~~MAY 2006~~

March 2007

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 March 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

PAUL S. ATKINS, COMMISSIONER

ROEL C. CAMPOS, COMMISSIONER

ANNETTE L. NAZARETH, COMMISSIONER

KATHLEEN L. CASEY, COMMISSIONER

42 Documents

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

FEB 0 5 2007

IN THE MATTER OF CYBERKEY SOLUTIONS, 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 CyberKey Solutions, Inc. ("CyberKey") because of questions regarding the accuracy of assertions made by CyberKey, and others, in press releases and other public statements to investors, concerning among other things: (1) contracts with the Department of Homeland Security and/or other government agencies, (2) revenues received pursuant to those contracts, and (3) accounts receivable generated by those contracts.

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 5, 2007 through 11:59 p.m. EST, on February 16, 2007.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

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SECURITIES AND EXCHANGE COMMISSION
(Release Nos. 33-8782, 34-55350; File No. 4-532)

Roundtable on International Financial Reporting Standards "Roadmap"

AGENCY: Securities and Exchange Commission

ACTION: Notice of roundtable meeting.

SUMMARY: On Tuesday, March 6, 2007 the Securities and Exchange Commission will hold a roundtable discussion on the "roadmap" regarding International Financial Reporting Standards (IFRS). The roadmap describes the path toward eliminating the need for non-U.S. companies to reconcile to U.S. GAAP financial statements they prepare pursuant to IFRS issued by the International Accounting Standards Board in filings with the Commission. The subject matter of the roundtable will be the effect on the capital raising process in the U.S. capital markets with respect to the roadmap, the effect on investors in the U.S. capital markets with respect to the roadmap, and the effect on issuers in the U.S capital markets with respect to the roadmap. Representative(s) of the following have been invited to participate: issuers, investors, securities counsel, underwriters, credit rating agencies, stock exchanges, academia, and audit firms.

The roundtable will take place at the Commission's headquarters at 100 F Street, NE, Auditorium, Room L-002, Washington, DC at 10:00 a.m. The public is invited to observe the roundtable discussions. Seating is available on a first-come, first-serve basis.

FOR FURTHER INFORMATION CONTACT: Katrina Kimpel at (202) 551-5313.

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

February 26, 2007

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Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55384 / March 2, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2570 / March 2, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12578

In the Matter of **John Paul Orr,** **Respondent.**	**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**

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 John Paul Orr ("Orr" or "Respondent").

II.

In anticipation of the institution of these proceedings, Orr has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Orr 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 ("Order"), as set forth below.

III.

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

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

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A. RELEVANT ENTITIES

1. Kmart Corporation ("Kmart" or the "company")

Kmart was a Michigan Corporation headquartered in Troy, Michigan, during the relevant period. On January 22, 2002, Kmart filed a voluntary petition for reorganization relief under Chapter 11 of the Bankruptcy code. The company's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act [15 U.S.C. § 78l(b)] and traded on the New York Stock Exchange until December 19, 2002, when trading was suspended. Kmart's fiscal year ends the last Wednesday in January.

2. Eastman Kodak Company ("Kodak")

Kodak is a New Jersey corporation headquartered in Rochester, New York. Kodak is one of the world's largest photo imaging companies and a major Kmart vendor. Kodak's 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.

B. RESPONDENT

Orr was Divisional Vice President of Kmart's photo division from October 1999 to February 15, 2001, when he left the company.

C. FACTS

1. Kmart Improperly Recognized Vendor Allowances

Kmart improperly recognized millions of dollars worth of vendor "allowances" prior to bankruptcy. Kmart obtained allowances from its vendors for various promotional and marketing activities. A significant number of allowances were recognized prematurely – or "pulled forward" -- on the basis of false information provided to Kmart's accounting department, while the true terms of the payments were set forth in undisclosed side agreements. As a result of these accounting irregularities, Kmart's cost of goods sold was understated for the fourth quarter of fiscal year ended January 26, 2000 ("fiscal year 1999").

2. Kmart's Vendor Allowance Tracking System ("VATS") Forms

The principal document involved in the pulling forward of vendor allowances was Kmart's VATS form. VATS forms summarized the basic terms of vendor allowances for the company's accounting department. Bookkeepers inputted information from the VATS form into the company's computerized accounting system, where it was eventually posted to the general ledger. To ensure proper accounting for an allowance, the VATS form should have reflected the true purpose of, and effective dates for, the payment. To pull forward an allowance, this information was misrepresented on the VATS form to make it look like the payment was for past performance, when in truth it related to future obligations. Kmart had a number of safeguards designed to ensure the accuracy of the VATS forms and proper recognition of vendor allowances. These included the requirement that vendors co-sign VATS forms.

3. Orr's Division Pulled Forward $2.5 Million Of Kodak Allowances

Towards the end of fiscal year 1999, Kmart's photo division was projecting a profit shortfall, meaning actual results were short of what senior management expected. Orr's division dealt with the profit shortfall in part by asking Kodak for additional allowances. Kodak responded by agreeing to pay $2.5 million to secure for itself the right to display product at the front of Kmart stores during calendar year 2000. On or about January 24, 2000, a Kmart buyer in the photography products group prepared and signed VATS No. 197017. VATS No. 197017 misrepresented the effective date of the $2.5 million allowance as 2/1/99 to 1/25/00. VATS No. 197017 also misrepresented that the allowance related to an "Annual Rolling Rack Program for 1999." This information was inaccurate because the allowance related to activity scheduled for calendar year 2000. On or about January 27, 2000, Kmart's accounting department entered the inaccurate VATS information into the company's computerized accounting system, where it was eventually posted to the general ledger. VATS No. 197017 caused cost of goods sold to be understated by $2.5 million in fiscal year 1999.

D. CONCLUSION

As a result of the foregoing, Orr caused a violation of Rule 13b2-1 of the Exchange Act.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanction agreed to in Orr's Offer.[2]

Accordingly, IT IS HEREBY ORDERED that Respondent Orr cease and desist from committing or causing any violations and any future violations of Rule 13b2-1 of the Exchange Act.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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[2] In connection with the institution of these proceedings, the Commission is voluntarily dismissing with prejudice as to Respondent a civil action previously filed against him in the United States District Court for the Eastern District of Michigan.

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55383 / March 2, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2569 / March 2, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12577

In the Matter of **David C. Kirkpatrick,** **Respondent.**	**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**

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 David C. Kirkpatrick ("Kirkpatrick" or "Respondent").

II.

In anticipation of the institution of these proceedings, Kirkpatrick has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Kirkpatrick 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 ("Order"), as set forth below.

III.

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

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

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A. RELEVANT ENTITIES

1. Kmart Corporation ("Kmart" or the "company")

Kmart was a Michigan Corporation headquartered in Troy, Michigan, during the relevant period. On January 22, 2002, Kmart filed a voluntary petition for reorganization relief under Chapter 11 of the Bankruptcy code. The company's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act [15 U.S.C. § 78l(b)] and traded on the New York Stock Exchange until December 19, 2002, when trading was suspended. Kmart's fiscal year ends the last Wednesday in January.

2. Coca Cola Enterprises Inc. ("CCE")

CCE is a Delaware corporation headquartered in Atlanta, Georgia. CCE is the world's largest bottler of Coca-Cola products and a major Kmart vendor. CCE's 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.

B. RESPONDENT

Kirkpatrick was National Sales Director for CCE in charge of the Kmart account at all relevant times through January 2004, when he was asked to resign. Kirkpatrick worked out of a Farmington Hills, Michigan, field office during the relevant period.

C. FACTS

1. Kmart Improperly Recognized Vendor Allowances

Kmart improperly recognized millions of dollars worth of vendor "allowances" prior to bankruptcy. Kmart obtained allowances from its vendors for various promotional and marketing activities. A significant number of allowances were recognized prematurely – or "pulled forward" -- on the basis of false information provided to Kmart's accounting department, while the true terms of the payments were set forth in undisclosed side agreements. As a result of these accounting irregularities, Kmart's cost of goods sold was understated, and earnings were materially overstated, for the fourth quarter of fiscal year ended January 31, 2001 ("fiscal year 2000").

2. Kmart's Vendor Allowance Tracking System ("VATS") Forms

The principal document involved in the pulling forward of vendor allowances was Kmart's VATS form. VATS forms summarized the basic terms of vendor allowances for the company's accounting department. Bookkeepers inputted information from the VATS form into the company's computerized accounting system, where it was eventually posted to the general ledger. To ensure proper accounting for an allowance, the VATS form should have reflected the true purpose of, and effective dates for, the payment. To pull forward an allowance, this information was misrepresented on the VATS form to make it look like the payment was for past performance, when in truth it related to future obligations. Kmart had a number of safeguards designed to ensure the accuracy of the VATS forms and proper recognition of vendor allowances. These included the requirement that vendors co-sign VATS forms.

3. Kirkpatrick Signed Two Misstated VATS Forms

At a meeting on or about January 5, 2001, Kirkpatrick learned that Kmart's food and consumables division needed $5 million from CCE to help cover a divisional profit shortfall. As explained in a subsequent e-mail to Kirkpatrick on January 11, 2001, "dave, i appreciate your efforts however i need to accelerate your schedule. with the close of our fiscal on 1/31 i need to line up another partner. the bottom line is we need the 5.0m stay in touch." Kirkpatrick responded by e-mail, "[] How about 7:30AM on Tuesday 1/16/0[1]? I'll bring the donuts and the checkbook." Kirkpatrick attended additional meetings at Kmart in mid to late January 2001, after which CCE agreed to "advance" $3 million worth of allowances in exchange for sales and promotional activities by Kmart during calendar year 2001 and to pay $2 million to settle accounts for calendar year 2000. To memorialize that agreement, Kmart and CCE entered into a written contract dated January 30, 2001 ("Coke Contract"), which was negotiated by Kirkpatrick on behalf of CCE. The Coke Contract provided in relevant part that CCE would pay $3 million to support mutually agreed-upon marketing activities during calendar year 2001. Kmart would earn this allowance if, and only if, it sold targeted amounts of CCE product during the calendar year.

At the end of January 2001, Kirkpatrick signed several VATS forms, including two relating to the $3 million "advance." The first, VATS No. 226003, purported to relate to a $2.25 million "Case display allowance" with an effective date of 02/01/00 to 12/31/00; the second, VATS No. 226004, purported to relate to a $750,000 "Holiday Display activation" allowance with an effective date of 11/01/00 to 12/31/00. VATS Nos. 226003 and 226004 misrepresented the effective dates and purpose of these allowances. The true terms of the allowances were set forth in the Coke Contract and a subsequent letter Kirkpatrick wrote, neither of which was provided to Kmart's accounting department or independent auditor. As explained therein, CCE agreed to pay $3 million to support mutually agreed-upon marketing activities during calendar year 2001.

On or about January 30, 2001, Kmart's accounting department entered the false VATS information into the company's computerized accounting system, where it was eventually posted to the general ledger. VATS Nos. 226003 and 226004 caused the cost of goods sold to be understated by approximately $3 million in fiscal year 2000. CCE paid the $3 million allowance by check dated April 4, 2001, but the money was subject to repayment if Kmart did not perform in accordance with the terms of the Coke Contract.

4. CCE's False Third-Party Confirmation

Kmart's independent auditor, PricewaterhouseCoopers LLP ("PwC"), sought to confirm with CCE the terms of the $2.25 million allowance during the fiscal year 2000 audit. Towards that end, PwC faxed Kirkpatrick a third-party confirm relating to VATS No. 226003 on or about February 19, 2001. The third-party confirm, which was on Kmart letterhead, read in relevant part, "Our auditors, PricewaterhouseCoopers L.P.P. are performing an annual audit of our financial statements. They have requested of us to confirm directly with you the following vendor allowance agreement [Vats No. 226003]." On or about March 5, 2001, Kirkpatrick filled out by hand, signed, and faxed to PwC an executed third-party confirm that, as he knew or was reckless in not knowing, misrepresented the nature of ("Case display allowance") and effective dates ("02/01/00 to 12/31/00") for the $2.25 million allowance.

5. **Kmart's Earnings Were Overstated**

On March 13, 2001 Kmart filed its Form 10-K for the period ended January 31, 2001. According to the financial statements incorporated into the Form 10-K, Kmart reported net income for the fourth quarter of $249 million or $0.48 per share, exceeding Wall Street analyst expectations of $0.47 by a penny. Kirkpatrick's accounting irregularities caused Kmart's net income for the quarter to be overstated by approximately 1.2 percent.

D. CONCLUSION

As a result of the foregoing, Kirkpatrick committed violations of Rule 13b2-1 of the Exchange Act and caused violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13b2-2 promulgated thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Kirkpatrick's Offer.[2]

Accordingly, IT IS HEREBY ORDERED that Respondent Kirkpatrick cease and desist from committing or causing any violations and any future violations Rule 13b2-1 of the Exchange Act and causing any violations and any future violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13b2-2 promulgated thereunder.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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[2] Kirkpatrick has agreed to pay a $25,000 civil penalty in connection with a related civil action.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Ch. II

[Release Nos. 33-8783, 34-55396, IA-2596, IC-27746, File No. S7-07-07

Regulatory Flexibility Agenda

AGENCY: Securities and Exchange Commission.

ACTION: Semiannual regulatory agenda.

SUMMARY: The Securities and Exchange Commission approved the publication of an agenda of its rulemaking actions, pursuant to the Regulatory Flexibility Act. The agenda, which is not a part of or attached to this document, was submitted by the Commission to the Regulatory Information Service Center for inclusion in the Unified Agenda of Federal Regulatory and Deregulatory Actions, which is scheduled for publication in the Federal Register in April 2007. Information in the agenda was accurate on March 2, 2007, the date on which the Commission's staff completed compilation of the data. To the extent possible, rulemaking actions by the Commission after that date will be reflected in the agenda. The Commission invites questions and public comment on the agenda and on the individual agenda entries.

DATES: Comments should be received on or before June 30, 2007.

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-07-07 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

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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 S7-07-07. 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/other.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: Anne Sullivan, Office of the General Counsel, 202-551-5019.

SUPPLEMENTARY INFORMATION: The Regulatory Flexibility Act ("RFA") (Pub. L. No. 96-354, 94 Stat. 1164 (September 19, 1980)) requires each federal agency in April and October of each year to publish in the Federal Register an agenda identifying rules that the agency expects to consider proposing or adopting that are likely to have a significant economic impact on a substantial number of small entities (5 U.S.C. 602(a)). The RFA specifically provides that publication of the agenda does not preclude an agency from considering or acting on any matter not included in the agenda, and that an agency is not required to consider or act on any matter which is included in the agenda (5 U.S.C. 602(d)). Actions that do not have an estimated date are placed in the long term category; the Commission may nevertheless act on items in that category within the next twelve months. The agenda includes new entries, entries carried over from previous publications, and rulemaking actions that have been completed (or withdrawn) since publication of the last agenda. The Commission invites public comment on the agenda and on the individual agenda entries.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: March 5, 2007

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8784 / March 5, 2007

SECURITIES EXCHANGE ACT OF 1934
Release No. 55399 / March 5, 2007

In the Matter of VERITAS SOFTWARE CORPORATION, Respondent.	**ORDER UNDER SECTION 27A(b) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(ii) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b)(1)(A)(ii) OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO SYMANTEC CORPORATION**

Symantec Corporation ("Symantec") has submitted a letter, dated January 30, 2007, for a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from Veritas Software Corporation's ("Veritas") settlement of a civil action against it. Veritas is a wholly-owned subsidiary of Symantec. On February 20, 2007, the Commission filed a settled federal court action against Veritas in the United States District Court for the District of Columbia. In its complaint, the Commission alleged that Veritas violated and aided and abetted violations of (among other provisions) Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Exchange Act Rule 10b-5. Without admitting or denying the allegations, Veritas consented to a final judgment that enjoins it from committing and aiding and abetting future violations of these provisions, orders it to pay disgorgement in the amount of $1 and a civil penalty in the amount of $30 million (the "Consent and Final Judgment").

