to clarify on Form 19b-4 that an individual who signs the Form 19b-4 digitally must be an officer authorized by the SRO's governing body to sign proposed rule changes on behalf of the SRO. Accordingly, the Commission proposes to amend Page 1 of Form 19b-4 to add the word "officer" to follow the phrase

"duly authorized" in the Signature Box appearing on that page.[27] The Commission notes that this change does not create any new obligation. Section F of the Instructions to Form 19b-4 provides that a "duly authorized officer" sign Form 19b-4 submissions, but the word "officer" was inadvertently omitted from the signature box when the electronic Form 19b-4 was adopted.[28]

III. Request for Comment

The Commission requests the views of commenters on all aspects of the proposed amendments, discussed above, to Rule 19b-7 and Form 19b-7, and to Rule 19b-4 and Form 19b-4 under the Act:

- In particular, the Commission requests comment on whether there is a need for an exception to the electronic filing requirement of Exhibit 5 to Form 19b-7 (Date of Effectiveness of Proposed Rule Change)? If so, what specific situations should be excepted, and what accommodations should be made?
- Would the proposed amendment create additional costs or other burdens for SROs that submit Form 19b-7s?

IV. Paperwork Reduction Act

Certain provisions of the proposed rule and form contain "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995.[29] The Commission has submitted the information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The Commission has submitted revisions to the current collection of information titled

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27 The proposed amendment to Form 19b-4 is attached as Appendix B.

28 See Electronic 19b-4 Adopting Release, supra note 4.

29 44 U.S.C. 3501 et seq.

"Rule 19b-7 Under the Securities Exchange Act of 1934" (OMB Control No. 3235-0553). The Commission has also submitted revisions to the current collection of information titled "Form 19b-7 Under the Securities Exchange Act of 1934" (OMB Control No. 3235-0553). In addition, the Commission has submitted revisions to the current collection of information titled "Rule 19b-4 Under the Securities Exchange Act of 1934" (OMB Control No. 3235-0045). Finally, the Commission has submitted revisions to the current collection of information titled "Form 19b-4 Under the Securities Exchange Act of 1934" (OMB Control No. 3235-0045). An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number.

A. Summary of Collection of Information

Rule 19b-7 currently requires an SRO that proposes to add, delete, or amend its rules relating to certain subjects[30] to submit such proposed rule change to the Commission on Form 19b-7. Form 19b-7 currently requires the respondent: (1) to state the purpose of the proposed rule change; (2) to state the authority and statutory basis for the proposed rule change; (3) to describe the proposal's impact on competition; (4) to provide a summary of any written comments on the proposed rule change received by the SRO; and (5) to describe the date upon which the proposed rule change becomes effective and provide supporting documentation relevant to the effectiveness date. The proposed amendments would add a technical requirement to Form 19b-7 that an SRO provide on Page 1 of Form 19b-7 more information about a staff member prepared to answer questions about the filing, such as the SRO staff member's title, email address

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30 See 15 U.S.C. 78f(g)(4)(B)(i) and 78o-3(k)(3)(A).

and fax number. The proposed amendments, would require Web site posting of all proposed rule changes, and any amendments thereto. In addition, the proposed amendments would codify in Rule 19b-7 the current requirement in Rule 19b-4(m) that SROs (1) post a current and complete set of their rules on their Web sites and (2) update their Web sites within two business days after a rule change becomes effective to reflect such rule changes filed pursuant to Section 19(b)(7) of the Act. The proposed amendment would also clarify that a mere assertion that the proposed rule change is consistent with the Act is not sufficient to describe why the proposed rule change is consistent with the Act. Rule 19b-4(m) would continue to require SROs to update their rules on their Web sites to reflect proposed rule changes filed pursuant to Section 19(b)(1) of the Act. All SROs that file Form 19b-4 and Form 19b-7 currently post this information on their Web sites. Therefore, SROs would not be required to provide additional information to comply with proposed Rule 19b-7(g) and current Rule 19b-4(m).

B. Proposed Use of Information

The information provided via EAUF, as required by the proposed amendments to Form 19b-7, would be used by the Commission to verify the identity of the SRO individual and provide such individual access to a secure Commission Web site for filing of the Form 19b-7. The Commission proposes to require that SROs post their proposed rule changes filed pursuant Section 19(b)(7) of the Act on their Web sites, so that these proposals could be viewed by the general public, SRO members, competing SROs, other market participants, and Commission staff. The information would enable interested parties to more easily access SRO rules and rule filings, which would facilitate public

comment on proposed SRO rules. Additionally, SRO staff, members, industry participants, and Commission staff would utilize the accurate and current version of SRO rules that are posted on the SRO Web site to facilitate compliance with such rules.

C. Respondents

There are currently five SROs[31] registered with the Commission as national securities exchanges under Section 6(g) of the Act or as a national securities association registered with the Commission under Section 15A(k) of the Act subject to the collection of information for Rule 19b-7, though that number may vary owing to the consolidation of SROs or the introduction of new entities. In a fiscal year, these respondents filed an average of 12 rule change proposals and 3 amendments to those proposed rule change proposals, for an average of 15 filings per fiscal year that are subject to the current collection of information.[32] Of the 12 proposed rule changes filed by SROs, all 12 ultimately became effective because the SROs did not withdraw any proposed rule changes.

D. Total Annual Reporting and Recordkeeping Burden

1. Background

The proposed amendments to Rule 19b-7 and Form 19b-7 are designed to modernize the SRO rule filing process and to make the process more efficient by conserving both SRO and Commission resources. Rule 19b-7 and Form 19b-7 would be amended to require SROs to electronically file their proposed rule changes. Form 19b-7

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31 The Board of Trade of the City of Chicago, Inc. ("CBOT"), Chicago Mercantile Exchange, Inc. ("CME"), CBOE Futures Exchange LLC ("CFE"), National Futures Association ("NFA"), and OneChicago LLC ("OC").

32 Since the implementation of the CFMA in 2001 to September 30, 2006, SROs have filed 62 proposed rule changes pursuant to Section 19(b)(7) of the Act and 13 amendments.

would be revised to accommodate electronic submission. In addition, SROs would be required to post on their Web sites proposed rule changes submitted on Form 19b-7 to the Commission and amendments thereto. A conforming amendment would codify in Rule 19b-7 the current requirement in Rule 19b-4(m) for SROs to maintain a current and complete set of their rules on their Web site.

2. Rule 19b-7 and Form 19b-7

The Commission does not expect that the amendments to Rule 19b-7 and Form 19b-7 relating to electronic filing of proposed rule changes and amendments would impose any material upfront cost on SROs. The technology for electronic filing would be Web-based; therefore, the SROs should not have any material upfront technology expenditures for electronic filing because all SROs currently have access to the Internet.

However, each SRO would be required to obtain a digital ID from a certificating authority. The Commission staff estimates the annual cost of the ID to be $20 for each SRO.[33] The Commission staff estimates that each SRO would purchase five such digital IDs for its staff. Thus, the annual cost of the ID for all SROs would be $500 (5 SROs x $20 x 5).

In addition, the Commission believes that SROs could incur some costs associated with training their personnel about the procedures for submitting proposed rule changes electronically via EFFS. However, the Commission believes that such costs will be one-time costs and relatively insubstantial since the SROs are already familiar with the information required in filing a proposed rule change with the Commission and would

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33 This estimate is based upon the price displayed for the ID on VeriSign's Web site as of December 21, 2006.

only be required to submit the same information electronically under this proposal. Based on the experience of the Commission staff in training SROs for the implementation of electronic Rule 19b-4 filings, the Commission estimates that each SRO would spend approximately two hours training each staff member who would use the EFFS to submit the proposed rule changes electronically. Accordingly, the Commission estimates that the upfront cost of training SRO staff members to use EFFS will be 50 hours (5 SROs x 2 hours x 5 staff members)

An SRO rule change proposal is generally filed with the Commission after a SRO's staff has obtained approval by its Board. The time required to complete a filing varies significantly and is difficult to separate from the time an SRO spends in developing internally the proposed rule change. However, the Commission estimates that 15.5 hours is the amount of time required to complete an average rule filing using present Form 19b-7.[34] This figure includes an estimated 11.5 hours of in-house legal work and four hours of clerical work. The amount of time required to prepare amendments varies because some amendments are comprehensive, while other amendments are submitted in the form of a one-page letter. The Commission staff estimates that, under current rules, seven hours is the amount of time required to prepare an amendment to the rule proposal. This figure includes an estimated two hours of in-house legal work and five hours of clerical work.