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward-looking statement that is "made with respect to the business or operations of an issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of a judicial . . . order arising out of a government action that . . .

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prohibits future violations of the antifraud provisions of the federal securities laws." Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications apply except "to the extent otherwise specifically provided by rule, regulation, or order of the Commission." Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act.

Because the violations alleged in the complaint were committed at Veritas before Symantec acquired Veritas and those responsible for the fraud are no longer employed by Symantec, the Commission has determined that the request for a waiver of the disqualifications resulting from the Consent and Final Judgment is appropriate and should be granted.

Accordingly, **IT IS ORDERED,** pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provisions of 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to Symantec resulting from the entry of the Consent and Final Judgment is hereby granted.

By the Commission.

Nancy M. Morris
Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55402 / March 6, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12582

In the Matter of **Preview Systems, Inc.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

In anticipation of the institution of these proceedings, Preview Systems has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Preview Systems consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

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

1. Preview Systems (CIK No. 1091271) is a Delaware corporation located in Portland, Oregon. At all times relevant to this proceeding, the common stock of Preview Systems has been registered with the Commission under Exchange Act Section 12(g). As of August

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31, 2006, Preview Systems' common stock was quoted on the Pink Sheets (symbol: PRVWZ).

2. Preview Systems has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended September 30, 2001.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Preview Systems' securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55401 / March 6, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12581

In the Matter of Mill Creek Research, Inc., Respondent.	ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act"), against Mill Creek Research, Inc. ("Mill Creek" or "Respondent").

II.

In anticipation of the institution of these proceedings, Mill Creek has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Mill Creek consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

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

1. Mill Creek (CIK No. 1116773) is a Utah corporation based in Seymour, Texas. At all times relevant to this proceeding, the common stock of Mill Creek has been registered with the Commission under

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Exchange Act Section 12(g). The common stock of Mill Creek is not quoted on any exchange.

2. Mill Creek has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended September 30, 2004.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Mill Creek's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55400 / March 6, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12580

In the Matter of ABS Industries, Inc., Respondent.	ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

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

II.

In anticipation of the institution of these proceedings, ABS has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, ABS consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

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

1. ABS (CIK No. 313368) is a void Delaware corporation located in Wilmington, Delaware. At all times relevant to this proceeding, the common stock of ABS was registered with the Commission under Exchange Act Section 12(g). As of October 11, 2006, the common stock

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of ABS (symbol "ABSI") was quoted on the Pink Sheets, had one market maker, and was eligible for the piggyback exemption of Exchange Act Rule 15c2-11(f)(3).

2. ABS has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended October 31, 1995.

IV.

Section 12(j) of the Exchange Act provides as follows:

> The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of ABS's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

T.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55404 / March 6, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12584

In the Matter of **Washington Corp.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

In anticipation of the institution of these proceedings, Washington Corp. has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Washington Corp. consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

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

1. Washington (CIK No. 314625) is a Maryland corporation based in Bethesda, Maryland. At all times relevant to this proceeding, the common stock of Washington has been registered with the Commission

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common stock of Washington has been registered with the Commission under Exchange Act Section 12(g). As of April 26, 2005, there was no public trading market for Washington's securities. The Respondent liquidated in accordance with the Plan of Liquidation approved by shareholders at a Shareholder's Meeting held June 27, 2003. The Respondent filed Articles of Dissolution with the Maryland State Secretary of State on June 28, 2004.

2. Washington has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended September 30, 2003.

IV.

Section 12(j) of the Exchange Act provides as follows:

> The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of Washington's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55403 / March 6, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12583

In the Matter of **SVT, Inc.,** **Respondent.**	**ORDER INSTITUTING PROCEEDINGS, MAKING FINDINGS, AND REVOKING REGISTRATION OF SECURITIES PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

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

II.

In anticipation of the institution of these proceedings, SVT has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, SVT consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), and to the findings as set forth below.

III.

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

1. SVT (CIK No. 914271) is a Delaware corporation based in New York, New York. At all times relevant to this proceeding, the common stock of SVT has been registered with the Commission under

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Exchange Act Section 12(g). As of April 25, 2006, the common stock of SVT (symbol "SVTV") was quoted on the Pink Sheets.

2. SVT has failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder while its securities were registered with the Commission in that it has not filed any periodic reports for any fiscal period subsequent to the period ended September 30, 2003.

IV.

Section 12(j) of the Exchange Act provides as follows:

The Commission is authorized, by order, as it deems necessary or appropriate for the protection of investors to deny, to suspend the effective date of, to suspend for a period not exceeding twelve months, or to revoke the registration of a security, if the Commission finds, on the record after notice and opportunity for hearing, that the issuer of such security has failed to comply with any provision of this title or the rules and regulations thereunder. No member of a national securities exchange, broker, or dealer shall make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security the registration of which has been and is suspended or revoked pursuant to the preceding sentence.

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

Accordingly, it is hereby ORDERED, pursuant to Section 12(j) of the Exchange Act, that registration of each class of SVT's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55417 / March 7, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12586

In the Matter of ALEXANDRE PONZIO DE AZEVEDO, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Alexandre Ponzio De Azevedo ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

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III.

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

1. Respondent was employed with Banco ABN AMRO Real S.A., which, through common control by its parent company ABN AMRO Holding N.V., headquartered in Amsterdam, was associated with ABN AMRO Inc., based in Chicago, Illinois, which in turn was registered with the Commission as a broker dealer. Respondent, 33 years old, is a resident of São Paulo, Brazil.

2. On February 27, 2007, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Exchange Act Sections 10(b) and 14(e) and Rules 10b-5 and 14e-3 thereunder, in the civil action entitled Securities and Exchange Commission v. Alexandre Ponzio De Azevedo, Civil Action Number 1:07CV00380, in the United States District Court for the District of Columbia.

3. The Commission's complaint alleged that, in connection with the tender offer by Sadia S.A. for Perdigão S.A. announced on July 16, 2006, for which Banco ABN AMRO Real S.A. had agreed to provide financing to Sadia S.A., Respondent purchased 14,000 American Depositary Shares ("ADSs") of Perdigão S.A. on June 20, 2006, on the basis of material, nonpublic information then in his possession concerning the tender offer, which information he knew, or was reckless in not knowing, was both material and nonpublic, and that he later sold 10,500 of these same ADSs on July 18, 2006.

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 be, and hereby is barred from association with any broker or dealer, with the right to reapply for association after three (3) years to the appropriate self-regulatory organization, or if there is none, to the Commission;

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

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

By the Commission.

Nancy M. Morris
Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55416 / March 7, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2573 / March 7, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12585

In the Matter of **NORTHWESTERN CORPORATION,** **Respondent.**	**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**

I.

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

II.

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

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III.

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

Summary

During the first three quarters of 2002, NorthWestern filed quarterly and current reports with the Commission that materially misstated NorthWestern's financial position and misrepresented or did not disclose required information about its non-utility businesses, Expanets, Inc. ("Expanets") and Blue Dot Services, Inc. ("Blue Dot"). In its filings, after the effect of taxes, NorthWestern overstated its income from continuing operations for the first three quarters of 2002 by approximately 176%, 618%, and 109%, respectively, due to the company's improper accounting for accounts receivable, adjustments to customers' bills, and allocation of losses to minority interests. NorthWestern also misrepresented or did not disclose, among other things, the effects of significant problems with Expanets' new information technology system, the material impact of Expanets' reserve reductions and its receipt of non-compete payments on Expanets' income, large intercompany advances NorthWestern made to support Expanets and Blue Dot, and the timing of anticipated payments from the sale of certain utility assets. Through its financial misstatements, misrepresentations, and omissions, NorthWestern obscured the continuing poor performance of its subsidiaries at a time when it was publicly relying on these subsidiaries' operations to strengthen its financial condition.

Respondent

1. NorthWestern, a Delaware corporation with its principal executive offices in Sioux Falls, South Dakota, operates a regulated utility business in South Dakota, Nebraska, and Montana. During the period of conduct discussed herein, NorthWestern consolidated the financial results of two non-utility entities, Expanets and Blue Dot. NorthWestern's common stock was registered with the Commission under Section 12(b) of the Exchange Act and traded on the New York Stock Exchange until it was delisted shortly before NorthWestern declared bankruptcy in September 2003. In November 2004, NorthWestern emerged from bankruptcy. Its common stock is now registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NASDAQ Global Select Market.

Other Relevant Entities

2. Expanets, formerly headquartered in Englewood, Colorado, was formed by NorthWestern in 1997 and provided networked telecommunications equipment and services to medium-sized businesses nationwide. NorthWestern wrote off substantially all of its investment in Expanets during the fourth quarter of 2002 as disclosed in the company's 2002 Form 10-K and announced its intention to sell Expanets in April 2003. In the second quarter of 2003, Expanets'

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

operations were discontinued, and in May 2004, Expanets (n/k/a Netexit) filed for Chapter 11 bankruptcy protection. Proceeds from the sale of Expanets' assets were distributed in bankruptcy.

3. Blue Dot, formerly headquartered in Sunrise, Florida, and Sioux Falls, South Dakota, was formed by NorthWestern in 1997 and provided heating, ventilation and air conditioning ("HVAC") services nationwide. NorthWestern wrote off substantially all of its investment in Blue Dot during the fourth quarter of 2002 as disclosed in the company's 2002 Form 10-K and announced its intention to sell Blue Dot in April 2003. In the second quarter of 2003, Blue Dot's operations were discontinued, and NorthWestern thereafter sold or closed each of Blue Dot's HVAC businesses.

Background

4. For more than seventy years, NorthWestern operated a public utility business, providing electricity and natural gas to customers in South Dakota and Nebraska. In the late 1990s, NorthWestern formed Expanets and Blue Dot (the "non-utility businesses") to diversify into the telecommunications and HVAC sectors. NorthWestern's business plan was to acquire small telecommunications and HVAC companies and make them more profitable through central management, national branding and other economies of scale.

5. From 1998 through the end of 2001, Expanets acquired twenty-six small telecommunications companies and a sales division of a large competitor. From 1997 through the end of 2001, Blue Dot acquired over ninety different HVAC and plumbing companies. By the end of 2001, NorthWestern had invested hundreds of millions of dollars in Expanets and Blue Dot to make these acquisitions and build those subsidiaries' central management. However, Expanets and Blue Dot incurred losses during most years and posted only small profits in other years. Because of their performance, Expanets and Blue Dot required investments of substantial amounts of cash by NorthWestern.

6. In February 2002, NorthWestern effectively quadrupled its utility customer base by acquiring Montana Power Company ("Montana Power") for approximately $1.1 billion. NorthWestern originally financed its acquisition of Montana Power by utilizing, among other things, a $720 million acquisition loan. In March 2002, as part of a debt offering to retire the acquisition loan, NorthWestern issued $720 million in the form of senior notes.

7. The magnitude of NorthWestern's increased debt as a result of the Montana Power acquisition threatened the company's credit ratings. As a result, NorthWestern announced its intention to conduct an equity offering during 2002 to raise approximately $200 million to pay down its debt and improve its debt/equity ratios.

8. NorthWestern recognized that improvement in the performance of both Expanets and Blue Dot was critical to its planned equity offering. NorthWestern made public statements that both Expanets and Blue Dot would achieve 2002 targeted earnings and begin providing cash to the NorthWestern consolidated entity in 2002.

9. NorthWestern conducted its equity offering during the third quarter of 2002, and raised approximately $87 million. Also during the third quarter of 2002, NorthWestern completed its registration and exchange of new notes for $720 million of debt it incurred to purchase Montana Power.

10. In December 2002, NorthWestern disclosed that significant operational problems at Expanets and Blue Dot would materially impact the company's consolidated year-end financial results. In April 2003, NorthWestern filed its 2002 Form 10-K and simultaneously restated each of its Forms 10-Q for the first three quarters of 2002. NorthWestern's restated Forms 10-Q corrected material misstatements of previously reported financial results relating to Expanets and Blue Dot, and disclosed various operational difficulties these subsidiaries experienced throughout 2002. NorthWestern's 2002 Form 10-K further disclosed that the company did not anticipate recovering its past investments of hundreds of millions of dollars in Expanets and Blue Dot, and that neither entity would generate cash flows in sufficient amounts to provide meaningful contributions to service NorthWestern's debt load. NorthWestern's liquidity situation continued to deteriorate until the company filed for bankruptcy in September 2003. NorthWestern stock, which had traded for more than $20 per share in early 2002, was trading for less than a dollar by the time NorthWestern filed bankruptcy.

Problems Relating to Expanets' Computer System

Functionality of the EXPERT System

11. During 2000 and 2001, Expanets developed an information technology system, called the "EXPERT" system, to serve as a platform for virtually all of its operations, including sales, inventory, project management, billing, collections and financial statement preparation. Because of its planned scope and impact across operations, the functionality of the EXPERT system was critical to Expanets.

12. However, following its implementation in November 2001, the EXPERT system was unable to perform many of the basic tasks for which it had been designed. For example, for approximately a month after it was implemented, EXPERT could not generate any customer bills. From January through May 2002, many customer bills EXPERT generated were incomplete and inaccurate. Until approximately September 2002, the EXPERT system also could not properly apply cash collected to customer accounts or track the aging of accounts receivable balances. These problems materially affected Expanets' results from operations throughout 2002.

13. NorthWestern's Forms 10-Q for the first and second quarters of 2002 and associated press releases attached to Forms 8-K mischaracterized EXPERT's billing activities as "fully operational" or "operational" and failed to adequately disclose the magnitude of the system's problems and the material impact of those problems on Expanets' operations. In its Form 10-Q for the third quarter of 2002, NorthWestern disclosed that EXPERT had encountered some problems, particularly as to billings and collections, but did not disclose the extent to which these system problems had impacted Expanets' operations. NorthWestern did not fully and adequately disclose the severity of the problems with the EXPERT system and the impact of those problems on

Expanets' operations until April 2003 when it filed its 2002 Form 10-K and restated its Forms 10-Q for the first three quarters of 2002.

Aged Accounts Receivable

14. In anticipation that some customer accounts might prove uncollectible, Expanets maintained a "bad debt" reserve, which had the effect of reducing Expanets' operating income. Prior to its implementation of EXPERT, Expanets calculated its bad debt reserve based on the age of uncollected receivables outstanding in a given period. However, during the first and second quarters of 2002, the EXPERT system could not properly apply cash collected from customers to their accounts or accurately track the aging of Expanets' accounts receivable. As a result, rather than considering the age of all of its receivables, Expanets estimated its bad debt reserve based on the percentage of revenue that had typically resulted in uncollectible accounts receivable.

15. Expanets' bad debt reserve in 2002 was inadequate. As an initial matter, Expanets did not make appropriate adjustments for known aged receivables that pre-dated implementation of the EXPERT system.

16. Expanets also failed to increase its bad debt reserve despite the markedly increased difficulties with collections that resulted from the EXPERT system's problems. For example, since EXPERT could not apply cash collected to the proper accounts, Expanets could not determine from which customers to seek payment, causing uncollected receivables to age further.

17. Beginning in the third quarter of 2002, for the first time, the EXPERT system was able to generate accurate accounts receivable aging reports. These reports demonstrated that Expanets' uncollectible accounts receivable exceeded its existing bad debt reserve by tens of millions of dollars. Despite such data, Expanets did not increase its bad debt reserve or directly write off uncollectible accounts receivable.

18. In its first and second quarter Forms 10-Q, NorthWestern did not disclose information indicating that a loss as a result of its uncollectible accounts receivable was probable or reasonably possible. In its third quarter Form 10-Q, NorthWestern disclosed that the EXPERT system's problems might lead to an increase in Expanets' bad debt reserve. However, this disclosure was inadequate since NorthWestern knew at that time that Expanets' bad debt reserve was materially insufficient.

19. In December 2002, NorthWestern announced that it anticipated that Expanets would take substantial charges in the fourth quarter relating to Expanets' uncollectible accounts receivable. In April 2003, NorthWestern restated its Forms 10-Q for the first three quarters of 2002 and increased Expanets' bad debt reserve for each of these periods by approximately $5.2 million, $5.1 million, and $6.3 million, respectively.

20. As a result of its improper accounting for uncollectible accounts receivable, NorthWestern overstated its income from continuing operations by approximately 16%, 19%, and 39% for the first three quarters of 2002, respectively, as reported in its Forms 10-Q and press

releases attached to Forms 8-K. Moreover, in its segment reporting for Expanets, NorthWestern understated Expanets' operating loss by approximately 66% for the first quarter of 2002, and overstated Expanets' operating income by approximately 86% and 270%, respectively, for the second and third quarters of 2002.

Adjustments to Customer Bills

21. As a result of the inaccurate customer bills generated by the EXPERT system, Expanets issued partial credits to affected customers. Expanets recorded these credits as "billing adjustments," which reduced both its revenue and income in the current period. Since Expanets credited customer accounts in periods after it initially recognized revenue from a transaction, Expanets maintained a "billing adjustment reserve" for anticipated credits to customer accounts. Expanets calculated its billing adjustment reserve based on the revenue it billed, its actual billing adjustments during the reporting period, and its evaluation of the aggregate accuracy of its customer bills.

22. Because EXPERT generated a significant number of inaccurate and incomplete customer bills in the first quarter of 2002, Expanets' billing adjustments in the first quarter of 2002 surpassed projected levels of approximately $2 million per month and reached more than $3 million for March 2002. During the first quarter of 2002, Expanets also internally forecasted that EXPERT's billing accuracy problems would continue for several months. Still, Expanets increased its billing adjustment reserve by a net of only approximately $1.5 million in the first quarter of 2002.

23. As EXPERT billings problems persisted during the second quarter of 2002, Expanets' billing adjustments significantly exceeded originally-projected levels and reached approximately $6 million for the month of June 2002. Expanets estimated that its billing adjustments would be $13 million higher than it had originally forecasted for the remainder of the year. However, Expanets did not increase its billing adjustment reserve to comport with these internal forecasts. Instead, Expanets reduced its billing adjustment reserve by $2.3 million during the second quarter, thereby increasing its operating income by the same amount.

24. For the third quarter of 2002, Expanets' billing adjustments totaled more than $22 million, which again significantly exceeded its original and revised projections. Expanets further estimated that, due to a planned correction of a certain category of customer bills, its billing adjustments for the fourth quarter would exceed its revised estimates by an additional $3.4 million. However, Expanets again did not increase its billing adjustment reserve. Instead, it reduced this reserve by $4 million during the third quarter, which increased Expanets' operating income by the same amount.

25. In December 2002, NorthWestern announced that it anticipated that Expanets would take substantial charges in the fourth quarter relating to Expanets' billing adjustments. In its April 2003 restatements for the first three quarters of 2002, NorthWestern acknowledged that it had understated its billing adjustment reserve in each of these quarters, and as a result, the company

reduced reported revenues and income by approximately $18.3 million, $10.1 million, and $5.4 million, respectively.

26. As a result of its improper accounting for billing adjustments, NorthWestern overstated its income from continuing operations by approximately 98%, 46%, and 31% for the first three quarters of 2002, respectively, as reported in its Forms 10-Q and press releases attached to Forms 8-K. In its segment reporting for Expanets, NorthWestern understated Expanets' operating loss by approximately 87% for the first quarter of 2002, and overstated Expanets' operating income by approximately 1094% and 164%, respectively, for the second and third quarters of 2002. NorthWestern also did not disclose in any of its filings for the first three quarters of 2002 that losses resulting from billing adjustments were probable or reasonably possible.

The Quality of Expanets' Income

Reserve Reductions

27. During the first three quarters of 2002, Expanets reduced amounts it had recorded in at least fourteen of the reserve accounts it maintained on its balance sheet, including the billing adjustments reserve account discussed above. These reductions materially increased Expanets' and NorthWestern's income.

28. In the first quarter of 2002, $2.6 million of Expanets' income was derived from reserve reductions. This amount reduced by approximately 50% Expanets' reported segment operating loss of approximately $2.7 million and represented approximately 7% of NorthWestern's reported income from continuing operations for that quarter.

29. In the second quarter of 2002, $8.8 million of Expanets' income was derived from reserve reductions. This amount represented approximately 80% of Expanets' reported segment operating income of $11 million and approximately 27% of NorthWestern's income from continuing operations for that quarter.

30. In the third quarter of 2002, $27 million of Expanets' income was derived from reserve reductions. With this income, Expanets was able to report $8.7 million of operating income rather than a substantial operating loss. In addition, with this income, NorthWestern was able to report $14.6 million of income from continuing operations for that quarter rather than an operating loss.

31. NorthWestern's Forms 10-Q for the first three quarters of 2002 did not disclose the material impact that these reserve reductions had on the reported results of operations of Expanets and NorthWestern during these periods. NorthWestern did not disclose the material impact of these reserve reductions until April 2003 when it restated its Forms 10-Q for the first three quarters of 2002.

Unusual Transactions

32. In conjunction with Expanets' acquisition of certain assets of a competitor, Expanets agreed that, in exchange for payments from the competitor, Expanets would not solicit specific business of the competitor's customers. Expanets' competitor was obligated to make these "non-compete" type of payments to Expanets until March 2005. These payments were not characteristic of Expanets' regular operations and therefore represented unusual transactions.

33. In the first quarter of 2002, NorthWestern reported in its segment disclosures that Expanets had an operating loss of approximately $2.7 million. Approximately $9.3 million of Expanets' income came from the non-compete payments. The $9.3 million also represented approximately 25% of NorthWestern's consolidated income from continuing operations for the quarter.

34. In the second quarter of 2002, NorthWestern reported in its segment disclosures that Expanets had operating income of approximately $11 million. Approximately $10 million of Expanets' income came from the non-compete payments. The $10 million also represented approximately 31% of NorthWestern's consolidated income from continuing operations for the quarter.

35. In the third quarter of 2002, NorthWestern reported in its segment disclosures that Expanets had operating income of approximately $8.7 million. Approximately $15.3 million of Expanets' income came from the non-compete payments. The $15.3 million also represented approximately 68% of NorthWestern's consolidated income from continuing operations for the quarter.

36. NorthWestern's Forms 10-Q for the first three quarters of 2002 did not disclose Expanets' receipt of these unusual non-compete payments and their material effects on Expanets' and NorthWestern's income. NorthWestern did not disclose the existence of these non-compete payments or their effect until it filed its 2002 Form 10-K and restated its 2002 Forms 10-Q in April 2003.

NorthWestern's Intercompany Advances to Expanets and Blue Dot

37. EXPERT's inability to generate any customer bills in late 2001 and early 2002 and other billing problems that followed caused Expanets' cash flow from operations during the first quarter of 2002 to be a deficit of approximately $68.7 million. As a result, NorthWestern provided Expanets with significant intercompany advances during the first quarter of 2002 to enable Expanets to pay operating and other expenses, including a scheduled amount on a third-party credit facility. By the end of the first quarter of 2002, NorthWestern's intercompany advances to Expanets totaled $63.3 million.

38. During the second quarter of 2002, EXPERT's continuing billing and collections problems caused Expanets' cash collections to lag significantly behind expected levels. NorthWestern therefore provided Expanets with additional intercompany advances of

approximately $50 million to help Expanets pay operating expenses and another scheduled amount on a third-party credit facility. By the end of the second quarter, NorthWestern's intercompany advances to Expanets totaled $113.4 million.

39. Similarly, during the first quarter of 2002, NorthWestern provided Blue Dot with approximately $21 million in intercompany advances so that Blue Dot could pay off a large credit facility and operating expenses when due. NorthWestern's outstanding intercompany advances to Blue Dot totaled approximately $37.1 million at the end of the first quarter of 2002.

40. In the second quarter of 2002, Blue Dot paid back some of the cash advanced by NorthWestern with proceeds from a one-time sale and leaseback transaction. Nevertheless, NorthWestern's outstanding intercompany advances to Blue Dot still totaled approximately $22.8 million at the end of that quarter.

41. NorthWestern's intercompany advances to Expanets and Blue Dot demonstrated that these businesses were continuing to require further investments from the parent company, rather than providing cash to the consolidated entity. NorthWestern's need to advance funds to Expanets and Blue Dot was information that was necessary to understand NorthWestern's financial condition and was reasonably likely to impact NorthWestern's liquidity.

42. NorthWestern's Form 10-Q for the first quarter of 2002 did not disclose NorthWestern's intercompany advances to Expanets or Blue Dot, or the significance of those advances. NorthWestern disclosed in its Form 10-Q for the second quarter of 2002 that it made intercompany advances to Expanets. However, NorthWestern still did not disclose its intercompany advances to Blue Dot or any information about the significance of the intercompany advances to either subsidiary. NorthWestern did not disclose the existence and amount of its intercompany advances until September 2002.

Allocation of Losses to Blue Dot Minority Interests

43. When Blue Dot acquired other businesses, it paid the former owners in part with Blue Dot common stock. As a result of these transactions, the former owners held minority interests in Blue Dot. NorthWestern allocated a portion of Blue Dot's losses to these minority interests, which had the effect of increasing NorthWestern's consolidated income from continuing operations. This accounting treatment was proper only to the extent that the losses applicable to the Blue Dot minority interest did not exceed the minority interest in the equity capital of Blue Dot.

44. Before it filed its financial statements for the second quarter of 2002, NorthWestern received a third-party appraisal of Blue Dot for the purpose of assessing Blue Dot's enterprise value. Based on the total value of the Blue Dot entity as reflected in the appraisal, Blue Dot's common stock was worthless.

45. Despite this information, in its financial statements for the second quarter of 2002, NorthWestern allocated $8.1 million of Blue Dot's losses to minority interests based on stock issued for acquisitions Blue Dot made that quarter. In addition, NorthWestern failed to disclose in

its second quarter Form 10-Q the material effects of the decrease in value of Blue Dot common stock, or any uncertainties about NorthWestern's ability to allocate losses to Blue Dot minority interests.

46. Because of its improper allocation of losses to minority interests, NorthWestern reported income from continuing operations of approximately $20.9 million rather than $12.8 million, an overstatement of approximately 63%, in its Form 10-Q for the second quarter of 2002 and a press release attached to a Form 8-K. NorthWestern reversed its allocation of losses to Blue Dot's minority interests when it restated its second quarter 2002 Form 10-Q in April 2003.

The Colstrip Utility Asset Sale

47. In February 2002, when NorthWestern purchased Montana Power, NorthWestern became the successor-in-interest to a contract for the sale of certain assets known as the "Colstrip" transmission assets ("Colstrip assets"). The contract called for a payment of approximately $97 million to NorthWestern upon the satisfaction of certain conditions. During the second quarter of 2002, NorthWestern announced that it expected to collect the proceeds from the sale of the Colstrip assets by June or July 2002.

48. Throughout 2002, the sale of the Colstrip assets was significant to NorthWestern because it would have generated significant cash for the company and enhanced its liquidity position. Accordingly, analysts and rating agencies tracked the status of the sale.

49. Between May and July 2002, the other party to the Colstrip assets sale contract repeatedly informed NorthWestern that it would not close the sale until the parties were able to resolve other claims. On August 5, 2002, NorthWestern filed but did not serve a complaint against this party in a Montana State court.

50. NorthWestern's Form 10-Q for the second quarter of 2002 did not disclose the Colstrip asset sale dispute and its potential impact on NorthWestern's financial condition, including its impact on NorthWestern's liquidity. On September 4, 2002, NorthWestern served its complaint on the other party to the Colstrip sale and subsequently disclosed the existence of its lawsuit in its third quarter Form 10-Q. In May 2005, NorthWestern settled the lawsuit by agreeing to retain the Colstrip assets in exchange for, among other things, a $9 million payment from the other party.

Violations

51. Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 require issuers to make and keep accurate books, records, and accounts, to file quarterly and current reports with the Commission, and to keep reported information current and not misleading. As a result of the conduct described above, NorthWestern violated Sections 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

52. Section 13(b)(2)(B) of the Exchange Act requires issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles. As a result of the conduct described above, NorthWestern violated Section 13(b)(2)(B) of the Exchange Act.

IV.

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

V.

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

Accordingly, it is hereby ORDERED that Respondent cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-11, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

March 8, 2007

IN THE MATTER OF CERTAIN COMPANIES QUOTED ON THE PINK SHEETS:	ORDER OF SUSPENSION OF TRADING
Advanced Powerline Technologies Inc.	
America Asia Petroleum Corp.	
Amerossi Int'l Group, Inc.	
Apparel Manufacturing Associates, Inc.	
Asgard Holdings Inc.	
Biogenerics Ltd.	
China Gold Corp.	
CTR Investments & Consulting, Inc.	
DC Brands International, Inc.	
Equal Trading, Inc.	
Equitable Mining Corp.	
Espion International, Inc.	
Goldmark Industries, Inc.	
GroFeed Inc.	
Healtheuniverse, Inc.	
Interlink Global Corp.	
Investigative Services Agencies, Inc.	
iPackets International, Inc.	
Koko Petroleum Inc.	
Leatt Corporation	
LOM Logistics, Inc.	
Modern Energy Corp.	
National Healthcare Logistics, Inc.	
Presidents Financial Corp.	
Red Truck Entertainment Inc.	
Relay Capital Corp.	
Rodedawg International Industries, Inc.	
Rouchon Industries, Inc.	
Software Effective Solutions Corp.	
Solucorp Industries Ltd.	
Sports-stuff.com Inc.	
UBA Technology, Inc.	
Wataire Industries Inc.	
WayPoint Biomedical Holdings, Inc.	
Wineco Productions Inc.	
File No. 500-1	

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It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of the issuers listed below. As set forth below for each issuer, questions have arisen regarding the adequacy and accuracy of publicly disseminated information concerning, among other things: (1) the companies' assets, (2) the companies' business operations, (3) the companies' current financial condition, and/or (4) financing arrangements involving the issuance of the companies' shares.