Based upon the experience of electronic filing of proposed rule changes on Form 19b-4, the Commission expects that an electronic Form 19b-7 and new requirements to Form 19b-7 would reduce by three hours the amount of SRO clerical time required to

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34 See 19b-7 Adopting Release supra note 6.

prepare the average proposed rule change and by four hours for an amendment thereto. The Commission does not believe that the new instruction specifying that an SRO describe the purpose of the proposed rule change in sufficient detail to enable the Commission to determine whether abrogation is appropriate will add any additional burden to the Form 19b-7 filing process because the existing Instructions to Form 19b-7 provide an obligation that all information in the Form must be presented in a manner which will enable the Commission to make such a determination. The Commission does not believe that the additional contact information of an SRO staff member on Page 1 of the Form will add any measurable burden to an SRO submitting a Form 19b-7, because the information is so readily accessible to the party submitting the filing. With the proposed electronic filing, the Commission staff estimates that 12.5 hours is the amount of time that would be required to complete an average rule filing and that three hours is the amount of time required to complete an average amendment. These figures reflect the three hours in savings in clerical hours that would result from the use of an electronic form for rule filings and four hours for amendments.[35] The Commission staff estimates that the reporting burden for filing rule change proposals and amendments with the Commission under the proposed amendments would be 159 hours (12 rule change proposals x 12.5 hours + 3 amendments x 3 hours).

3. Posting of Proposed Rule Changes filed under Rule 19b-7 on SRO Web sites

The proposed amendments would also require SROs to post proposed rule changes filed under Rule 19b-7, and any amendments thereto, on their Web sites. The

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35 The SROs' four hour time savings would result from the elimination of tasks, such as making multiple copies of the Form 19b-7 and amendments, arranging for couriers, and making follow-up telephone calls to ensure Commission receipt.

Commission staff estimates that 30 minutes is the amount of time that would be required to post a proposed rule on an SRO's Web site and that 30 minutes is the amount of time that would be required to post an amendment on an SRO's Web site.[36] The Commission staff estimates that the reporting burden for posting rule change proposals and amendments on the SRO Web sites would be eight hours (12 rule change proposals x 0.5 hours + 3 amendments x 0.5 hours).

4. SRO Rule Text

Currently, all SROs are required to post their current rules on their Web sites pursuant to Rule 19b-4(m). The Commission estimates, based upon its analysis in the Electronic 19b-4 Adopting Release, that the amount of the time required to update an SRO's rule text on its Web site after a proposed rule change becomes effective to be four hours. Proposed rule changes submitted under Section 19(b)(7)(A) become effective an average of 12 times a year. Therefore, the Commission staff estimates that the reporting burden for updating the posted SRO rules on the SRO Web site will be 48 hours (12 proposed rule changes submitted pursuant to Section 19(b)(7)(A) x 4 hours).

The proposal would move the burden associated with complying with this provision from Rule 19b-4(m) to Rule 19b-7(g). Based upon the Commission's reporting burden estimate described above, the Commission estimates that the proposal will reduce the burden associated with SROs' compliance with the requirement provided in Rule 19b-4 that SROs post current and complete rule text on their Web sites and update that rule text after it changes following the effectiveness of a proposed rule change by 48

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36 This estimate is based on information from the Commission's Office of Information Technology.

hours annually and increase the corresponding burden for compliance with Rule 19b-7 by 48 hours.

5. Total Annual Reporting Burden

Thus, the Commission staff estimates that the total annual reporting burden under the proposed rule would be 167 hours (159 hours for filing proposed rule changes and amendments + 8 hours for posting proposed rule changes and amendments on the SROs' Web sites + 48 hours for posting and updating complete sets of SRO rule text pursuant to Rule 19b-7 – 48 hours for posting and updating complete sets of SRO rule text pursuant to Rule 19b-4).

In addition to the 155 hour annual burden, the Commission believes that SROs could incur some costs associated with training their personnel about the procedures for submitting proposed rule changes electronically and submission of the information via EFFS. However, the Commission believes that such costs would be one-time costs and relatively insubstantial since the SROs are already familiar with the information required in filing a proposed rule change with the Commission and would only be required to submit the same information electronically under this proposal. The Commission estimates that each SRO would spend approximately two hours training each staff member who will use the EFFS to submit the proposed rule changes electronically. Accordingly, the Commission estimates that the upfront cost of training SRO staff members to use EFFS would be 50 hours (5 SROs x 2 hours x 5 staff members).

The Commission does not expect that the proposed amendments with regard to electronic filing would impose any material additional costs on SROs. Instead, the Commission believes that the proposed amendments to Rule 19b-7 and Form 19b-7, on

balance, would reduce paperwork costs related to the submission of SRO proposed rule changes. The technology for electronic filing would be web-based; therefore, the SROs should not have any technology expenditures for electronic filing because all SROs currently have access to the Internet.

As previously stated, the SROs could incur costs of eight hours annually to post on their Web site their proposed rules, and amendments thereto, no later than two business days after filing with by the Commission. With regard to posting of and updating of accurate and complete text of SRO final rules, the Commission believes that the proposal would increase the burden associated with complying Rule 19b-7 by 48 hours and reduce the burden associated with complying with Rule 19b-4 by 48 hours. In addition, the Commission does not anticipate that SROs would incur any additional costs in complying with the change to Form 19b-4, which proposes to add the word "officer" to the Signature Box because the addition of the word simply provides transparency to an obligation that already exists.[37] Accordingly, the Commission does not believe that SROs would incur any additional costs in posting this information on their Web sites.

E. Retention Period of Recordkeeping Requirements

The SROs would be required to retain records of the collection of information (the manually signed signature page of the Form 19b-7) for a period of not less than five years, the first two years in an easily accessible place, according to the current recordkeeping requirements set forth in Rule 17a-1 under the Act.[38] The SROs would be required to retain proposed rule changes, and any amendments, on their Web sites until 60 days after

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37 See Section F of the Instructions to Form 19b-4.

38 SROs may also destroy or otherwise dispose of such records at the end of five years according to Rule 17a-5 under the Act. 17 CFR 240.17a-5.

effectiveness of the proposed rule that is filed with both the Commission and the CFTC or abrogation of the proposed rule change.[39] The SRO would be required at all times to maintain an accurate and up-to-date copy of all of its rules on its Web site.[40]

F. Collection of Information is Mandatory

Any collection of information pursuant to the proposed amendments to Rule 19b-7 and Form 19b-7 to require electronic filing with the Commission of SRO proposed rule changes would be a mandatory collection of information filed with the Commission as a means for the Commission to review, and, as required, take action with respect to SRO proposed rule changes. Any collection of information pursuant to the proposed amendments to require Web site posting by the SROs of their proposed and final rules would also be a mandatory collection of information.

G. Responses to Collection of Information Will Not Be Kept Confidential

Other than information for which an SRO requests confidential treatment and which may be withheld from the public in accordance with the provisions of 5 U.S.C. 522, the collection of information pursuant to the proposed amendments to Rule 19b-7 and Form 19b-7 under the Act would not be confidential and would be publicly available.[41]

H. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comments to:

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39 See proposed Rule 19b-7(f).

40 See proposed Rule 19b-7(g).

41 However, consistent with applicable law, proposed SRO rule changes containing proprietary or otherwise sensitive information may be kept confidential and nonpublic, including requests submitted pursuant to the protection afforded for such information in the Freedom of Information Act, 5 U.S.C. 552.

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;

2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

3. Enhance the quality, utility and clarity of the information to be collected; and

4. Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, OMB, Room 3208, New Executive Office Building, Washington, DC 20503; and (2) Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-06-07. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-06-07, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, Station Place, 100 F Street, NE, Washington, DC 20549.

V. Costs and Benefits of the Proposed Rulemaking

The Commission is considering the costs and benefits of the proposed amendments to Rule 19b-7 and Form 19b-7 discussed above. As noted above, the Commission staff estimates that the total annual paperwork reporting burden under the proposed rule would be 155 hours. The Commission staff, however, believes that there would be an overall reduction of costs based on the proposed amendments.[42] The Commission encourages commenters to identify, discuss, analyze, and supply relevant data regarding any such costs or benefits.