1. **Advanced Powerline Technologies Inc.** is a Nevada company based in Oklahoma. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and performance.

2. **America Asia Petroleum Corp.** is a Nevada company with offices in Nevada and China. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's assets and operations.

3. **Amerossi Int'l Group, Inc.**, is a Wyoming company with offices in Bangkok, Thailand. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's assets.

4. **Apparel Manufacturing Associates, Inc.**, is a Delaware company with offices in Bloomfield, Connecticut. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's management and operations.

5. **Asgard Holdings Inc.** is a Nevada company based in California. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and concerning stock promoting activity by the company.

6. **Biogenerics Ltd.** is a Nevada company with offices in Texas. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and assets.

7. **China Gold Corp.** is a Nevada company with offices in China. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and assets.

8. **CTR Investments & Consulting, Inc.**, is a Nevada company based in Maryland. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

9. **DC Brands International, Inc.**, is a company incorporated and based in Colorado. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

10. **Equal Trading, Inc.**, is a Nevada company with offices in Illinois. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and financial condition.

11. **Equitable Mining Corp.** is a Wyoming company with offices in Toronto, Ontario. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's assets.

12. **Espion International, Inc.**, is a Nevada company based in California. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and financing arrangements.

13. **Goldmark Industries, Inc.**, is a Nevada company based in Vancouver, British Columbia, Canada. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and financing arrangements and the adequacy of publicly available information concerning the company's management.

14. **GroFeed Inc.** is a Nevada company with offices in Toronto, Ontario, Canada. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and assets.

15. **Healtheuniverse, Inc.**, is a company incorporated and based in California. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and concerning stock promoting activity.

16. **Interlink Global Corp.** is a company incorporated and based in Florida. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and concerning stock promoting activity by the company.

17. **Investigative Services Agencies, Inc.**, is a company incorporated and based in Illinois. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and financial performance.

18. **iPackets International, Inc.**, is a Nevada company with offices in Vancouver, British Columbia, Canada. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and assets.

19. **Koko Petroleum Inc.** is a Nevada company with offices in British Columbia, Canada. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's assets.

20. **Leatt Corporation** is a Nevada company with offices in Las Vegas, Nevada. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's assets and operations.

21. **LOM Logistics, Inc.**, is a Louisiana company. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

22. **Modern Energy Corp.** is a Wyoming company with offices in California. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and financial condition.

23. **National Healthcare Logistics, Inc.**, is a Nevada company with offices in Tennessee. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

24. **Presidents Financial Corp.** is a Nevada company with offices in Vancouver, British Columbia, Canada. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's management and operations.

25. **Red Truck Entertainment Inc.** is a Nevada company with offices in Scottsdale, Arizona. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and financial performance and the adequacy of publicly available information concerning the company's stock issuances.

26. **Relay Capital Corp.** is a Nevada company with offices in Scottsdale, Arizona. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

27. **Rodedawg International Industries, Inc.**, is a Nevada company with offices in California. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

28. **Rouchon Industries, Inc.**, is a company incorporated and based in California. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's financing arrangements and financial performance.

29. **Software Effective Solutions Corp.** is a Louisiana company located in the Philippines. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

30. **Solucorp Industries Ltd.** is a Canadian company with offices in Florida. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's financial performance and the adequacy of publicly available information concerning insider stock holdings and transactions.

31. **Sports-stuff.com Inc.** is a Nevada company. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

32. **UBA Technology, Inc.**, is a Nevada company. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

33. **Wataire Industries Inc.** is a Nevada company with offices in Surrey, British Columbia, Canada. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and assets.

34. **WayPoint Biomedical Holdings, Inc.**, is a Nevada company with offices in California. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations and financing arrangements.

35. **Wineco Productions Inc.** is a Nevada company with offices in Florida. Questions have arisen regarding the adequacy and accuracy of press releases concerning the company's operations.

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 companies listed above.

Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the companies listed above is suspended for the period from 9:30 a.m. EST, March 8, 2007, through 11:59 p.m. EDT, on March 21, 2007.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55434 / March 9, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2575 / March 9, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12589

In the Matter of **C. BURT DUREN (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 C. Burt Duren ("Respondent" or "Duren") 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

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[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . 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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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. Duren, 46, was employed as Vice President of Finance and Treasurer for One Price Clothing Stores, Inc. ("One Price") until October 2003, when he was appointed as CFO of the company. Duren was terminated from that position in December 2003. Duren is and has been a certified public accountant licensed to practice in the State of South Carolina.

2. One Price is a Delaware corporation headquartered in Duncan, South Carolina. Before filing for bankruptcy in February 2004, One Price operated a chain of discount retail clothing stores. One Price's common stock is registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"). During the relevant period, One Price's common stock was listed on the NASDAQ National Market until January 2003, and was then listed on the NASDAQ Small Cap Market from January 2003 until June 2003 after which One Price's shares were quoted on the Pink Sheets quotation service. On February 9, 2004, One Price filed a voluntary Chapter 11 bankruptcy petition in the Southern District of New York.

3. On March 1, 2007, a final judgment was entered against Duren, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), 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, in the civil action entitled Securities and Exchange Commission v. Leonard M. Snyder, et al., Civil Action Number 7-05-2471-RBH, in the United States District Court for the District of South Carolina. Duren was also ordered to pay a $35,000 civil money penalty and barred from serving as the officer or director of a public company for five years.

4. The Commission's complaint alleged, among other things, that in order to increase One Price's allowable borrowings and avoid default under its credit facility, Duren and others caused One Price to falsely report as inventory merchandise that was ordered but never shipped to the company. The complaint also alleged that this false reporting of in-transit inventory was a default under the terms of One Price's credit facility. The complaint further alleged that based upon the artificially inflated inventory levels reported to its lender, One Price misrepresented that it was in continual compliance with the credit facility in its Form 10-K filed with the Commission for the fiscal year ended February 1, 2003, and Forms 10-Q for the quarters ended May 3, August 2 and November 1, 2003, when in fact One Price was in default under the terms

of the credit facility during each of those periods. Additionally, the complaint alleged that One Price included the falsely inflated levels of inventory in its general ledger and thus reported false and inflated levels of inventory in the interim financial statements One Price filed with the Commission on Forms 10-Q for the quarters ended May 3, August 2 and November 1, 2003.

IV.

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

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

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

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

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

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

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

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

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

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

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

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55432 / March 9, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2574 / March 9, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12587

In the Matter of **STEVEN J. LANDMANN** **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 Steven J. Landmann ("Respondent" or "Landmann") 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 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. Landmann, age 47, is and has been a holder of a certificate of public accountancy in the State of Missouri. He served as Controller of Engineered Support Systems, Inc. ("ESSI") from 1998 until January 2006.

2. ESSI was, at all relevant times, a Missouri corporation with its principal place of business in St. Louis, Missouri. ESSI was engaged in the business of manufacturing electronics and equipment, and providing systems integration services for the United States and foreign militaries. At all relevant times, ESSI's common stock was registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and was traded on the NASDAQ NMS.

3. On February 6, 2007, the Commission filed a complaint against Landmann in SEC v. Landmann (Civil Action No. 4:07-cv-00271-CAS). On February 12, 2007, the court entered an order, by consent, permanently enjoining Landmann from future violations of Section 17(a) of the Securities Act of 1933, Sections 10(b), 13(b)(5), and 14(a) of the Exchange Act and Rules 10b-5, 13b2-1, 13b2-2, and 14a-9 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. Landmann was also ordered to pay $518,972.50 in disgorgement of ill-gotten gains from his sales of stock while participating in the fraud, and $108,099 in prejudgment interest; and a $259,486 civil money penalty.

4. The Commission's complaint alleged, among other things, that Landmann, at the direction of others, engaged in a fraudulent scheme which resulted in ESSI filing materially false and misleading statements and/or materially misstated financial statements in the company's annual reports on Form 10-K for the fiscal years ended October 31, 1997 through 2002, in quarterly reports on Form 10-Q filed during fiscal years 1997 through 2002, and in proxy statements filed from 1997 through 2003. The Complaint alleged that Landmann, at the direction of others, backdated ESSI stock options to coincide with low points in the closing market price for ESSI common stock, resulting in approximately $20 million of ill-gotten benefits to ESSI insiders

through grants of disguised "in-the-money" options. The Complaint also alleged that, in two instances when ESSI's stock price fell after options were awarded, Landmann, at the direction of others, cancelled those options and reissued them with a new backdated grant date and price. The Complaint further alleged that Landmann, at the direction of others, issued stock options to non-employee directors beyond what the directors were authorized to receive under ESSI's stock option plans. None of these practices were disclosed in Commission filings. The Complaint alleged that these undisclosed practices caused ESSI to make false and misleading statements relating to ESSI's stock options in filings with the Commission, including the false statement that the options were granted with an exercise price equal to the closing price of ESSI's common stock on the date the options were awarded. The Complaint alleges that Landmann prepared portions of financial statements filed with the Commission that materially understated ESSI's compensation expense and materially overstated its income in its financial statements filed with the Commission.

IV.

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

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

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

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 240

[Release No. 34-55431; File No. S7-08-07]

RIN 3235-AJ85

Amendments to Financial Responsibility Rules for Broker-Dealers

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

ACTION: Proposed rule.

SUMMARY: The Commission is proposing for comment amendments to its net capital, customer protection, books and records, and notification rules for broker-dealers under the Securities Exchange Act of 1934 ("Exchange Act"). The proposed amendments would address several emerging areas of concern regarding the financial requirements for broker-dealers. They also would update the financial responsibility rules and make certain technical amendments.

DATES: Comments should be received on or before [insert date 60 days after publication in the Federal Register].

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-08-07 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

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- 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 S7-08-07. 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). Comments will also be 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: Michael A. Macchiaroli, Associate Director, at (202) 551-5525; Thomas K. McGowan, Assistant Director, at (202) 551-5521; Randall Roy, Branch Chief, at (202) 551-5522; or Bonnie Gauch, Attorney, (202) 551-5524; Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-6628.

SUPPLEMENTARY INFORMATION:

I. BACKGROUND

We are proposing for comment amendments to the broker-dealer net capital rule (Rule 15c3-1),[1] customer protection rule (Rule 15c3-3),[2] books and records rules (Rules 17a-3 and 17a-4),[3] and notification rule (Rule 17a-11).[4]

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1 17 CFR 240.15c3-1.

2 17 CFR 240.15c3-3.

II. PROPOSED AMENDMENTS

A. Amendments to the Customer Protection Rule

The Commission adopted the customer protection rule (Rule 15c3-3) in 1972 in response to a congressional directive to strengthen the financial responsibility requirements for broker-dealers that carry customer assets.[5] The rule requires a broker-dealer to take certain steps to protect the credit balances and securities it holds for customers. Under the rule, a broker-dealer must, in essence, segregate customer funds and fully paid and excess margin securities held by the firm for the accounts of customers.[6] The intent of the rule is to require a broker-dealer to hold customer assets in a manner that enables their prompt return in the event of an insolvency, which, in turn, increases the ability of the firm to wind down in an orderly self-liquidation and, thereby avoid the need for a proceeding under the Securities Investor Protection Act of 1970 ("SIPA").[7]

The required amount of customer funds to be segregated is calculated pursuant to a formula set forth in Exhibit A to Rule 15c3-3.[8] Under the formula, the broker-dealer adds up

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3 17 CFR 240.17a-3 and 17 CFR 240.17a-4.

4 17 CFR 240.17a-11.

5 See Exchange Act Release No. 9856 (November 10, 1972), 1972 SEC LEXIS 189.

6 Subparagraph (a)(3) of Rule 15c3-3 defines "fully paid securities" as securities carried in any type of account for which the customer has made a full payment. Subparagraph (a)(5) defines "excess margin securities" as securities having a market value in excess of 140% of the amount the customer owes the broker-dealer and which the broker-dealer has designated as not constituting margin securities.

7 15 U.S.C. 78aaa et seq.

8 17 CFR 240.15c3-3a.

various credit and debit line items. The credit items include cash balances in customer accounts and funds obtained through the use of customer securities. The debit items include money owed by customers (e.g., from margin lending), securities borrowed by the broker-dealer to effectuate customer short sales, and required margin posted to certain clearing agencies as a consequence of customer securities transactions. If, under the formula, customer credit items exceed customer debit items, the broker-dealer must maintain cash or qualified securities in that net amount in a "Special Reserve Bank Account for the Exclusive Benefit of Customers." This account must be segregated from any other bank account of the broker-dealer. Generally, a broker-dealer with a deposit requirement of $1 million or more computes its reserve requirement on a weekly basis as of the close of the last business day of the week (usually Friday).[9] The weekly calculation determines the required minimum balance the broker-dealer must maintain in the reserve account.

As noted, Rule 15c3-3 also requires a broker-dealer to maintain physical possession or control of all fully paid and excess margin securities carried for customers.[10] This means the broker-dealer cannot lend or hypothecate these securities and must hold them itself or, as is more common, in a satisfactory control location. Under the rule, satisfactory control locations include regulated securities clearing agencies, US banks, and, with the approval of the Commission, certain foreign financial institutions.[11] In order to meet the possession or control requirement, a broker-dealer must determine on a daily basis the amount of customer fully paid and excess

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9 17 CFR 240.15c3-3(e)(3).

10 17 CFR 240.15c3-3(b)(1).

11 17 CFR 240.15c3-3(c).

margin securities (by issuer and class) it holds for customers.[12] It then compares that amount with the amount of securities it holds free of lien in its own possession or at one of the satisfactory control locations. If a shortfall exists, the firm must take certain actions under the rule.[13] The actions include: removing liens on securities collateralizing a bank loan; recalling securities loaned to a bank or clearing corporation; buying-in securities that have been failed to receive over thirty days; or buying-in securities receivable as a result of dividends, stock splits or similar distributions that are outstanding over forty-five days.[14]

1. Proprietary Accounts of Broker-Dealers

We are proposing an amendment to Rule 15c3-3 that would require broker-dealers to treat accounts they carry for domestic and foreign broker-dealers in the same manner generally as "customer" accounts for the purposes of the reserve formula of Rule 15c3-3.[15] The amendment is intended to address an inconsistency between the way these proprietary accounts of broker-dealers are protected under Rule 15c3-3 and the SIPA.

Specifically, because broker-dealers are not "customers" for purposes of Rule 15c3-3, a broker-dealer that carries the proprietary accounts of other broker-dealers is not required to include credit and debit items associated with those accounts in the customer reserve formula.

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12 17 CFR 240.15c3-3(d).

13 Id.

14 Id.

15 See 17 CFR 240.15c3-3(a)(1). This paragraph defines "customer" for the purposes of Rule 15c3-3. Broker-dealers, both domestic and foreign, are excluded from the definition and, consequently, are not treated as "customers" for the purposes of the rule's reserve and possession and control requirements. Some foreign broker-dealers also operate as banks. These firms are not deemed "customers" to the extent that their accounts at the US broker-dealer involve proprietary broker-dealer activities.

Conversely, under SIPA, broker-dealers are considered "customers" and, consequently, entitled to certain protections. When a broker-dealer is liquidated under SIPA, an estate of customer property is created.[16] Customers of the failed broker-dealer, including customers that are broker-dealers, are entitled to a pro rata share of the estate of customer property. Thus, while broker-dealers need not reserve for accounts carried for other broker-dealers under Rule 15c3-3, in a SIPA liquidation, broker-dealer accountholders may share in the fund of customer property. This disparity increases the risk that, in the event a clearing broker is liquidated under SIPA, customer claims will exceed the amount of customer property.