A. Benefits

The proposed amendments are designed to modernize the filing, receipt, and processing of SRO proposed rule changes and to make the SRO rule filing process more efficient by conserving both SRO and Commission resources. The Commission believes that the proposed changes to Rule 19b-7 and Form 19b-7 would permit SROs to file proposed rule changes with the Commission more quickly and economically. For example, SROs are currently required to pay for delivery costs of multiple paper copies to the Commission, as well as the costs associated with monitoring the Commission's Public Reference Room for competitors' rule filings. Requiring SROs to electronically file proposed rule changes under Rule 19b-7 should reduce expenses associated with clerical time, postage, and copying and should increase the speed, accuracy, and availability of information beneficial to investors, other SROs, and financial markets.

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42 As noted in the Paperwork Reduction Act analysis, the Commission staff based this total reporting burden of 159 hours for filing proposed rule changes and amendments + 8 hours for posting proposed rule changes and amendments on the SROs' Web sites.

The Commission does not expect that the proposed amendments would impose additional costs on SROs. Instead, the Commission believes that the proposed amendments to Rule 19b-7 and Form 19b-7, on balance, would reduce costs related to the submission of SRO proposed rule changes. The technology for electronic filing would be web-based; therefore, the SRO should not have any material increase in technology expenditures for electronic filing because all SROs currently have access to the Internet. Accordingly, the Commission believes that the proposed amendments to Rule 19b-7 and Form 19b-7, by requiring the SROs to submit proposed rule changes electronically, would reduce their costs.

Because Commission staff would no longer manually process the receipt and distribution of SRO rule filings submitted on Form 19b-7, electronic filing would also expedite the Commission's receipt of SRO proposed rule changes filed under Rule 19b-7 and provide the SROs with the certainty that the Commission has received the proposed rule changes and has captured pertinent information about the rule changes in SRTS. Based on the Commission's experience with electronic filing of Form 19b-4, the Commission believes that integrating this electronic filing technology with SRTS should also enhance the Commission's ability to monitor and process SRO proposed rule changes.

Moreover, requiring SROs to post proposed rule changes filed under Rule 19b-7 on their Web sites no later than two business days after filing with the Commission should increase availability of SRO proposed rules and thereby facilitate the ability of interested parties to comment on proposed rule changes. For instance, the posting of these proposed rule changes would provide the public with access to the filings on the

SROs' Web sites and thereby reduce the burden on SRO and Commission staff of providing information about proposed rule changes to interested parties. The Commission believes that the posting of the proposed rule changes submitted on Form 19b-7 would also save SRO resources that are currently being used to monitor the Commission's Public Reference Room for competitors' proposed rule changes.

B. Costs

As noted, the Commission staff estimates that the annual paperwork reporting costs would be 155 hours under the proposed rule. If the proposed changes were adopted, the Commission believes that SROs could incur some costs associated with training their personnel about the procedures for submitting proposed rule changes electronically and submission of the information via EAUF. However, the Commission believes that such costs would be one-time costs and insubstantial since the SROs are already familiar with the information required in filing a proposed rule change with the Commission and would only be required to submit the same information electronically under this proposal. The Commission believes that the total amount of one-time costs that SROs would incur in training personnel how to use EAUF is 50 hours. The Commission staff believes that the SROs could also incur some minimal costs (currently $20 per year) associated with purchasing digital IDs for each duly authorized officer electronic signatories.[43] The Commission also believes that the SROs would have to make temporary adjustments to their recordkeeping procedures since, under the proposal, the SROs would be required to print out the Form 19b-7 signature block, manually sign

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[43] The Commission staff estimates that each SRO will purchase five of their staff such digital IDs. Thus, the annual cost of the digital ID for all SROs would be $500 (5 SROs x $20 x 5).

proposed rule changes, and retain the manual signature for not less than five years. However, there should be no additional costs associated with such recordkeeping as SROs are currently required to retain the Form 19b-7 for not less than five years. The Commission requests comment on the anticipated costs, if any, on SROs to comply with the proposed requirement of retaining a manual signature of each proposed rule change submitted electronically.

Moreover, the Commission believes that the proposed requirement that SROs post proposed rule changes on their Web sites would impose some but not substantial costs on most SROs. The Commission notes that no new costs will be associated with posting a current and complete version of their rules on their Web site because currently all SROs promptly post this information on their Web sites pursuant to Rule 19b-4(m). In addition, the Commission does not anticipate that SROs would incur any material additional costs in complying with the change to Form 19b-4, which proposes to add the word "officer" to the Signature Box because the addition of the word simply provides transparency to an obligation that already exists.[44] Therefore, at all times, each SRO should maintain a current and complete set of its rules to facilitate compliance with this requirement. Accordingly, the Commission does not believe that SROs would incur substantial costs in simply posting this information on their Web sites because they should already be doing so.

C. Request for Comment

The Commission requests data to quantify the costs and the benefits above. The Commission seeks estimates of these costs and benefits, as well as any costs and benefits

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44 See Section F of the Instructions to Form 19b-4.

not already defined, which could result from the adoption of these proposed amendments to Rule 19b-7 and Form 19b-7. Specifically, the Commission requests commenters to address whether proposed amendments to Rule 19b-7 and Form 19b-7 that would require electronic filing of SRO proposed rule changes and the posting of these proposed rule changes on the SROs' Web sites would generate the anticipated benefits or impose any unanticipated costs on the SROs and the public.

VI. Consideration of the Burden on Competition, Promotion of Efficiency, and Capital Formation

Section 3(f) of the Act[45] requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action will promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Act[46] requires the Commission, when promulgating rules under the Act, to consider the impact any such rules would have on competition. Section 23(a)(2) further provides that the Commission may not adopt a rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The proposed amendments to Rule 19b-7 and Form 19b-7 are intended to modernize the receipt and review of SRO proposed rule changes and to make the SRO rule filing process more efficient by conserving both SRO and Commission resources. They also are intended to improve the transparency of the SRO rule filing process and facilitate access to current and complete sets of SRO rules. In addition, none of these

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45 15 U.S.C. 78c(f).

46 15 U.S.C. 78w(a)(2).

changes would have an adverse impact on competition or capital formation and they would therefore benefit investors.

The Commission generally requests comment on the competitive or anticompetitive effects of these amendments to Rule 19b-7 and Form 19b-7 on any market participants if adopted as proposed. The Commission also requests comment on what impact the amendments, if adopted, would have on efficiency and capital formation. Commenters should provide analysis and empirical data to support their views on the costs and benefits associated with the proposal.

VII. Regulatory Flexibility Act Certifications

The Regulatory Flexibility Act ("RFA")[47] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)[48] of the Administrative Procedure Act,[49] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."[50] Section 605(b) of the RFA specifically states that this requirement shall not apply to any proposed rule, or proposed rule amendment, which if adopted, would not "have a significant economic impact on a substantial number of small entities."

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47 5 U.S.C. 601 et seq.

48 5 U.S.C. 603(a).

49 5 U.S.C. 551 et seq.

50 Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term small entity for the purposes of Commission rulemaking in accordance with the RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982).

Proposed amendments to Rules 19b-7 and Form 19b-7 would require SROs to electronically file proposed rule changes submitted pursuant to Section 19(b)(7)(A) of Act and require SROs to post all such proposed rule changes on their Web sites. Only exchanges registered with the Commission under Section 6(g) of the Act and national securities associations registered with the Commission under Section 15A(k) of the Act would be subject to the proposed amendments to Rule 19b-7 and Form 19b-7. None of the exchanges registered under Section 6(g) or national securities associations registered with the Commission under Section 15A(k) that would be subject to the proposed amendments are "small entities" for purposes of the Regulatory Flexibility Act.[51]

In addition, the proposal would make certain conforming changes to Rule 19b-4 and Form 19b-4. National securities exchanges and national securities associations that would be subject to the proposed amendments to Rule 19b-4 and Form 19b-4 are not "small entities" for the purposes of the RFA.[52]

For the above reasons, the Commission certifies that the proposed amendments to Rule 19b-4 and 19b-7 and Form 19b-4 and 19b-7, if adopted, would not have a

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51 See 17 CFR 240.0-10(e). Paragraph (e) of Rule 0-10 states that the term "small business," when referring to an exchange, means any exchange that has been exempted from the reporting requirements of Rule 601 of Regulation NMS, 17 CFR 242.601, and is not affiliated with any person (other than a natural person) that is not a small business or small organization as defined in Rule 0-10. Under this standard, none of the exchanges subject to the proposed amendments to Rule 19b-7 and Form 19b-7 is a "small entity" for the purposes of the RFA. In addition, the NFA is not a "small entity" for purposes of the RFA. See Securities Exchange Act Release No. 44279 (May 8, 2001), 66 FR 26978, 26990 (May 15, 2001) (S7-10-01) (Rule 19b-7 Proposing Release).