In order to correct the gap between Rule 15c3-3 and SIPA, we are proposing amendments to Rules 15c3-1, 15c3-3 and 15c3-3a that would require carrying broker-dealers to perform a separate reserve computation for proprietary accounts of other domestic and foreign broker-dealers in addition to the reserve computation currently required for "customer" accounts, and establish and fund a separate reserve account for the benefit of these domestic and foreign

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16 In particular, under SIPA, the pool of "customer property" is established using assets recovered from the failed broker-dealer. The statute determines the assets that become a part of the pool of customer property. 15 U.S.C. 78lll(4). Customer property includes "cash and securities...at any time received, acquired, or held by or for the account of the debtor from or for the securities accounts of a customer, and the proceeds of any such property transferred by the debtor, including property unlawfully converted." Therefore, "customer property" includes those securities positions that are held for customers and the cash that is owed to customers. After being established, customer property is distributed to customers pro rata based on the amounts of their claims (i.e., their net equity). While broker-dealers are not entitled to advances from the SIPC fund to make up for shortfalls in the fund of customer property (see 15 U.S.C 78fff-3(a)(5)), they may be "customers" as that term is defined in SIPA and, therefore, entitled to a pro rata distribution from the fund of customer property.

broker-dealers.[17] This added protection also would mitigate potential contagion that might arise in the event of a failure of a broker-dealer with a large number of broker-dealer customers.

The proposed amendments, in many respects, would codify a no-action letter regarding proprietary accounts of introducing brokers ("PAIB Letter") previously issued by Commission staff.[18] One significant difference is that the amendments would have a broader scope by including proprietary accounts of foreign brokers-dealers and banks acting as broker-dealers. In the PAIB Letter, the staff stated it would not recommend any action to the Commission if an introducing broker-dealer did not take a net capital deduction under Rule 15c3-1 for cash held in a securities account at another broker-dealer, provided the other broker-dealer agreed to (1) perform a reserve computation for broker-dealer accounts, (2) establish a separate special reserve bank account, and (3) maintain cash or qualified securities in the reserve account equal to the computed reserve requirement ("PAIB agreement").[19] The PAIB Letter, however, did not

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17 The amendment would exclude from the broker-dealer reserve computation accounts established by a broker-dealer that fully guarantees the obligations of, or whose accounts are fully guaranteed by, the clearing broker. In these circumstances, the guarantor must take deductions under Rule 15c3-1 for guaranteed obligations of the other firm. In addition, the amendment would exclude delivery-versus-payment and receipt-versus-payment accounts. These types of accounts pose little risk of reducing the estate of customer property in a SIPA liquidation since they only hold assets for short periods of time.

18 See Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, to Raymond J. Hennessy, Vice President, NYSE, and Thomas Cassella, Vice President, NASD Regulation, Inc. (Nov. 10, 1998).

19 Under Rule 15c3-1, broker-dealers generally are required to deduct unsecured receivables from their net worth when computing their net capital. Paragraph (c) of the rule contains certain exceptions to this requirement. Among the enumerated exceptions are commissions receivable from another broker-dealer outstanding 30 days or less. This exception is limited to receivables from a clearing broker-dealer related to transactions in accounts introduced by the broker-dealer. Frequently, introducing broker-dealers as well as other broker-dealers will have receivables from another broker-dealer arising from

completely address the disparity between Rule 15c3-3 and SIPA, because the procedures set forth in the letter are voluntary and foreign broker-dealers are not subject to Rule 15c3-1 and, consequently, have no incentive to enter into PAIB agreements. Therefore, carrying firms do not include the accounts of foreign broker-dealers in either the Rule 15c3-3 or PAIB computations. However, these entities may be customers for the purposes of SIPA.

The proposed amendments – like the PAIB Letter – would establish reserve requirements for a carrying broker with respect to proprietary accounts it carries for other broker-dealers. Paragraph (e) of Rule 15c3-3 would be amended to require the carrying broker to perform a reserve computation for a proprietary account of another broker-dealer (referred to as a "PAB account") and to establish and maintain a reserve account at a bank for these PAB accounts.[20] A new paragraph (a)(16) would be added to define "PAB account," paragraph (f) would be amended to require the carrying broker-dealer to notify the bank about the status of the PAB reserve account and obtain an agreement and notification from the bank that the PAB reserve account will be maintained for the benefit of the PAB accountholders. In addition, paragraph (g) would be amended to specify when the carrying broker-dealer could make withdrawals from a PAB reserve account. The carrying broker would have to maintain cash or qualified securities in

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proprietary transactions in an account at the other broker-dealer. There is no exception in Rule 15c3-1 permitting these receivables to be included in a broker-dealer's net capital amount. However, under the terms of the PAIB Letter, a broker-dealer could include them.

20 Under paragraph (e), broker-dealers are required to perform the customer reserve computation as of the close of business on the last business day of the week or, in some cases, the month. Broker-dealers from time to time may perform a mid-week computation if it would permit them to make a withdrawal. Under the proposed amendments, a broker-dealer would need to compute both the customer and PAB reserve requirements simultaneously before making a withdrawal from either account based on a mid-week computation. Moreover, a withdrawal could not be made from one account if the mid-week computation demonstrated an increased requirement in the other account.

the PAB reserve account in an amount equal to the PAB reserve requirement. Consistent with the no-action relief provided in the PAIB Letter, if the PAB reserve computation results in a deposit requirement, the proposed amendment would allow the requirement to be offset to the extent there are excess debits in the customer reserve computation of the same date. However, in order to provide greater protection to customers that are not broker-dealers, a deposit requirement resulting from the customer reserve computation would not be able to be offset by excess debits in the PAB reserve computation. This means the carrying broker-dealer could use PAB credits to finance "customer" debits, but not the other way around. Thus, "customers" (which include retail investors but exclude broker-dealers) would receive greater protection.

Paragraph (b) of Rule 15c3-3 would be amended to provide that a broker-dealer carrying PAB accounts would not be required to maintain physical possession or control of fully paid and excess margin securities carried for PAB accounts, provided it obtains the written permission of the PAB accountholder to use such securities in the ordinary course of its securities business. This provision would be consistent with Rule 15c3-3, which is intended to provide greater protection to customers that are not broker-dealers customers. It also would accommodate industry practice of carrying broker-dealers using the securities of their broker-dealer accountholders, which contributes to the liquidity of the securities markets.

Finally, paragraph (c)(2)(iv)(E) of Rule 15c3-1 would be amended to require a broker-dealer to deduct from net worth when calculating net capital the amount of its cash in a proprietary account at another broker-dealer where the other broker-dealer is not treating the cash in compliance with the proposed requirements described above. This would prevent broker-dealers from including assets in their net capital amounts that may not be readily available. We would not expect broker-dealers to audit or examine their carrying broker-dealers to determine whether the carrying broker-dealer is in compliance with the proposed rules.

We request comment on all aspects of these proposed amendments, including whether the accounts of other non-customers under Rule 15c3-3 (e.g., principal officers of the broker-dealer) should be included in the PAB computation.

2. Banks Where Special Reserve Deposits May Be Held

Broker-dealers must deposit cash or "qualified securities" into the customer reserve account maintained at a "bank" under Rule 15c3-3(e).[21] Rule 15c3-3(f) further requires the broker-dealer to obtain a written contract from the bank in which the bank agrees not to re-lend or hypothecate securities deposited into the reserve account.[22] Consequently, the securities should be readily available to the broker-dealer. Cash deposits, however, are fungible with other deposits carried by the bank and may be freely used in the course of the bank's commercial lending activities. Therefore, to the extent a broker-dealer deposits cash in a reserve bank account, there is a risk the cash could be lost or inaccessible for a period if the bank experiences financial difficulties. This could adversely impact the broker-dealer and its customers if the balance of the reserve deposit is concentrated at one bank in the form of cash.

This risk may be heightened when the deposit is held at an affiliated bank in that the broker-dealer may not exercise due diligence with the same degree of impartiality when assessing the financial soundness of an affiliate bank as it would with a non-affiliate bank.

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21 The term "qualified securities" is defined in paragraph (a)(6) of Rule 15c3-3 to mean a securities issued by the United States or guaranteed by the United States with respect to principal and interest. 17 CFR 240.15c3-3(a)(6). The term "bank" is defined in paragraph (a)(7) of Rule 15c3-3.

22 See 17 CFR 240.15c3-3(f).

Moreover, the broker-dealer's customers may not derive any significant protection from the reserve requirement in the event of the parent's insolvency.

To address these risks, we are proposing an amendment to Rule 15c3-3 that would exclude cash deposits at affiliate banks for the purposes of meeting customer or PAB reserve requirements and place limitations on the amount of cash a broker-dealer could maintain in a customer or PAB special reserve bank account at one unaffiliated bank. The exclusion and limitations would not apply to deposits of securities since these assets do not become a part of a bank's working capital. As discussed below, the limitations would prevent a broker-dealer from maintaining a reserve deposit in the form of cash at a single unaffiliated bank that exceeds a percentage of the broker-dealer's or the bank's capital. This is designed to mitigate the risk that an impairment of the reserve deposit at an unaffiliated single bank will have a material negative impact on the broker-dealer's ability to meet its obligations to customers and PAB accountholders.[23]

Under the proposal, a paragraph (e)(5) would be added to Rule 15c3-3. This new paragraph would provide that – in determining whether the broker-dealer maintains the minimum reserve deposits required (customer and PAB) – the broker-dealer would be required to exclude a cash deposit at an affiliated bank. With respect to unaffiliated banks, the broker-dealer would be required to exclude the deposit to the extent that it exceeded (1) 50% of the broker-dealer's excess net capital (based on the most recently filed FOCUS Report),[24] or (2) 10% of the bank's

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23 These amendments are not intended to affect the practice whereby customer free credit balances are swept into a bank deposit account and the customer receives Federal Deposit Insurance Protection.

24 Under Rule 17a-5 (17 CFR 240.17a-5) broker-dealers must file periodic reports on Form X-17a-5 (Financial and Operational Combined Uniform Single Reports ("FOCUS

equity capital (based on the bank's most recently filed Call Report or Thrift Financial Report).[25] The goal is to limit cash reserve account deposits to reasonably safe amounts as measured against the capitalization of the broker-dealer and the bank. Excess net capital is the amount that a broker-dealer's net capital exceeds its minimum requirement and, therefore, constitutes a cushion to absorb unexpected losses. We believe limiting a cash deposit in one bank to 50% of excess net capital means the broker-dealer has a reserve to absorb the loss or impairment of the deposit plus an additional amount to absorb other losses. The amount of a bank's equity capital is a measure of its financial solvency. We believe limiting the cash deposit to 10% of the bank's equity capital means the broker-dealer would not commit customer cash to an institution in an amount that is out of proportion to the bank's capital base.

We request comment on all aspects of these proposed amendments, including whether the proposed reserve deposit limitations of 50% of excess net capital or 10% of the bank's equity capital adequately address the risks of concentrating cash deposits at any one bank or whether other thresholds should apply.

3. Expansion of the Definition of Qualified Securities to Include Certain Money Market Funds

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Reports"). The FOCUS Report form requires, among other financial information, a balance sheet, income statement, and net capital and customer reserve computations.

25 Commercial banks insured by the Federal Deposit Insurance Corporation ("FDIC"), savings banks supervised by the FDIC, and non-insurance trust companies supervised by the Office of the Comptroller of the Currency file quarterly Call Reports. Savings Associations and non-insured trust companies supervised by the Office of Thrift Supervision file Thrift Financial Reports (TFRs). These reports include a line item for equity capital. A report for a specific institution can be obtained by accessing the following website: http://www2.fdic.gov/call_tfr_rpts/search.asp.

As noted above, a broker-dealer is limited to depositing cash or "qualified securities" into the bank account it maintains to meet the customer reserve deposit requirements under Rule 15c3-3. Paragraph (a)(6) of Rule 15c3-3 defines "qualified securities" as securities issued by the United States or guaranteed by the United States with respect to principal and interest ("US Treasury securities").[26] These strict limitations on the types of assets that can be used to fund a broker-dealer's customer reserve account are designed to further the purpose of Rule 15c3-3; namely, that customer assets be segregated and held in a manner that makes them readily available to be returned to the customer. For example, paragraph (e)(2) of Rule 15c3-3 makes it unlawful for a broker-dealer to use customer credits (generally, cash balances in securities accounts) for any purpose other than financing customer debits (fully secured margin loans).[27] Under the rule, the amount of excess credits (i.e., credits net of debits) must be held in the customer reserve account and, as noted, the account must be funded with either cash or US Treasury securities.[28]

Federated Investors, Inc. ("Federated") has filed a petition with the Commission requesting that Rule 15c3-3 be amended to include certain types of money market funds in the definition of qualified securities.[29] We believe expanding the definition to include money market funds that only invest in securities meeting the definition of "qualified security" in Rule 15c3-3 would be appropriate. The assets held by such a money market fund would be same as those a

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26 17 CFR 240.15c3-3(a)(6).

27 17 CFR 240.15c3-3(e)(2).

28 Id.

29 See Public Petition for Rulemaking No. 4-478 (April 3, 2003), as amended (April 4, 2005), available at http://www.sec.gov/rules/petitions/petn4-478.htm.

broker-dealer can hold directly in its customer reserve account. Consequently, a broker-dealer might choose to deposit qualifying money market fund shares into the customer reserve account based on operational considerations such as avoiding the need to actively manage a portfolio of US Treasury securities. This operational benefit also could decrease burdens on those broker-dealers that would be impacted by our proposed amendments discussed above with respect to customer reserve account cash deposits into affiliate and non-affiliate banks. A broker-dealer that deposits cash into the customer reserve account to avoid the operational aspects of holding and managing US Treasury securities would have the option of depositing a qualifying money market fund to replace the cash deposit.

We believe, however, that there should be safeguards in place designed to ensure that qualifying money market fund shares could be redeemed quickly. A broker-dealer in financial difficulty must be able to liquidate quickly the assets in its customer reserve account so that customer credit balances can be returned without delay. Consequently, in addition to the limitations on holdings discussed above, our proposal to expand the definition of "qualified securities" to include money market funds includes the following safeguards. First, the money market fund could not be a company affiliated with the broker-dealer. The broker-dealer may experience financial difficulty caused by liquidity problems at the holding company level that are adversely impacting an affiliated money market fund as well in terms of the fund's ability to promptly redeem shares. Second, our proposal would require the broker-dealer to use a fund that agrees to redeem fund shares in cash on the next business day. There should be no ability of the fund to delay redemption beyond one-day or to require a multi-day redemption notification period.

Finally, our proposal would require that the money market fund have an amount of net assets (assets net of liabilities) that is at least ten times the value of the fund's shares held by the broker-dealer in its customer reserve account. This is designed to prevent a broker-dealer from holding too concentrated a position in single fund. It also limits a potential redemption request by the broker-dealer to 10% or less of the fund's assets. While a redemption request that equaled 10% of a fund's net assets would be very substantial, we believe it is a reasonable threshold between a request that could be handled promptly and one that could have the potential to cause the fund some degree of difficulty in meeting the request within one business day. We seek comment on this threshold, particularly with respect to whether it should be smaller (e.g., 5% or 2%) or higher (e.g., 15% or 25%).