52 See 17 CFR 240.0-10(e). Under this standard, described supra in note 51, none of the exchanges affected by the proposed amendments to Rule 19b-4 and Form 19b-4 is a small entity for the purposes of the RFA. The Commission has also found that NASD is not a small entity.

significant economic impact on a substantial number of small entities for purposes of the Regulatory Flexibility Act. The Commission invites commenters to address whether the proposed rules would have a significant economic impact on a substantial number of small entities, and, if so, what would be the nature of any impact on small entities. The Commission requests that commenters provide empirical data to support the extent of such impact.

VIII. Statutory Basis and Text of Proposed Amendments

The amendments to Rule 19b-7 and Form 19b-7 under the Act are being proposed pursuant to 15 U.S.C. 78a et seq., particularly sections 3(b), 6, 15A, 19(b), and 23(a) of the Act.

List of Subjects in 17 CFR Parts 240, and 249

Reporting and recordkeeping requirements, Securities.

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

PART 240--GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

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

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

* * * * *

2. Section 240.19b-4 is amended by revising paragraph (m) to read as follows:

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

* * * * *

(m) Each self-regulatory organization shall post and maintain a current and complete version of its rules on its Web site. The self-regulatory organization shall update its Web site to reflect rule changes filed pursuant to section 19(b)(2) of the Act (15 U.S.C. 78s(b)(2)) within two business days after it has been notified of the Commission's approval of a proposed rule change, and to reflect rule changes filed pursuant to section 19(b)(3)(A) of the Act (15 U.S.C. 78s(b)(3)(A)) within two days of the Commission's notice of such proposed rule change. If a rule change is not effective for a certain period, the self-regulatory organization shall clearly indicate the effective date in the relevant rule text.

* * * * *

3. Section 240.19b-7 is amended by:

a. Adding a preliminary note;

b. Revising paragraphs (a) and (b)(1); and

c. Adding paragraphs (d), (e), (f) and (g)

The additions and revisions read as follows:

§240.19b-7 Filings with respect to proposed rule changes submitted pursuant to Section 19(b)(7) of the Act.

Preliminary Note: A self-regulatory organization also must refer to Form 19b-7 (17 CFR 249.822) for further requirements with respect to the filing of proposed rule changes.

(a) Filings with respect to proposed rule changes by a self-regulatory organization submitted pursuant to section 19(b)(7) of the Act (15 U.S.C. 78s(b)(7)) shall be made electronically on Form 19b-7 (17 CFR 249.822).

(b) ***

(1) A completed Form 19b-7 (17 CFR 249.822) is submitted electronically; and

* * * * *

(d) Filings with respect to proposed rule changes by a self-regulatory organization submitted on Form 19b-7 (17 CFR 249.822) electronically shall contain an electronic signature. For the purposes of this section, the term electronic signature means an electronic entry in the form of a magnetic impulse or other form of computer data compilation of any letter or series of letters or characters comprising a name, executed, adopted or authorized as a signature. The signatory to an electronically submitted rule filing shall manually sign a signature page or other document, in the manner prescribed by Form 19b-7, authenticating, acknowledging or otherwise adopting his or her signature that appears in typed form within the electronic filing. Such document shall be executed before or at the time the rule filing is electronically submitted and shall be retained by the filer in accordance with 17 CFR 240.17a-1.

(e) If the conditions of this section and Form 19b-7 (17 CFR 249.822) are otherwise satisfied, all filings submitted electronically on or before 5:30 p.m. Eastern Standard Time or Eastern Daylight Saving Time, whichever is currently in effect, on a business day, shall be deemed filed on that business day, and all filings submitted after 5:30 p.m. Eastern Standard Time or Eastern Daylight Saving Time, whichever is currently in effect, shall be deemed filed on the next business day.

(f) The self-regulatory organization shall post the proposed rule change, and any amendments thereto, submitted on Form 19b-7 (17 CFR 249.822), on its Web site within two business days after the filing of the proposed rule change, and any amendments thereto, with the Commission. Unless the self-regulatory organization withdraws the proposed rule change or is notified that the proposed rule change is not properly filed, such proposed rule change and amendments shall be maintained on the self-regulatory organization's Web site until 60 days after:

(1) The filing of a written certification with the Commodity Futures Trading Commission under section 5c(c) of the Commodity Exchange Act (7 U.S.C. 7a-2(c));

(2) The Commodity Futures Trading Commission determines that review of the proposed rule change is not necessary; or

(3) The Commodity Futures Trading Commission approves the proposed rule change; and

(4) In the case of a proposed rule change, or any amendment thereto, that has been withdrawn or not properly filed, the self-regulatory organization shall remove the proposed rule change, or any amendment, from its Web site within two business days of notification of improper filing or withdrawal by the self-regulatory organization of the proposed rule change.

(g) Each self-regulatory organization shall post and maintain a current and complete version of its rules on its Web site. The self-regulatory organization shall update its Web site to reflect rule changes filed pursuant to section 19(b)(7) of the Act (15 U.S.C. 78s(b)(7)) within two business days after it takes effect upon filing of a written certification with the Commodity Futures Trading Commission under section

5c(c) of the Commodity Exchange Act (7 U.S.C. 7a-2(c)), upon a determination by the Commodity Futures Trading Commission that review of the proposed rule change is not necessary, or upon approval by the Commodity Futures Trading Commission. If a rule change is not effective for a certain period, the self-regulatory organization shall clearly indicate the effective date in the relevant rule text.

PART 249 - FORMS, SECURITIES EXCHANGE ACT OF 1934

4. The authority citation for Part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq. and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

5. Section 249.822 is revised to read as follows:

§249.822 Form 19b-7, for electronic filing with respect to proposed rule changes by self-regulatory organizations under Section 19(b)(7)(A) of the Securities Exchange Act of 1934.

This form shall be used by self-regulatory organizations, as defined in section 3(a)(25) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(25)), to file electronically proposed rule changes with the Commission pursuant to section 19(b)(7) of the Act (15 U.S.C. 78s(b)(7)) and §240.19b-7 of this chapter.

6. Form 19b-7 (referenced in §249.822) is revised to read as follows:

[Note: Form 19b-7 is attached as Appendix A to this document.]

[Note: The text of Form 19b-7 will not appear in the Code of Federal Regulations.]

By the Commission.

Nancy M. Morris
Secretary

Date: February 23, 2007

APPENDIX A

GENERAL INSTRUCTIONS FOR FORM 19b-7

A. Use of the Form

All self-regulatory organization proposed rule changes submitted pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 ("Act"), shall be filed in an electronically through the Electronic Form Filing System ("EFFS"), a secure Web site operated by the Commission. This form shall be used for filings of proposed rule changes by all self-regulatory organizations pursuant to Section 19(b)(7) of the Act. National securities exchanges registered pursuant to Section 6(g) of the Act and limited purpose national securities associations registered pursuant to Section 15A(k) of the Act are self-regulatory organizations for purposes of this form.

B. Need for Careful Preparation of the Completed Form, Including Exhibits

This form, including the exhibits, is intended to elicit information necessary for the public to provide meaningful comment on the proposed rule change and for the Commission to determine whether abrogation of the proposal is appropriate because it unduly burdens competition or efficiency, conflicts with the securities laws, or is inconsistent with the public interest and the protection of investors. The self-regulatory organization must provide all the information called for by the form, including the exhibits, and must present the information in a clear and comprehensible manner.

The proposed rule change shall be considered filed with the Commission on the date on which the Commission receives the proposed rule change if the filing complies with all requirements of this form. Any filing that does not comply with the requirements of this form may be returned to the self-regulatory organization at any time before the

issuance of the notice of filing. Any filing so returned shall for all purposes be deemed not to have been filed with the Commission. See also Rule 0-3 under the Act (17 CFR 240.0-3).