For the foregoing reasons, we propose amending the definition of "qualified security" in paragraph (a)(6) of Rule 15c3-3 to include an unaffiliated money market fund that: (1) is described in Rule 2a-7 of the Investment Company Act of 1940; (2) invests solely in securities issued by the United States or guaranteed by the United States as to interest and principal; (3) agrees to redeem fund shares in cash no later than the business day following a redemption request by a shareholder; and (4) has an amount of net assets equal to at least 10 times the value of the shares deposited by the broker-dealer in its customer reserve account.

We solicit comment on all aspects of this proposal, including whether these types of money market funds are appropriate for the customer reserve account in terms of liquidity and safety and whether the 10% net asset limitation would be an adequate safeguard in terms of ensuring a broker-dealer could quickly redeem its shares.

4. Allocation of Customers' Fully Paid and Excess Margin Securities to Short Positions

Paragraph (d) of Rule 15c3-3 sets forth steps a broker-dealer must take to retrieve securities from non-control locations if there is a shortfall in the fully paid or excess margin securities it is required to hold. The rule does not require the broker-dealer to act when a short position on the broker-dealer's stock record allocates to a customer long position; for example, if the broker-dealer sells short a security to its customer. In such a circumstance, the broker-dealer would not be required to have possession or control of the security its customer has paid for in full. Instead, the broker-dealer would put the mark-to-market value of the security as a credit item in the reserve formula. The cash paid by the customer to purchase the security could be used by the broker-dealer to make any increased deposit requirement caused by the credit item. If the increase is less than the cash paid, the broker-dealer could use the excess funds in its own business operations. Moreover, if the value of the security decreases, the broker-dealer could withdraw funds out of the reserve account and use them as well. In effect, this permits the broker-dealer to monetize the customer's security. This is contrary to the customer protection goals of Rule 15c3-3, which seeks to ensure that broker-dealers do not use customer assets for proprietary purposes.

Accordingly, we are proposing to add a new paragraph (d)(4) to Rule 15c3-3, which would add an additional action with respect to retrieving securities from non-control positions when the broker-dealer needs to obtain possession or control over a specific issue and class of securities.[30] Specifically, under the proposal, the broker-dealer would be required to take prompt steps to obtain physical possession or control over securities of the same issue and class as those

[30] Current paragraph (d)(4) of Rule 15c3-3 would be re-designated as paragraph (d)(5).

included on the broker-dealer's books as a proprietary short position or as a short position for another person. By requiring the broker-dealer to obtain physical possession or control over the security, it would no longer be able to monetize the value of the security and use the cash for proprietary activities.

Under the proposal, the action would not be required until the short position had aged more than 10 business days (or more than 30 calendar days if the broker or dealer is a market maker in the securities).[31] Allowing broker-dealers 10 business days before they must take action is consistent with paragraph (m) of Rule 15c3-3, which similarly allows a broker-dealer up to 10 business days after settlement date to purchase securities that a customer has sold through the broker-dealer but failed to deliver. As with the requirement in paragraph (m), the proposal's objective is to require a broker-dealer to close an open transaction but within a timeframe that permits a degree of flexibility. The longer 30 calendar day period for securities in which the broker-dealer makes a market is intended to accommodate the short-selling that is integral to market-making activities.

We request comment on all aspects of this proposed amendment, including whether the proposed time periods should be longer or shorter.

5. Treatment of Free Credit Balances and Importation of Rule 15c3-2 Requirements into Rule 15c3-3

i. Treatment of Free Credit Balances

[31] The proposed amendment would not apply to securities that are sold for a customer but not obtained from the customer within ten days after the settlement date. This circumstance is addressed by paragraph (m) of Rule 15c3-3, which requires the broker-dealer to close the transaction by purchasing securities of like kind and quantity. 17 CFR 240.15c3-3(m).

Free credit balances are funds payable by a broker-dealer to its customers on demand.[32] They may result from cash deposited by the customer to purchase securities, proceeds from the sale of securities or other assets held in the customer's account, or earnings from dividends and interest on securities and other assets held in the customer's account. Broker-dealers may, among other things, pay interest to customers on their free credit balances, or offer to transfer (sweep) them into a specific money market fund or interest bearing bank account. The customer earns dividends on the money market fund or interest on the bank account until such time as the customer chooses to liquidate the position in order to use the cash, for example, to purchase securities.

In recent years, broker-dealers have on occasion changed the product to which a customer's free credit balances are swept – most frequently from a money market fund product to an interest bearing bank account. There are differences in these two types of products, including the type of protection afforded the customer in the event of an insolvency. The money market shares – as securities – would receive up to $500,000 in SIPA protection in the event the broker-dealer failed. The bank deposits – as cash – would receive $100,000 in protection from the Federal Deposit Insurance Corporation ("FDIC") in the event the bank failed. On the other hand, the money market fund as a security theoretically could lose its principal; whereas the bank deposit would be guaranteed up to the FDIC's $100,000 limit. There also may be differences in the amount of interest earned from the two products. In short, while not judging the

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32 See 17 CFR 240.15c3-3(a)(8).

appropriateness of either option, we note there may be consequences to changing options and believe that customers should have a sufficient opportunity to make an informed decision.[33]

For these reasons, we are proposing to amend Rule 15c3-3 by adding a new paragraph (j) that would make it unlawful for a broker-dealer to convert, invest or otherwise transfer free credit balances except under three circumstances. The first circumstance, set forth in proposed paragraph (j)(2)(i) of Rule 15c3-3, would permit a broker-dealer to convert, invest, or otherwise transfer the free credit balances to any type of investment or other product, or to a different account within the broker-dealer or at another institution, or otherwise dispose of the free credit balances, but only upon a specific order, authorization, or draft from the customer, and only under the terms and conditions specified by the customer in the order, authorization or draft. This proposal is not addressing free credit balance sweeps to money market funds and bank deposit accounts, but rather the use of customer free credit balances for other purposes (e.g., to purchase securities other than money market funds, or to transfer to a different account or financial institution). In these circumstances, the proposed paragraph would prohibit any investment, conversion, or other transfer of the free credit balances except on the customer's specific order, authorization, or draft.

The second and third circumstances, set forth in proposed paragraphs (j)(2)(ii) and (iii) of Rule 15c3-3, address the sweeping of free credit balances to either a money market fund or a

33 In 2005, The New York Stock Exchange LLC ("NYSE") addressed the issue of disclosure. Specifically, the NYSE issued an information memo to its members discussing, among other things, the disclosure responsibilities of a broker-dealer offering a bank sweep program to its customers. See Information Memo 05-11 (February 15, 2005). The Memo stated that broker-dealers should disclose material differences in interest rates between the different products and, with respect to the bank sweep program, the terms and conditions, risks and features, conflicts of interest, current interest rates, the manner by which future interest rates will be determined, and the nature and extent of FDIC and SIPC protection. See id.

bank deposit account. The former applies to new customers and the latter to existing customers as of the date the proposed amendments would become effective.

Proposed paragraph (j)(2)(ii) of Rule 15c3-3 would permit a broker-dealer to have the ability to change the sweep option of a new customer from a money market fund to a bank deposit account (and vice versa), provided certain specific conditions are met. First, the customer would need to agree prior to the change (e.g., in the account opening agreement) that the broker-dealer could switch the sweep option between those two types of products. Second, the broker-dealer would need to provide the customer with all notices and disclosures regarding the investment and deposit of free credit balances required by the self-regulatory organizations for which the broker-dealer is a member.[34] Third, the broker-dealer would need to provide the customer with notice in the customer's quarterly statement that the money market fund or bank deposit account can be liquidated on the customer's demand and converted back into free credit balances held in the customer's securities account. Fourth, the broker-dealer would need to provide the customer with notice at least 30 calendar days before changing the product (e.g., from one money market fund to another), the product type (e.g., from a money market fund to a bank account), or the terms and conditions under which the free credit balances are swept. The notice would need to describe the change and explain how the customer could opt out of it.

The third circumstance, set forth in proposed paragraph (j)(2)(iii) of Rule 15c3-3, would apply to existing customers as of the effective date of the proposed rule. It would permit a broker-dealer to have the option to change an existing customer's sweep option from a money market fund to a bank deposit account (and vice versa), provided the second, third, and fourth conditions set forth in proposed paragraph (j)(2)(ii) discussed above were met. To minimize the

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34 See NYSE Information Memo 05-11 (February 15, 2005).

burden on the broker-dealer, proposed paragraph (j)(2)(iii) would not require the broker-dealer to obtain the customer's previous agreement to permit the broker-dealer to switch the sweep option between money market fund products and bank deposit account products. This would avoid the necessity of having to amend each existing customer account agreement. Because all the other conditions in proposed paragraph (j)(2)(ii) would apply, the broker-dealer would be required to provide existing customers with the various notices and disclosures that must be made to new customers, including giving notice at least 30 calendar days before the sweep option was changed and in that notice explain the change and how the customer could opt out of it.

We request comment on all aspects of this proposed amendment, including: (1) whether it would provide adequate protection to customers with respect to changes in the treatment of their free credit balances, (2) on the cost burdens (quantified to the extent possible) that would result if the condition in proposed paragraph (j)(2)(ii)(A) of Rule 15c3-3 to obtain a new customer's prior agreement were to be applied to existing customers, (3) whether there are other sweep products in addition to money market mutual funds and bank deposit accounts that could be contemplated in proposed paragraphs (j)(2)(ii) and (iii) of Rule 15c3-3, and (4) whether the treatment of free credit balances has already been adequately addressed by the self-regulatory organizations.

ii. Importation of Rule 15c3-2

Rule 15c3-2 requires a broker-dealer holding free credit balances to provide its customers (defined as any person other than a broker-dealer) at least once every three months with a statement of the amount due the customer and a notice that (1) the funds are not being segregated, but rather are being used in the broker-dealer's business, and (2) that the funds are payable on demand. The rule was adopted in 1964 before the adoption of Rule 15c3-3.[35] Since the adoption of Rule 15c3-3, a broker-dealer, as noted above, has been limited in how it may use customer free credit balances. While the reserve account required under Rule 15c3-3 is in the name of the broker-dealer and the assets therein remain a part of its capital, the assets in the account are held for the exclusive benefit of the broker-dealer's customers. In a liquidation of the broker-dealer, the assets in the account will be available to satisfy customer claims ahead of all other creditors.

We believe the adoption of Rule 15c3-3 has eliminated the need to have a separate Rule 15c3-2. At the same time, we believe certain of the requirements in Rule 15c3-2 should be imported into Rule 15c3-3; namely, the requirements that broker-dealers inform customers of the amounts due to them and that such amounts are payable on demand.[36] Accordingly, we are proposing to eliminate Rule 15c3-2 and amend Rule 15c3-3 to include these latter requirements.

We request comment on all aspects of this proposed amendment. Commenters are encouraged to provide data to support their views.

6. Aggregate Debit Items Charge

Note E(3) to the customer reserve formula (Rule 15c3-3a) requires a broker-dealer using the "basic method" of computing net capital under Rule 15c3-1 to reduce by 1% the total debits

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[35] See Exchange Act Release No. 7266 (March 12, 1964).

[36] Rule 15c3-2 contains an exemption for broker-dealers that also are banking institutions supervised by a Federal authority. This exemption would not be imported into Rule 15c3-3 because there are no broker-dealers left that fit within the exemption. Further, under the proposed amendment, the definition of "customer" for purposes of the imported 15c3-2 requirements would be the definition of "customer" in Rule 15c3-3, which is somewhat narrower than the definition in Rule 15c3-2.

in Item 10 of the formula (i.e., debit balances in customer's cash and margin accounts).[37] This 1% reduction in Item 10 debits lowers the amount of total debit items in the formula. Because the debits offset aggregate credits in determining customer reserve requirements, the reduction has the potential to increase the amount a broker-dealer must maintain in the reserve account. Under paragraph (a)(1)(ii)(A) of Rule 15c3-1 however, broker-dealers using the "alternative standard"[38] to compute their minimum net capital requirement must reduce aggregate debit items by 3% in lieu of the 1% reduction required by Note E(3).[39] Thus, the deduction applicable to alternative standard firms can result in an even larger reserve deposit requirement.

The Commission adopted the alternative standard as part of the 1975 amendments to Rule 15c3-1, which expanded the rule's scope to apply to all broker-dealers.[40] The alternative standard constituted a new way of providing for the capital adequacy of a broker-dealer in that it diverged from the traditional notion of limiting a firm's leverage.[41] The alternative standard instead imposes a capital requirement based on the size of the broker-dealer's commitments to its customers through margin lending and other transactions. Thus, it requires a broker-dealer to hold net capital equal to a percentage of its customer commitments. The alternative standard was

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37 Under the "basic method," a broker-dealer cannot permit its aggregate indebtedness (generally total money liabilities) to exceed 1500% of its net capital. 17 CFR 15c3-1(a)(1)(i).

38 Under the "alternative standard," a broker-dealer's minimum net capital requirement is equal to 2% of the firm's aggregate debit items. 17 CFR 240.15c3-1(a)(1)(ii).

39 17 CFR 240.15c3-1(a)(1)(ii)(A).

40 See Exchange Act Release No. 11497 (June 26, 1975). Prior to 1975, the rule only applied to broker-dealers that were not a member of a securities exchange, since exchange members were subject to capital rules promulgated by the exchanges. Id.

41 See id.

designed to integrate a broker-dealer's capital requirement under Rule 15c3-1 with the customer protection requirements in Rule 15c3-3; hence it uses the aggregate debit computation required by Rule 15c3-3 to determine a broker-dealer's net capital requirement under Rule 15c3-1.[42]

As part of the amendments adopting the alternative standard, the Commission lowered the haircut on equity securities from 30% to 15% for a broker-dealer using the standard.[43] At the same time, it amended Rule 15c3-1 to require alternative standard firms to employ the greater 3% reduction of debit items.[44] The Commission explained the greater requirement as providing, "in the event of a liquidation [of the broker-dealer], an additional cushion of secured debit items which will be available to satisfy customers with whom the broker or dealer effects transactions."[45]

Originally, the alternative standard required a broker-dealer to hold net capital equal to 4% of its customer debits.[46] The Commission lowered this requirement to 2% in 1982.[47] It explained its decision as being based on broker-dealers' improved back-office systems and increased use of clearing agencies.[48] These developments made it possible for the firms to

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42 Id.

43 Id.

44 Id.

45 Id.

46 Id.

47 Exchange Act Release 18417 (January 13, 1982), 47 FR 3512 (January 25, 1982).

48 Id.

handle large volumes of trading without experiencing operational and bookkeeping problems.[49] The Commission also noted that the SROs had upgraded their surveillance programs and that the early warning rules of both the Commission and the SROs remained significantly higher than the 2% minimum requirement.[50]

In recent years, the amount of debit items carried by broker-dealers has increased substantially. Consequently, the 3% reduction in debit items has required many broker-dealers using the alternative standard to increase their reserve deposits by additional amounts that are far in excess of the additional cushion envisioned when the amendment was adopted in 1975. Furthermore, the level of risk assumed by broker-dealers does not increase proportionately as the aggregate amount of debits increases; due, in part, to an increase in diversity among the debits. The proportional 3% reduction of debit items does not recognize this diversification benefit.

Moreover, in 1992, the Commission amended Rule 15c3-1 to lower the haircut for broker-dealers using the basic method to 15%, which brought their requirement in line with the alternative standard firms.[51] The 15% haircut for equity securities has proven sufficient to cover most market moves and, therefore, we believe the increased level of protection derived from the greater 3% debit item reduction likely would not provide a benefit justified by the costs.

For these reasons, we believe it is now appropriate to treat broker-dealers using the alternative standard on a par with firms using the basic method and, therefore, propose lowering the debit reduction applicable to alternative standard firms. We would apply a 1% reduction,

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49 Id.

50 Id.

51 Exchange Act Release No. 31511 (November 24, 1992), 57 FR 56973 (December 2, 1992).

rather than a 3% reduction, for alternative standard firms. The 1% reduction should provide an adequate cushion, given these firms' current levels of debit items, which – as noted – are far greater than existed when the rule was adopted in 1975 or amended in 1982. Our proposal would amend paragraph (a)(1)(ii)(A) of Rule 15c3-1 by removing the provision requiring the 3% reduction. This would make alternative standard firms subject to the 1% reduction in debit items as required in Note E(3) of Rule 15c3-3a.

We request comment on all aspects of this proposed amendment, including whether the benefits of the 3% reduction outweigh any costs that might arise from the proposal. Commenters are requested to identify potential costs and provide data to support their views.

7. "Proprietary Accounts" under the Commodity Exchange Act

Certain broker-dealers also are registered as futures commission merchants under the Commodity Exchange Act ("CEA"). These firms carry both securities and commodities accounts for customers. The definition of "free credit balances" in paragraph (a)(8) of Rule 15c3-3 excludes funds that are carried in commodities accounts that are segregated in accordance with the requirements of the CEA.[52] However, regulations promulgated under the CEA exclude certain types of accounts ("proprietary accounts") from the segregation requirement.[53] The question has arisen as to whether a broker-dealer holding these types of accounts must include funds in them as "free credit balances" when performing a customer reserve computation.

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52 17 CFR 240.15c3-3(a)(8).

53 Rule 1.20 (17 CFR 1.20) requires a futures commission merchant to segregate "customer" funds. Rule 1.3(k) (17 CFR 1.3(k)) defines the term "customer" for this purpose. The definition of "customer" excludes persons who own or hold a "proprietary account" as that term is defined in Rule 1.3(y) (17 CFR 1.3(y)). Generally, the definition of "proprietary account" refers to persons who have an ownership interest in the futures commission merchant. See 17 CFR 1.3(y).

These funds likely would not be protected in a SIPA proceeding because they are related to commodities transactions.[54] The purpose behind the cash reserve requirements in Rule 15c3-3 is to require broker-dealers to hold sufficient funds with which to satisfy customer claims arising from securities (not commodities) transactions and, thereby, to minimize the need for a SIPA liquidation. This purpose would not be served by treating funds held in commodities accounts (that are not segregated under CEA regulations) as "free credit balances." Accordingly, we are proposing an amendment to paragraph (a)(8) of Rule 15c3-3, which would clarify that funds held in a commodity account meeting the definition of a "proprietary account" under CEA regulations are not to be included as "free credit balances" in the customer reserve formula.

We request comment on all aspects of this proposed amendment. Commenters are encouraged to provide data to support their views.

B. Holding Futures Positions in a Securities Portfolio Margin Account

The Chicago Board of Options Exchange, Incorporated ("CBOE") and the NYSE have amended their margin rules to permit broker-dealer members to compute customer margin requirements using a portfolio margin methodology ("Portfolio Margin Rules").[55] A portfolio

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[54] To receive protection under SIPA, a claimant must first qualify as a "customer" as that term is defined in the statute. Generally, a "customer" is any person who has (1) "a claim on account of securities received, acquired, or held by the [broker-dealer]," (2) "a claim against the [broker-dealer] arising out of sales or conversions of such securities" or (3) "deposited cash with the debtor for the purposes of purchasing securities." 15 U.S.C. 78lll(2). The definition of "security" in SIPA specifically excludes commodities and non-securities futures contracts (see 15 U.S.C. 78lll(14)) and, thus, a person with a claim for such assets would not meet the definition of "customer."

[55] Exchange Act Release No. 54918 (December 12, 2006), 72 FR 1044 (January 9, 2007) (SR-NYSE-2006-13); Exchange Act Release No. 54919 (December 12, 2006), (SR-CBOE 2006-14); Exchange Act Release No. 52031 (July 14, 2005), 70 FR 42130 (July 21, 2005) (SR-NYSE-2002-19); Exchange Act Release No. 52032 (July 14, 2005), 70 FR 42118 (July 21, 2005) (SR-CBOE-2002-03).

margining methodology computes margin requirements based on the net market risk of all positions in an account assuming certain potential market movements. Under the Portfolio Margin Rules, a broker-dealer can combine securities and futures positions into the portfolio margin account. SIPA, however, only protects customer claims for securities and cash and specifically excludes from protection futures contracts that are not also securities.[56] This raises a question as to how futures positions in a portfolio margin account would be treated in a SIPA liquidation. Consequently, we are proposing amendments to Rules 15c3-3 and 15c3-3a that are designed to provide the protections of Rule 15c3-3 and SIPA to futures positions in a securities account under the Portfolio Margin Rules.

First, we propose amending the definition of "free credit balances" in paragraph (a)(8) of Rule 15c3-3 to include funds resulting from margin deposits and daily marks to market related to, and proceeds from the liquidation of, futures on stock indices and options thereon carried in a securities account pursuant to a portfolio margining rule of an SRO. Under this amendment, a broker-dealer holding such funds would have to treat them as "credit items" for purposes of the customer reserve computation. Consequently, the futures-related funds in a portfolio margin account would need to be included with all other credit items when a broker-dealer computed its customer reserve requirement under Rule 15c3-3. Further, because free credit balances

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56 The definition of "security" in SIPA includes a futures contract that also is a security; namely, a "security future" as defined in section 3(a)(55)(A) of the Exchange Act. See 15 U.S.C. 78lll(14).

constitute "cash" in a customer's account, they are "cash" for purposes of determining a customer's "net equity" in a SIPA liquidation.[57]

Our proposed amendment to the definition of "free credit balances" also would bring within the definition's scope the market value of futures options in a portfolio margin account as of the SIPA "filing date."[58] Unlike futures contracts, futures options do not take the form of cash balances in the account (i.e., they have market value at the end of a trading day). Since the broker-dealer is not holding cash for the customer there is not the need to treat the futures options as a "free credit balance" and require a credit in the reserve formula. However, if the broker-dealer is liquidated under SIPA, the unrealized gains or losses of the futures options should be included in calculating the customer's net equity in the account (along with the cash balances related to the futures contracts and the securities positions and related cash balances). The proposed amendment is designed to provide for this outcome by defining the market value of the futures options as a free credit balance in the event the broker-dealer becomes subject to a SIPA proceeding. As "free credit balances," funds resulting from margin deposits and daily marks to market related to futures and the market value of futures options as of the SIPA filing date would constitute claims for cash in a SIPA proceeding and, therefore, become a part of a

57 If a person qualifies as a "customer" under SIPA, the next inquiry is to value the amount of the customer's claim. This step is accomplished by reference to the definition of "net equity" in SIPA. 15 U.S.C 78lll(11). Generally, "net equity" is the "dollar amount of the [customer's] account" as determined by calculating the sum that would have been owed the customer had the securities in the customer's account been liquidated on the date the SIPA proceeding was commenced minus any amounts owed by the customer to the broker-dealer.

58 The term "filing date" is defined in SIPA as, generally, being the date a SIPA proceeding is commenced. See 15 U.S.C. 78lll(7).

customer's "net equity" claim and be entitled to up to $100,000 in advances to make up for shortfalls.[59]

On the debit side of the customer reserve formula, we are proposing an amendment to Rule 15c3-3a Item 14 that would permit the broker-dealer to include as a debit item the amount of customer margin required and on deposit at a futures clearing organization related to futures positions carried in a securities account pursuant to an SRO portfolio margin rule. Under SIPA, the term "customer property" includes "resources provided through the use or realization of customers' debit cash balances and other customer-related debit items as the Commission defines by rule."[60] Under this provision of SIPA, this proposed amendment to Rule 15c3-3a would make the margin required and on deposit at a futures clearing organization part of the "customer property" in the event the broker-dealer is placed in a SIPA liquidation.[61] Thus, it would be available to the liquidation trustee for distribution to the failed firm's customers.

We believe our proposed amendments designed to provide the protections of Rule 15c3-3 and SIPA to all positions in a securities account established under an SRO portfolio margin rule are warranted given that the futures positions in the account serve as hedges for the securities positions and, therefore, reduce the risk of the securities positions. The intermingled nature of the positions, margin or deposit, and the fact that the futures positions reduce the amount of

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59 Generally, futures and futures options in a portfolio margin account would be transferred to a solvent broker-dealer or liquidated before the initiation of a SIPA proceeding. Consequently, these proposals are highly cautionary as it is unlikely that a broker-dealer would be placed in a SIPA liquidation while still holding these types of positions in customer accounts.

60 15 U.S.C. 78lll(4)(B).

61 Margin posted at a futures clearing organization for securities futures products currently is treated in this manner. See 17 CFR 240.15c3-3a.

margin necessary to carry the securities positions makes it highly practical to treat all the positions in accordance with the requirements of Rule 15c3-3 and, as part of the customer's "net equity" in a SIPA liquidation.

We solicit comment on whether this approach represents a workable solution to providing SIPA protection to portfolio margin accountholders. In particular, we request comment as to whether there are other approaches the Commission may pursue that are designed to provide SIPA protection to futures related cash and futures options in portfolio margin accounts.

C. Amendments With Respect to Securities Lending and Borrowing and Repurchase/Reverse Repurchase Transactions

Securities lending and repurchase transactions by institutions are an important element of the financial markets. In a typical securities lending transaction, the parties agree that the owner of the securities (e.g., a pension fund, institutional investor, bank, or broker-dealer) will lend securities to a borrower, and the borrower will be required to return securities of like kind and quantity to the lender. To protect the lender's interest, the borrower typically will provide cash or other securities as collateral in excess of the market value of the securities loaned.[62] In the typical securities repurchase/reverse repurchase transaction ("repo transactions"), a buyer agrees to purchase securities from a seller and the seller agrees to repurchase them at some time in the future at the sale price plus some additional consideration. Thus, if the securities increase in

62 In computing net capital under Rule 15c3-1, a broker-dealer generally must make a deduction in the amount that the market value of securities loaned exceeds the value of collateral received. 17 CFR 240.15c3-1(c)(2)(iv)(B). Likewise, a broker-dealer must make a deduction in the amount the value of collateral posted exceeds the value of securities borrowed to the extent the excess is greater than certain percentages. This permits the broker-dealer to provide excess collateral in conformance with industry standards without taking the deduction. In either case, the broker-dealer is not required to take the deduction, provided it issues a mark-to-market call and collects payment the same day.

value, the seller is at risk that the buyer will default on its obligation to resell them at the original contract price. Conversely, if the securities decrease in value, the buyer is at risk that the seller will default on its obligation to repurchase them at the original contract price. To address these risks, the securities underlying the agreement are marked to market daily and, if their value rises above the contract price, the buyer provides margin to the seller to secure the buyer's obligation to resell the securities at a price lower than market value. Alternatively, if the value of the securities falls below the contract price, the seller provides margin to the buyer to secure the seller's obligation to repurchase the securities at a price above the market value.

In addition to participating in securities lending transactions, broker-dealers provide a variety of services to other borrowers and lenders, including counterparty credit evaluation, collateral management, and administration of distributions and corporate actions. Moreover, a broker-dealer may negotiate the loan as agent for both parties (divulging their identities just prior to the transaction) or by interposing itself as principal between two undisclosed counterparties as a conduit lender.

The failure of MJK Clearing, Inc. ("MJK") – the largest SIPA liquidation to date – raised several concerns regarding securities lending transactions. The Commission, in two civil complaints,[63] alleged that MJK engaged in conduit securities lending transactions involving shares of a company called GenesisIntermedia, Inc. According to the complaints, MJK borrowed shares of GenesisIntermedia shares from one broker-dealer, providing cash collateral

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63 See SEC Litigation Release No. 18641, 2004 LEXIS 706 (March 26, 2004); SEC Complaint, SEC v. Thomas G. Brooks, Civil Action No. CV 03-3319 ADM/AJB, United States District Court (D. Minn. June 2, 2003); SEC v. Thomas G. Brooks, SEC Litigation Release No. 18168, 2003 SEC LEXIS 1321 (June 3, 2003); SEC Complaint, SEC v. Kenneth P. D'Angelo et al., Case No. LACV 03-6499 CAS (VBKx), United States District Court (C.D.Cal. September 11, 2003); SEC Litigation Release No. 18344, 2003 SEC LEXIS 2173 (September 11, 2003).

equal to the market value of the borrowed shares. MJK then re-lent the GenesisIntermedia shares to other broker-dealers that provided cash collateral in return. As indicated in the complaints, after the transactions, the market value of the GenesisIntermedia shares declined dramatically. The complaints also describe how MJK returned cash collateral to the borrowing broker-dealers as the shares declined in value but did not collect excess cash collateral provided to the broker-dealer that lent the shares to MJK. Eventually, MJK went out of business. At the time of its failure, MJK still owed cash collateral to several of the borrowing broker-dealers.[64]

MJK's failure caused losses to the borrowing broker-dealers and to other firms to whom those broker-dealers re-lent the borrowed securities.[65] In subsequent litigation, disputes have arisen as to whether certain of these broker-dealers were acting as principals or agents.[66] Uncertainty as to whether broker-dealers are acting as principal or agent in a securities loan transaction raises concerns as to whether firms are taking required net capital charges related to their securities lending activities.[67] A broker-dealer might not take the required charges on the

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64 Id.; See also, In re MJK Clearing, Inc., 2003 U.S. Dist. LEXIS 5954 (D.Minn. 2003).

65 See, e.g., Nomura v. E*Trade, 280 F.Supp. 2d 184 (S.D.N.Y. 2003).

66 See id.

67 Under paragraph (c)(2)(iv)(B) of Rule 15c3-1, broker-dealers are required to deduct from net worth most unsecured receivables, including the amount that the market value of a securities loan exceeds the value of collateral obtained for the loan. Similarly, with respect to repo transactions, a broker-dealer obligated to resell securities must, in computing net capital, deduct the amount that the market value of the securities is less than the resale price. 17 CFR 240.15c3-1(c)(2)(iv)(F). A broker-dealer obligated to repurchase securities must, in computing net capital, deduct the amount that the market value of the securities is greater than the repurchase price to the extent the excess is greater than certain percentages. 17 CFR 240.15c3-1(c)(2)(iv)(F).

theory that it was arranging the loans as agent, rather than principal, notwithstanding the fact that there was no express disclaimer of principal liability.