C. Documents Comprising the Completed Form

The completed form filed with the Commission shall consist of the Form 19b-7 Page 1, numbers and captions for all items, responses to all items, and exhibits required in Instruction H. In responding to an item, the completed form may omit the text of the item as contained herein if the response is prepared to indicate to the reader the coverage of the item without the reader having to refer to the text of the item or its instructions. Each filing shall be marked on the Form 19b-7 with the initials of the self-regulatory organization, the four-digit year, and the number of the filing for the year (i.e., SRO-YYYY-XX). If the self-regulatory organization is filing Exhibit 2 or 3 via paper, the exhibits must be filed within 5 business days of the electronic submission of all other required documents.

D. Amendments

If information on this form is or becomes inaccurate before the proposed rule change becomes effective, the self-regulatory organization shall file amendments correcting any such inaccuracy. Amendments shall be filed as specified in Instruction E.

Amendments to a filing shall include the Form 19b-7 Page 1 marked to number consecutively the amendments, numbers and captions for each amended item, amended response to the item, and required exhibits. The amended description is Section II. A. 1. of Exhibit 1 shall explain the purpose of the amendment and, if the amendment changes the purpose of or basis for the proposed rule change, the amended response shall also

provide a revised purpose and basis statement for the proposed rule change. Exhibit 1 shall be re-filed if there is a material change from the immediately preceding filing in the language of the proposed rule change or in the information provided.

If the amendment alters the text of an existing rule, the amendment shall include the text of the existing rule, marked in the manner described in Section I. of Exhibit 1 using brackets to indicate words to be deleted from the existing rule and underscoring to indicate words to be added. The purpose of this marking requirement is to maintain a current copy of how the text of the existing rule is being changed.

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e., partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

If, after the rule change is filed but before it becomes effective, the self-regulatory organization receives or prepares any correspondence or other communications reduced to writing (including comment letters) to and from such self-regulatory organization concerning the proposed rule change, the communications shall be filed as Exhibit 2. If information in the communication makes the rule change filing inaccurate, the filing shall be amended to correct the inaccuracy. If such communications cannot be filed electronically in accordance with Instruction E, the communications shall be filed in accordance with Instruction F.

E. Signature and Filing of the Completed Form

All proposed rule changes, amendments, extensions, and withdrawals of proposed rule changes shall be filed through the EFFS. In order to file Form 19b-7 through EFFS, self-regulatory organizations must request access to the SEC's External Application Server by completing a request for an external account user ID and password for the use of the External Application User Authentication Form.

Initial requests will be received by contacting the Market Regulation Administrator located on our Web site (http://www.sec.gov). An e-mail will be sent to the requestor that will provide a link to a secure Web site where basic profile information will be requested.

A duly authorized officer of the self-regulatory organization shall electronically sign the completed Form 19b-7 as indicated on Page 1 of the Form. In addition, a duly authorized officer of the self-regulatory organization shall manually sign one copy of the completed Form 19b-7, and the manually signed signature page shall be maintained pursuant to Section 17 of the Act.

F. Procedures for Submission of Paper Documents for Exhibits 2 and 3

To the extent that Exhibit 2 or 3 cannot be filed electronically in accordance with Instruction E, four copies of Exhibit 2 or 3 shall be filed with the Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628. Page 1 of the electronic Form 19b-7 shall accompany paper submissions of Exhibit 2 or 3. If the self-regulatory organization is filing Exhibit 2 or 3 via paper, they must be filed within five days of the electronic filing of all other required documents.

G. Withdrawals of Proposed Rule Changes

If a self-regulatory organization determines to withdraw a proposed rule change, it must complete Page 1 of the Form 19b-7 and indicate by selecting the appropriate check box to withdraw the filing.

H. Exhibits

List of exhibits to be filed, as specified in Instructions C and D:

Exhibit 1. Completed Notice of Proposed Rule Change for publication in the Federal Register. It is the responsibility of the self-regulatory organization to prepare Items I, II and III of the notice. Leave a 1-inch margin at the top, bottom, and right hand side, and a 1 ½ inch margin at the left hand side. Number all pages consecutively. Double space all primary text and single space lists of items, quoted material when set apart from primary text, footnotes, and notes to tables. Amendments to Exhibit 1 should be filed in accordance with Instructions D and E.

Exhibit 2. (a) Copies of notices issued by the self-regulatory organization soliciting comment on the proposed rule change and copies of all written comments on the proposed rule change received by the self-regulatory organization (whether or not comments were solicited), presented in alphabetical order, together with an alphabetical listing of such comments. If such notices and comments cannot be filed electronically in accordance with Instruction E, the notices and comments shall be filed in accordance with Instruction F.

(b) Copies of any transcript of comments on the proposed rule change made at any public meeting or, if a transcript is not available, a copy of the summary of comments on the proposed rule change made at such meeting. If such transcript of comments or

summary of comments cannot be filed electronically in accordance with Instruction E, the transcript of comments or summary of comments shall be filed in accordance with Instruction F.

(c) Any correspondence or other communications reduced to writing (including comment letters and e-mails) concerning the proposed rule change prepared or received by the self-regulatory organization. All correspondence or other communications should be presented in alphabetical order together with an alphabetical listing of the authors, and shall be filed in accordance with Instruction E. If such communications cannot be filed electronically in accordance with Instruction E, the communications shall be filed in accordance with Instruction F.

(d) If after the proposed rule change is filed but before it becomes effective, the self-regulatory organization prepares or receives any correspondence or other communications reduced to writing (including comment letters and e-mails) to and from such self-regulatory organization concerning the proposed rule change, the communications shall be filed in accordance with Instruction E. All correspondence or other communications should be presented in alphabetical order together with an alphabetical listing of the authors. If such communications cannot be filed electronically in accordance with Instruction E, the communications shall be filed in accordance with Instruction F.

Exhibit 3. If any form, report, or questionnaire is

(a) proposed to be used in connection with the implementation or operation of the proposed rule change, or

(b) prescribed or referred to in the proposed rule change,

then the form, report, or questionnaire must be attached and shall be considered as part of the proposed rule change. If completion of the form, report or questionnaire is voluntary or is required pursuant to an existing rule of the self-regulatory organization, then the form, report, or questionnaire, together with a statement identifying any existing rule that requires completion of the form, report, or questionnaire, shall be attached as Exhibit 3. If the form, report, or questionnaire cannot be filed electronically in accordance with Instruction E, the documents shall be filed in accordance with Instruction F.

Exhibit 4. The self-regulatory organization must attach as Exhibit 4 proposed changes to its rule text. Changes in, additions to, or deletions from, any existing rule shall be set forth with brackets used to indicate words to be deleted and underscoring used to indicate words to be added. Exhibit 4 shall be considered part of the proposed rule change.

Exhibit 5. The self-regulatory organization must attach one of the following:

Certificate of Effectiveness of Proposed Rule Change: Attach a copy of the certification submitted to the CFTC pursuant to Section 5c(c) of the Commodity Exchange Act.

CFTC Request or Determination that Review of the Proposed Rule Change is Not Necessary: Attach a copy of any request submitted to the CFTC for determination that review of the proposed rule change is not necessary and any indication from the CFTC that it has determined that review of the proposed rule change is not necessary.

Request for CFTC Approval of Proposed Rule Change: Attach a copy of any request submitted to the CFTC for approval of the proposed rule change and any indication received from the CFTC that the proposed rule change has been approved.

OMB APPROVAL	
OMB Number:	3235-0553
Expires:	October 31, 2007
Estimated average burden hours per response	15.5

Page 1 of

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-7

File No. SR - 2006 -
Amendment No.

Proposed Rule Change by sroName

Pursuant to Rule 19b-7 under the Securities Exchange Act of 1934

Initial ☐ Amendment ☐ Withdrawal ☒

Exhibit 2 Sent As Paper Document ☒ Exhibit 3 Sent As Paper Document ☒

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name
Title
E-mail
Telephone Fax

SRO Governing Body Action

Describe action on the proposed rule change taken by the members or board of directors or other governing body of the SRO (limit 250 characters).

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 02/23/2007

By

(Name) (Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

Digitally Sign and Lock Form

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-7 instructions please refer to the EFFS website.

Exhibit 1- Notice of Proposed Rule Change

Add Remove View

The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal.

The Notice section of this Form 19b-7 must comply with the guidelines for publication in the Federal Register, as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC and CFTC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases and Commodities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2- Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction E, they shall be filed in accordance with Instruction F.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change. If such documents cannot be filed electronically in accordance with Instruction E, they shall be filed in accordance with Instruction F.

Exhibit 4 - Proposed Rule Text

Add Remove View

The self-regulatory organization must attach as Exhibit 4 proposed changes to rule text. Exhibit 4 shall be considered part of the proposed rule change.

Exhibit 5 - Date of Effectiveness of Proposed Rule Change

The self-regulatory ogranization must attach one of the following:

CFTC Certification ☒

CFTC Request or Determination that Review of Proposed Rule Change Is Not Necessary ☐

Request for CFTC Approval of Proposed Rule Change ☐

CFTC Certification: Attach a copy of the certification submitted to the CFTC pursuant to section 5c(c) of the Commodity Exchange Act.

Add Remove View

Exhibit Sent As Paper Document ☐

Partial Amendment

Add Remove View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission staff's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

Information To Be Included in the Completed Exhibit 1

SECURITIES AND EXCHANGE COMMISISON

(Release No. 34- ; File No. SR-[SRO Name]-[YYYY]-[XX])

SELF-REGULATORY ORGANIZATIONS; Proposed Rule Change by [Name of Self-Regulatory Organization] Relating to [brief description of the subject matter of the proposed rule change].

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934 ("Act"),[53] notice is hereby given that on [date[54]], the [name of self-regulatory organization] filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. [Name of self-regulatory organization] also has filed this proposed rule change concurrently with the Commodity Futures Trading Commission ("CFTC"). [Section 19(b)(7)(B) provides that a proposed rule change may take effect upon the occurrence of one of three events. The self-regulatory organization should include one of the following sentences, whichever is applicable:]

The [name of self-regulatory organization] filed a written certification with the CFTC under Section 5c(c) of the Commodity Exchange Act on [date]; or

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53 15 U.S.C. 78s(b)(7).

54 To be completed by the Commission. This date will be the date on which the Commission receives the proposed rule change filing if the filing complies with all requirements of this form. See General Instructions for Form 19b-7.

The [name of self-regulatory organization] on [date], has requested that the CFTC make a determination that review of the proposed rule change of the [self-regulatory organization] is not necessary. The CFTC has [made such determination on [date]]; or [has not made such determination]; or

The [name of self-regulatory organization] on [date] submitted the proposed rule change to the CFTC for approval. The CFTC [approved the proposed rule change on [date]]; or [has not approved the proposed rule change].

I. Self-Regulatory Organization's Description and Text of the Proposed Rule Change

[Supply a brief statement of the terms of substance of the proposed rule change. If the proposed rule change is relatively brief, a separate statement need not be prepared, and the text of the proposed rule change may be inserted in lieu of the statement of the terms of substance. If the proposed rule change amends an existing rule, indicate the changes in the rule by brackets for words to be deleted and underscoring for words to be added.]

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-

regulatory organization has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for the Proposed Rule Change

1. Purpose

[Provide a statement of the purpose of the proposed rule change. The statement must describe the text of the proposed rule change in a sufficiently detailed and specific manner as to enable the public to provide meaningful comment on the proposal. At a minimum, the statement should:

(a) [Describe the reasons for adopting the proposed rule change, any problems the proposed rule change is intended to address, the manner in which the proposed rule change will resolve those problems, the manner in which the proposed rule change will affect various persons (e.g. brokers, dealers, issuers, and investors), and any significant problems known to the self-regulatory organization that persons affected are likely to have in complying with the proposed rule change; and]

(b) [Describe how the proposed rule change relates to existing rules of the self-regulatory organization. If the self-regulatory organization reasonably expects that the proposed rule change will have any direct effect, or significant indirect effect, on the application of any other rule of the self-regulatory organization, set forth the designation or title of any such rule and describe the anticipated effect of the proposed rule change on the application of such other rule. Include the file numbers for prior filings with respect to any existing rule specified.]

2. Statutory Basis

[Explain why the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the self-regulatory organization. A mere assertion that the proposed rule change is consistent with those requirements is not sufficient. Certain limitations that the Act imposes on self-regulatory organizations are summarized in the notes that follow.

NOTE 1. National Securities Exchanges. Under Section 6 of the Act, rules of a national securities exchange may not permit unfair discrimination between customers, issuers, brokers, or dealers, and may not regulate, by virtue of any authority conferred by the Act, matters not related to the purposes of the Act or the administration of the self-regulatory organization.

NOTE 2. Limited Purpose National Securities Associations. Under Section 15A(k) of the Act, rules of a national securities association registered for the limited purpose of regulating the activities of members who are registered as brokers or dealers in security futures products must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general to protect investors and the public interest, including rules governing sales practices and the advertising of security futures products reasonably comparable to those of other national securities associations registered pursuant to Section 15A(a) that are applicable to security futures products. The rules may not be designed to regulate, by virtue of any

authority conferred by the Act, matters not related to the purposes of the Act or the administration of the association.]

B. Self-Regulatory Organization's Statement on Burden on Competition

[The information required by this section must be sufficiently detailed and specific to support the premise that the proposed rule change does not unduly burden competition. In responding to this section, the self-regulatory organization must:

- State whether the proposed rule change will have an impact on competition and, if so
  - (i) state whether the proposed rule change will impose any burden on competition or whether it will relieve any burden on, or otherwise promote, competition, and
  - (ii) specify the particular categories of persons and kinds of businesses on which any burden will be imposed and the ways in which the proposed rule change will affect them.
- Explain why any burden on competition is not undue; or, if the self-regulatory organization does not believe that the burden on competition is significant, explain why.

In providing those explanations, set forth and respond in detail to written comments as to any significant impact or burden on competition perceived by any person who has made comments on the proposed rule change to the self-regulatory organization.]

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

[If written comments were received (whether or not comments were solicited) from members of or participants in the self-regulatory organization or others, summarize

the substance of all such comments received and respond in detail to any significant issues that those comments raised about the proposed rule change.

If an issue is summarized and responded to in detail under Section II.A.1. or Section II.B. of this Form 19b-7 Notice, that response need not be duplicated if appropriate cross-reference is made to the place where the response can be found. If comments were not or are not to be solicited, so state.]

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

[The self-regulatory organization shall include the following with the applicable phrase on the proposed rule change's effectiveness:]

The proposed rule change has become effective on [insert date of filing of written certification with the CFTC under Section 5c(c) of the Commodity Exchange Act; or the date of determination by the CFTC that review of the proposed rule change is not necessary; or the date of approval of the proposed rule change by the CFTC]. [or]

The proposed rule change is not effective because the CFTC [has not determined that review of the proposed rule changes is not necessary or has not approved the proposed rule change].

At any time within 60 days of the date of effectiveness of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be refiled in accordance with the provisions of Section 19(b)(1) of the Act.

IV. Solicitation of Comments

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

Electronic comments:

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

Paper comments:

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

All submissions should refer to File Number SR-[SRO]-[YYYY]-[XX]. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for

inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the [SRO]. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR-[SRO]-[YYYY]-[XX] and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[1]

Secretary

---

[1] 17 CFR 200.30-3(a)(73).

APPENDIX B

OMB APPROVAL	
OMB Number:	3235-0045
Expires:	June 30, 2007
Estimated average burden hours per response	38

Page 1 of

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. SR - -
Amendment No.

Proposed Rule Change by Select SRO

Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial	Amendment	Withdrawal	Section 19(b)(2)	Section 19(b)(3)(A)	Section 19(b)(3)(B)
☒	☐	☒	☒	☒	☐

Pilot ☐

Extension of Time Period for Commission Action ☒

Date Expires

Rule

- ☒ 19b-4(f)(1)
- ☒ 19b-4(f)(2)
- ☒ 19b-4(f)(3)
- ☒ 19b-4(f)(4)
- ☒ 19b-4(f)(5)
- ☒ 19b-4(f)(6)

Exhibit 2 Sent As Paper Document ☒

Exhibit 3 Sent As Paper Document ☒

Description

Provide a brief description of the proposed rule change (limit 250 characters).

Contact Information

Provide the name, telephone number and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the proposed rule change.

First Name Last Name

Title

E-mail

Telephone Fax

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized officer.

Date 02/23/2007

By

(Name)

(Title)

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change

Add | Remove | View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

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Exhibit Sent As Paper Document ☐

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

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Exhibit Sent As Paper Document ☐

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add | Remove | View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

Add | Remove | View

If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
February 26, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12574

In the Matter of	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND NOTICE OF HEARING**
Melhado, Flynn & Associates, Inc., George M. Motz and Jeanne McCarthy,	
Respondents.	