We are proposing two amendments designed to improve regulatory oversight of securities lending and repo transactions. The first proposal would amend subparagraph (c)(2)(iv)(B) to Rule 15c3-1 to clarify that broker-dealers providing securities lending and borrowing settlement services are assumed, for purposes of the rule, to be acting as principals and are subject to applicable capital deductions. Under the proposed amendment, these deductions could be avoided if a broker-dealer takes certain steps to disclaim principal liability. Namely, the broker-dealer would be required to disclose the identities of the borrower and lender to each other and obtain written agreements from the borrower and lender stating that the broker-dealer is acting exclusively as agent and assumes no principal liability in connection with the transaction.[68]

The second proposal would add a paragraph (c)(5) to Rule 17a-11, which would require broker-dealers to notify the Commission whenever the total amount of money payable against all securities loaned or subject to a repurchase agreement, or the total contract value of all securities borrowed or subject to a reverse repurchase agreement exceeds 2,500 percent of tentative net capital; provided that, for purposes of this leverage threshold, transactions involving "government securities" as defined in Section 3(a)(42) of the Exchange Act, are excluded from

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68 Standard master securities loan agreements (including the annexes thereto) commonly used by the parties to a securities lending transaction contain similar provisions for establishing agent (as opposed to principal) status in a securities lending and borrowing transaction. See, e.g., 2000 Master Securities Loan Agreement, Annex I, published by The Bond Market Association.

the calculation.[69] Based on FOCUS report data, we estimate that a leverage threshold of 25 times tentative net capital would be triggered by 21 broker-dealers on a regular basis. We believe that this indicates the proposed threshold is high enough to only capture on a regular basis those few firms highly active in securities lending and repos. Accordingly, it is an appropriate notice trigger for a firm that historically has not been as active in these transactions but rapidly leverages up its positions.

We believe that receiving notice when this threshold is exceeded would help identify broker-dealers with highly leveraged non-government securities lending and borrowing and repo operations and make it easier for regulators to respond more quickly and protect customers in the event a firm is approaching insolvency. To avoid frequent filing by firms that engage predominantly in securities lending and repo transactions, the proposal would give a broker-dealer the option of submitting monthly reports regarding its securities lending and repo activities to its designated examining authority.

We request comment on all aspects of these proposed amendments, including whether there are other steps the Commission should take to reduce the risk that a broker-dealer will fail as a consequence of a breakdown in its securities lending or repurchase activities. We also seek comment on the appropriateness of the 2,500% of tentative net capital early warning trigger and whether a smaller or larger leverage test should be employed.

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69 15 U.S.C. 78c(a)(42). "Government securities" generally present less market risk than other types of securities used in securities lending and repo transactions. Consequently, they are excluded from the scope of this proposed rule.

D. Documentation of Risk Management Procedures

The failure of MJK highlights the importance of broker-dealers documenting their implemented controls for managing the material risk exposures that arise from their business activities. For example, a broker-dealer active in securities lending is exposed to a variety of risks, including market risk,[70] credit risk,[71] liquidity risk[72] and operational risk.[73] Other broker-dealer activities give rise to these risks as well, including managing a repo book, dealing in OTC derivatives, trading proprietary positions and lending on margin. A well-documented system of internal controls designed to manage material risk exposures enables a broker-dealer's management to identify, analyze, and manage the risks inherent in the firm's business activities with a view to preventing significant losses. The need for such controls is particularly urgent with respect to the largest broker-dealers, which generally engage in a wide range of highly complex businesses across many different markets and geographical locations.

We believe that, for the most part, these firms as a matter of business practice already have well-documented procedures and controls for managing risks. Moreover, many are part of

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70 Market risk involves the risk that prices or rates will adversely change due to economic forces. Such risks include adverse effects of movements in equity and interest rate markets, currency exchange rates, and commodity prices. Market risk can also include the risks associated with the cost of borrowing securities, dividend risk, and correlation risk.

71 Credit risk comprises risk of loss resulting from counterparty default on loans, swaps, options, and during settlement.

72 Liquidity risk includes the risk that a firm will not be able to unwind or hedge a position or meet cash demands as they become due.

73 Operational risk encompasses the risk of loss due to the breakdown of controls within the firm including, but not limited to, unidentified limit excesses, unauthorized trading, fraud in trading or in back office functions, inexperienced personnel, and unstable and easily accessed computer systems.

a public company subject to the requirements of section 404 of the Sarbanes-Oxley Act of 2002,[74] and the Commission's rules thereunder,[75] which require the company to include in its annual report a report of management on the company's internal control over financial reporting. Notwithstanding the fact that many broker-dealers already have documented their implemented internal controls as a matter of business practice or because they are part of public companies subject to the requirements under Sarbanes-Oxley, we believe it is important to reinforce the practice, particularly for broker-dealers that are not part of public companies, and make it easier for regulators to access a broker-dealer's procedures and controls. Consequently, we are proposing amendments to the books and records rules that would require certain broker-dealers to make and keep current records documenting their implemented systems of internal risk management control.

The proposal would add a paragraph (a)(23) to Rule 17a-3, which would require certain large broker-dealers to document any implemented internal risk management control designed to assist in analyzing and managing the risks (e.g., market, credit, liquidity, operational) arising from the business activities it engages in, including, for example, securities lending and repo transactions, OTC derivative transactions, proprietary trading and margin lending. The requirement only would apply to broker-dealers that have more than (1) $1,000,000 in aggregate credit items as computed under the customer reserve formula of Rule 15c3-3, or (2) $20,000,000 in total capital including debt subordinated in accordance with Appendix D to Rule 15c3-1. This would limit the proposed rule's application to the broker-dealers that, because of their

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74 Pub. L. 107-204, 116 Stat. 745 (2002).

75 See Securities Act Release No. 8238, Exchange Act Release No. 47986; Investment Company Act Release No. 26068 (June 5, 2003), 68 FR 36635 (June 18, 2003).

complexity and size, are subject to the greatest risks and whose failure to adequately manage the risks could have the largest systemic impact. We estimate there are approximately 500 such firms.

The proposal also would add a paragraph (e)(9) to Rule 17a-4, which would require a broker-dealer to maintain these records for three years after the date the broker-dealer ceases to use the system of controls. We believe that the additional three years creates an audit trail between former and current procedures and provides regulators with sufficient opportunity to review the records during the broker-dealer's normal exam cycle.

We are not proposing any minimum elements that would be required to be included in a firm's internal controls or specifying issues that should be addressed. Rather, the amendment is designed to ensure that broker-dealers clearly identify the procedures, if any, they use to manage the risks in their business. We believe the proposed documentation requirement would help firms and their designated examining authorities identify gaps in their internal procedures. Moreover, broker-dealers that have already documented their internal controls would not be required to take any further steps other than to retain the written procedures for three years after new controls were put in place and maintain the procedures in a manner that makes them readily available to the Commission and other securities regulators (to the extent they were not already readily available).

We request comment on all aspects of these amendments, including whether either of the criteria as to which broker-dealers would be subject to the proposed requirement should be lower or higher, or whether we should consider some other criteria for application of the proposed requirement.

E. Amendments to the Net Capital Rule

1. Requirement to Subtract From Net Worth Certain Liabilities or Expenses Assumed By Third Parties and Non-Permanent Capital Contributions

Under Rule 15c3-1, broker-dealers are required to maintain, at all times, a minimum amount of net capital. The rule generally defines "net capital" as a broker-dealer's net worth (assets minus liabilities), plus certain subordinated liabilities, less certain assets that are not readily convertible into cash (e.g., fixed assets), and less a percentage (haircut) of certain other liquid assets (e.g., securities).[76] Broker-dealers are required to calculate net worth using generally accepted accounting principles.

Based on our experience, we are concerned that some broker-dealers may be excluding from their calculations of net worth certain liabilities that relate directly to expenses or debts incurred by the broker-dealer. The accounting justification for the exclusion is that a third-party (usually a parent or affiliate) has assumed responsibility for these expenses and debts through an expense sharing agreement. In some cases, however, the third-party does not have the resources – independent of the broker-dealer's revenues and assets – to assume these liabilities. Thus, the third-party is dependent on the resources of the broker-dealer to pay the expenses and debts. Excluding liabilities from the broker-dealer's net worth calculation in these situations may misrepresent the firm's actual financial condition, deceive the firm's customers, and hamper the ability of regulators to monitor the firm's financial condition.

For these reasons, we are proposing an amendment to Rule 15c3-1 that would add a new paragraph (c)(2)(i)(F) requiring a broker-dealer to adjust its net worth when calculating net

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[76] See 17 CFR 240.15c3-1(c)(2).

capital by including any liabilities that are assumed by a third-party if the broker-dealer cannot demonstrate that the third-party has the resources independent of the broker-dealer's income and assets to pay the liabilities. To evidence a third-party's financial capacity, the broker-dealer could maintain as a record the third party's most recent and current (i.e., as of a date within the previous twelve months) audited financial statements, tax return or regulatory filing containing financial reports.

Based on our experience, we also are concerned that broker-dealers may be receiving capital contributions from individual investors that are subsequently withdrawn after a short period of time (often less than a year). In some cases, the capital may be contributed under an agreement giving the investor the option to withdraw the capital at the investor's discretion. In the past, the Commission has emphasized that capital contributions to broker-dealers should not be temporary[77] and the Commission staff has explained that a capital contribution should be treated as a liability if it is made with the understanding that the contribution can be withdrawn at the option of the investor.[78] We are proposing to codify these views by amending Rule 15c3-1 to add a paragraph (c)(2)(i)(G), which would require a broker-dealer to treat as a liability any capital that is contributed under an agreement giving the investor the option to withdraw it. The provision also would require a broker-dealer to treat as a liability any capital contribution that is intended to be withdrawn within a year unless the broker-dealer receives permission in writing

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[77] See Study of Unsafe and Unsound Practices of Broker-Dealers, Report and Recommendations of the Securities and Exchange Commission, H.R. Doc. NO. 92-231 (1971).

[78] Letter from Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Commission, to Raymond J. Hennessy, Vice President, NYSE, and Susan DeMando, Vice President, NASD Regulation, Inc. (February 23, 2000).

from its designated examining authority.[79] Under paragraph (c)(2)(i)(G)(2) of the proposed rule, a withdrawal made within one year of the contribution is presumed to have been intended to be withdrawn within a year and, therefore, presumed to be subject to the deduction.

We request comment on all aspects of these proposed amendments, including suggestions for records (in addition to audited financial statements, tax returns and regulatory filings) by which a broker-dealer could demonstrate a third-party's current financial capacity. We also request comment on potential metrics for measuring whether the third-party has sufficient financial resources to assume the broker-dealer's expenses for the purposes of calculating net capital under Rule 15c3-1. For example, would it be sufficient if the third-party's most recent financial statement, tax return or filing showed an amount of annual net revenue, excluding income derived from the broker-dealer (e.g., from management fees or dividends) that equaled or exceeded the broker-dealer's annual expenses assumed by the third-party? Would it be sufficient if a financial statement or filing showed the third-party had an amount of equity capital that, at a minimum, equaled 100%, 150%, 200%, 1000% or some other percentage of the broker-dealer's annual expenses assumed by the third-party?

With respect to the proposal on capital contributions and withdrawals, we request comment on whether the time period within which withdrawn and intended to be withdrawn contributions must be treated as liabilities should be longer than one year.

2. Requirement to Deduct the Amount a Fidelity Bond Deductible Exceeds SRO Limits

79 These requirements would not apply to withdrawals covered by paragraph (e)(4)(iii) of Rule 15c3-1, namely, withdrawals used to make tax payments or to pay reasonable compensation to partners. These types of payments are ordinary business expenditures and do not raise the types of concerns the proposed rule is designed to address.

Under SRO rules, certain broker-dealers that do business with the public or are required to become members of the Securities Investor Protection Corporation ("SIPC") must comply with mandatory fidelity bonding requirements.[80] While the form and amounts of the bonding requirements vary based on the nature of a broker-dealer's business, the SRO rules typically permit a broker-dealer to have a deductible provision included in the bond. However, the rules provide that the deductible may not exceed certain amounts.[81] With regard to firms that maintain deductible amounts over the maximum amount permitted, a number of SRO rules provide that the broker-dealer must deduct this excess amount from net worth when calculating net capital under Rule 15c3-1.[82]

Rule 15c3-1, however, does not specifically reference the SRO deductible requirements as a charge to capital. Accordingly, while the SROs require that the excess fidelity bond be deducted from net capital, the Commission's rule does not specify such a deduction. This means that a broker-dealer would not be required for the purposes of Commission rules to show the impact of the deduction in the net capital computation on the FOCUS report it is required to

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80 See, e.g., NYSE Rule 319, NASD Rule 3020, CBOE Rule 9.22, and Amex Rule 330. SRO fidelity bonding requirements typically contain agreements covering the following areas: a "Fidelity" insuring clause to indemnify against loss of property through dishonest or fraudulent acts of employees; an "On Premises" agreement insuring against losses resulting from crimes such as burglary and theft and from misplacement of property of the insured; an "In Transit" clause indemnifying against losses occurring while property is in transit; a "Forgery and Alteration" agreement insuring against loss due to forgery or alteration of various kinds of negotiable instruments; and a "Securities Loss" clause protecting against losses incurred through forgery and alteration of securities. Id.

81 See, e.g., NYSE Rule 319(b), which permits NYSE members and member organizations to self-insure to the extent of $10,000 or 10% of the minimum insurance requirement as prescribed by the NYSE.

82 See, e.g., NYSE Rule 319(b); NASD Rule 3020(b)(2).

periodically file.[83] To address this gap, we are proposing to amend Rule 15c3-1 by adding a paragraph (c)(2)(xiv) that would require a broker-dealer to deduct, with regard to fidelity bonding requirements prescribed by a broker-dealer's examining authority, the excess of any deductible amount over the maximum deductible amount permitted. We believe the fidelity bonding requirement is an important prudential safeguard because it serves as a measure to protect the broker-dealer's capital from unforeseen losses arising from, among other events, improper activity by an employee.[84]

We request comment on all aspects of this proposed amendment.

3. Broker-Dealer Solvency Requirement

We are proposing an amendment to Rule 15c3-1 that would require a broker-dealer to cease its securities business activities if certain insolvency events occur. The proposed amendment would prevent a broker-dealer from continuing to conduct a securities business while it is seeking protection in a bankruptcy proceeding. A broker-dealer that has made an admission of insolvency, or is otherwise deemed insolvent or entitled to protection from creditors, does not possess the financial resources necessary to operate a securities business. Continuing to operate in such circumstances poses a significant credit risk to counterparties and to the clearance and settlement system, and, in the event the firm ends up in a liquidation proceeding under SIPA, may impair the ability of the SIPA trustee to make customers of the broker-dealer whole and satisfy claims of other creditors out of the assets of the general estate.

We are proposing to amend paragraph (a) of Rule 15c3-1 to provide that a broker-dealer shall not be in compliance with the rule if the firm is "insolvent" as that term is defined in the

83 See 17 CFR 240.17a-5.

84 See, e.g., NYSE Rule 319, which specifies the type of coverage the bond must provide.

rule. "Insolvent" would be defined in a new paragraph (c)(16) as, among other things, a broker-dealer's placement in a voluntary or involuntary bankruptcy or similar proceeding; the appointment of a trustee, receiver or similar official; a general assignment by the broker-dealer for the benefit of its creditors; an admission of insolvency; or the inability to make computations necessary to establish compliance with Rule 15c3-1. The proposed definition of "insolvent" is intended to be broad enough to encompass any type of insolvency proceeding or condition