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") against Melhado, Flynn & Associates, Inc. ("MFA"), and Sections 15(b) and 21C of the Exchange Act, and Sections 203(f) and 203(k) of the Advisers Act against George M. Motz and Jeanne McCarthy (collectively with MFA, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

OVERVIEW

A. From at least January 2001 through April 2005 (the "relevant period") George M. Motz, the President, CEO and Chairman of the Executive Committee of MFA, engaged in fraudulent trade allocation – "cherry-picking" – at MFA. MFA is a registered broker-dealer and investment adviser. During the initial period of the scheme – January 2001 until approximately September 2003 – Motz unfairly allocated trades that had appreciated in value during the course of the day to MFA's proprietary trading account and allocated purchases that had depreciated in value during the day to the accounts of his advisory clients. Beginning in the summer of 2003, Motz engaged in cherry-picking to

favor one of the firm's advisory clients, a hedge fund affiliated with MFA, over his other advisory clients. Motz accomplished this cherry-picking by purchasing securities toward the beginning of the trading day but waiting until later in the day – after he saw whether the securities appreciated in value – to allocate the securities. In the fall of 2003, Motz with the assistance of Jeanne McCarthy, altered order tickets in an attempt to cover-up these fraudulent trade allocations. As a result of this fraud, MFA realized ill-gotten gains of approximately $1.4 million. In addition, MFA and Motz earned commissions and fees from advisory clients who were disadvantaged, and therefore harmed, by the cherry-picking scheme. Neither MFA nor Motz disclosed to clients that the firm was engaged in cherry-picking and that the firm would favor itself in the allocation of appreciated securities. Nor did they disclose that the firm engaged in cherry-picking to favor an advisory client hedge fund over other advisory clients. MFA also violated and Motz and Jeanne McCarthy aided, abetted and caused violations of the books and records provisions of both the Advisers Act and the Exchange Act.

RESPONDENTS

B. **MFA**, a New York corporation, is a registered broker-dealer (since December 29, 1976) and investment adviser (since February 18, 1977) with its main office located in New York City. As of April 30, 2005, MFA had approximately $318.2 million in assets under management and 749 advisory client accounts; the firm had discretionary control over 734 of those accounts whose assets totaled $249.2 million. MFA currently has approximately 34 registered representatives. MFA's clients include, among others, individuals, trusts and pension plans.

C. **George M. Motz**, age 66, is President and CEO, Director, and Chairman of the Executive Committee at MFA. Until October 2006, Motz was also Chief Compliance Officer of the firm. He has been employed at the firm since June 4, 1979. During the relevant period, Motz managed approximately 183 discretionary accounts and six non-discretionary accounts, which had assets at MFA of approximately $58.9 million and $19.6 million respectively. Motz is also the mayor of the incorporated village of Quogue, New York, a position he has held since 2002. In addition, he is a 9.3% equity owner of MFA. When called for testimony by the Division of Enforcement, Motz invoked his Fifth Amendment privilege and refused to answer questions. Motz earned over $300,000 annually from MFA during the relevant period. Motz holds Series 1, 24 and 40 licenses with the NASD.

D. **Jeanne McCarthy**, age 55, is Comptroller, Financial and Operations Principal ("FINOP"), and since approximately August of 2003, Director of Compliance Coordination ("DCC") at MFA. McCarthy had been Motz's administrative assistant for 20 years prior to becoming DCC. McCarthy is a partial equity owner of MFA. When called for testimony by the Division of Enforcement, McCarthy invoked her Fifth Amendment privilege and refused to answer questions. She currently resides in New York City.

OTHER RELEVANT ENTITY

E. **Third Millennium Fund, L.P.** ("Third Millennium"), a Delaware limited partnership, was formed in March 2002. The fund's shares are exempted from registration with the Commission under Regulation D of the Securities Act of 1933. Third Millennium GP, LLC, serves as a general partner of Third Millennium. MFA and Motz, among others, are members of the general partner. During the relevant period, Motz was responsible for investing a portion of the Third Millennium assets. During the relevant period, investors in the fund included high net worth individuals, some of whom were also advisory clients of MFA. Another advisory client opened an account with MFA pursuant to an agreement that the trading in its account would emulate the trading of Third Millennium (the "companion account").

RESPONDENTS' CONDUCT

F. From 2001 through approximately September 2003, Motz engaged in a cherry-picking scheme that generated virtually risk-free profits for the firm's trading account at the expense of the firm's advisory clients. Motz, the only MFA employee who executed trades in the firm's proprietary account, engaged in day-trading in the account. Motz was able to generate approximately $1.4 million in profits through this scheme. Then, beginning in the summer of 2003 until at least May 2005, Motz engaged in cherry-picking to boost the returns of the Third Millennium Fund, an advisory client hedge fund affiliated with MFA. During this period, Motz had trading responsibility for a portion of Third Millennium's assets.

F. To effectuate the cherry-picking scheme, Motz typically submitted equity buy orders to the MFA trading desk in the morning without indicating the accounts to which those purchases should be allocated. Motz did not provide the trading desk with allocation instructions concerning those purchases until much later in the day – often shortly before the close of the market. Thus, Motz purchased securities in the morning and then decided later in the day whether to sell the position and book the profit in MFA's proprietary account or to allocate the securities, often those which had depreciated in value during the day, to advisory client accounts.

G. Neither MFA nor Motz disclosed to clients that the firm was engaged in cherry-picking and that the firm would favor itself in the allocation of appreciated securities. Nor did MFA or Motz disclose to clients that the firm engaged in cherry-picking to favor Third Millennium over other advisory clients. In fact, the firm's ADV disclosures during the relevant period indicated that clients would not be disadvantaged by the firm's proprietary trading.

H. Trading records for MFA's proprietary account for January 2001 through September 2003 show that nearly every trade that Motz allocated to MFA's proprietary account during this period had appreciated in value from the time it was purchased earlier in the day. Through this cherry-picking scheme, Motz executed day-trades in MFA's

proprietary account that were more than 98% profitable and yielded a net gain of close to $1.4 million.

I. Performance data for the proprietary account was used by MFA employees to solicit investments in Third Millennium.

J. Motz was advised by others in the firm that he should allocate his trades at the time he submitted the order but through at least April 2005, Motz did not change his allocation practices.

K. In June 2003, Motz began to engage in cherry-picking to boost the returns of Third Millennium. During the period from December 18, 2003 through May 9, 2005, Third Millennium had a number of trades that were opened and closed out on the same or the next trading day. The profitability of such trades conducted in the Third Millennium account during this period was 100%. Motz also favored the companion account in the allocation of securities during this period. The profitability of the trades that were opened and closed out on the same or the next trading day in the companion account was over 98%. Consequently, Motz continued to harm certain MFA advisory clients by consistently allocating profitable trades to Third Millennium and the companion account during this period.

L. As a result of the unfair allocations during the relevant period, MFA earned approximately $1.4 million in profit. In addition, MFA and Motz received significant management fees and commissions from their advisory clients who were disadvantaged, and therefore harmed, by the cherry-picking scheme.

M. During an SEC examination of MFA in the fall of 2003, Motz, with the assistance of Jeanne McCarthy, altered certain order tickets relating to the cherry-picked trades in order to try to conceal his fraudulent practices from regulators. Specifically, Motz, with the assistance of McCarthy, gathered relevant order tickets from their designated locations and altered some of the tickets by adding markings or changing existing markings to make it appear that allocations had been made at the time of the initial purchases rather than later in the day.

N. During the time of the order ticket alteration, McCarthy was aware of Motz's late-day allocation practices. In addition, at the time of the order ticket alteration, McCarthy held a compliance role at MFA. Thus, by assisting in the alteration of these order tickets, McCarthy substantially assisted the ongoing fraudulent scheme.

O. MFA failed to make and keep true, accurate and current order memoranda for the purchase and sale of any security on behalf of a client. When submitting his initial trades, Motz failed to indicate the account for which the trades were entered, sometimes leaving the customer name field blank on order tickets. In addition, Motz and McCarthy were involved in the alteration of order tickets which rendered the memoranda inaccurate.

P. Motz signed and caused to be filed with the Commission on behalf of MFA materially misleading Forms ADV. Specifically, in response to Item 9 of Part II of MFA's Forms ADV filed during the relevant period, the firm acknowledged that it "buys and sells for itself securities that it also recommends to clients." An investment adviser that answers "yes" to that question is then required to disclose on Schedule F "what restrictions or internal procedures, or disclosures are used for conflicts of interest in" transactions in which it buys or sells for itself the same securities that it recommends to clients. Rather than disclosing its internal procedures, MFA disclosed only that "[t]he Investment Advisor might be purchasing or selling the same security for his/her own account as that of the client's in which case the Investment Advisor account never receives a lower price in cases of a purchase or a higher price in cases of a sale." Accordingly, as MFA and Motz willfully made material misstatements in the Forms ADV for the relevant period, these Forms ADV were misleading.

Q. From October 5, 2004 through at least April 2005, MFA was an investment adviser registered with the Commission that failed to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act by the adviser or any of its supervised persons. This failure permitted Motz to continue his allocation practices and cherry-pick trades to favor Third Millennium.

VIOLATIONS

R. By knowingly or recklessly allocating profitable trades to MFA at the expense of advisory clients, and later, to Third Millennium at the expense of other advisory clients as described above, Motz and MFA willfully violated and McCarthy willfully aided and abetted and caused violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities. In addition, through this cherry-picking scheme and by failing to disclose the scheme, MFA willfully violated and Motz and McCarthy willfully aided and abetted and caused violations of Sections 206(1) and 206(2) of the Advisers Act, which prohibit fraudulent conduct by an investment adviser with respect to advisory clients or prospective clients.

S. As described above, MFA willfully violated, and Motz and McCarthy willfully aided and abetted and caused MFA's violations of Section 204 of the Advisers Act and Rule 204-2(a)(3) thereunder, and Section 17(a)(1) of the Exchange Act and Rule 17a-3(a)(6)(i) thereunder which require registered investment advisers and broker-dealers to make and keep true, accurate and current order memoranda for the purchase and sale of any security on behalf of a client by failing to make accurate order tickets that contained all the information required by those rules. In addition, MFA willfully violated, and Motz and McCarthy willfully aided and abetted and caused MFA's violations of Section 204 of the Advisers Act and Rule 204-2(a)(3) thereunder, and Section 17(a)(1) of the Exchange Act and Rule 17a-4(b)(1) thereunder by subsequently altering order tickets.

T. In addition, MFA willfully either failed to create a general ledger for substantial portions of the relevant period in violation of Section 204 of the Advisers Act

and Rule 204-2(a)(2) thereunder and Section 17(a)(1) and Rules 17a-3(a)(2) of the Exchange Act, or it created a general ledger which it failed to maintain for substantial portions of the relevant period in violation of Section 204 of the Advisers Act and Rule 204(2)(a)(2) thereunder and Section 17(a)(1) and Rules 17a-4(a) of the Exchange Act. MFA also willfully failed to maintain a record of a trial balance during much of this period in violation of Rule 204-2(a)(6) of the Advisers Act and Rule 17a-4(b)(5) of the Exchange Act. As President and CEO, Chief Compliance Officer, Director, and Chairman of the Executive Committee of MFA, Motz willfully aided and abetted and caused these violations.

U. During the relevant period, MFA filed misleading Forms ADV that willfully made material misstatements – i.e., falsely asserting that when MFA buys or sells for itself the same securities that it recommends to clients, it "never receives a lower price in cases of a purchase or a higher price in cases of a sale." Therefore, MFA willfully violated Section 207 of the Advisers Act. By signing and causing to be filed on behalf of MFA these misleading Forms ADV, Motz also willfully violated Section 207 of the Advisers Act.

V. From October 5, 2004, MFA was an investment adviser registered with the Commission but failed to adopt and implement written policies and procedures reasonably designed to prevent violation of the Advisers Act by the adviser or any of its supervised persons. By failing to adopt and implement written policies and procedures, MFA violated and Motz aided and abetted and caused violations of Section 206(4) and Rule 206(4)-7 thereunder.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Motz pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, including, but not limited to, disgorgement, prejudgment interest, and civil penalties pursuant to Section 21B of the Exchange Act and Sections 203(i) and 203(j) of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against McCarthy pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, including, but not limited to, civil penalties pursuant to Section 21B of the Exchange Act and Sections 203(i) of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against MFA pursuant to Section 15(b)(4) of the Exchange Act and Section 203(e) of the Advisers Act including, but not limited to, disgorgement, prejudgment interest, and civil penalties pursuant to Section 21B of the Exchange Act and Sections 203(i) and 203(j) of the Advisers Act;

E. Whether, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, MFA and Motz should be ordered to cease and desist from committing or causing violations of and any future violations of the Sections or Rules specified in Section II, above, and whether MFA and Motz should be ordered to pay disgorgement and prejudgment interest pursuant to Section 21C(e) of the Exchange Act and Section 203(k)(5) of the Advisers Act; and

F. Whether, pursuant to Section 21C of the Exchange Act and Section 203(k) of the Advisers Act, McCarthy should be ordered to cease and desist from committing or causing violations of and any future violations of the Sections or Rules specified in Section II, above.

IV.

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

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

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

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

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

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

By the Commission.

Nancy M. Morris
Secretary

Florence E Harmon

By: Florence E. Harmon
Deputy Secretary

Commissioner Campos
Not Participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55359 / February 27, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2566 / February 27, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12575

In the Matter of **Robert A. Ness, Jr.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted against Robert A. Ness, Jr., ("Respondent" or "Ness") pursuant to Rule 102(e)(3)(i) of the Commission's Rules of Practice.[1]

[1] Rule 102(e)(3)(i) provides, in relevant part, that:

The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . suspend from appearing or practicing before it any . . . accountant . . . who has been by name . . . permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder.

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II.

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

III.

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

1. Ness, age 42, passed the Certified Public Accountant ("CPA") examination in the State of Washington, and received a certificate allowing him to use the title CPA-Inactive, but has never been a licensed CPA. He served as Controller of Metropolitan Mortgage & Securities Co., Inc. ("Metropolitan") from 2001 until his termination in April 2004.

2. Metropolitan was, at all relevant times, a closely-held Washington corporation with its principal place of business in Spokane, Washington that was engaged in the business of originating high-risk commercial real estate loans and selling real estate. While all of Metropolitan's common stock was held by former CEO C. Paul Sandifur, Jr. ("Sandifur") or his family, Metropolitan registered debt securities and preferred stock with the Commission pursuant to Sections 12(b) and 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). Metropolitan listed its securities on the Pacific Exchange and the American Stock Exchange until both exchanges delisted the securities in December 2003. Metropolitan had its registrations revoked pursuant to Section 12(j) of the Exchange Act on January 27, 2006. On February 4, 2004, Metropolitan filed for Chapter 11 bankruptcy in United States Bankruptcy Court in the Eastern District of Washington. Metropolitan's assets are currently being liquidated.

3. On September 26, 2005, the Commission filed a complaint against Ness in SEC v. Robert A. Ness, et al. (Civil Action No. 2:05-CV-1631). On February 2, 2007, the court entered an order permanently enjoining Ness, by consent, from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b) and 13(b)(5) of the Exchange Act and Rules 10b-5, 13a-14, 13b2-1 and 13b2-2 thereunder, and aiding and abetting violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

4. The Commission's complaint alleged, among other things, that Ness, at the direction of Metropolitan's former President and Chief Executive Officer, approved the use of an accounting treatment that did not comply with Generally Accepted Accounting Principles ("GAAP"). The inappropriate accounting treatment recognized the full gain on several sales of

real estate immediately, when one or more of the criteria required by GAAP had not been met. To facilitate the real estate sales Metropolitan had financed all or nearly all of the sales prices to the buyers. Under GAAP, recognition of the full gain on these real estate sales was not permitted until various criteria were met including, that the buyers make their own substantial initial down payments demonstrating their commitments to pay for the properties. Despite this, Ness approved the immediate recognition of the full gain for the transactions even though he knew, or was reckless in not knowing, that such accounting treatment was a departure from GAAP and contrary to the advice Metropolitan had received from its auditor. The fraudulently recorded income from the transactions allowed Metropolitan to report a net profit for the third fiscal quarter of 2002 and the 2002 fiscal year instead of a net loss.

IV.

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

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

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

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

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

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

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

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

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

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

C. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission as an accountant provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission as a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission provided that his state CPA license or certificate is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary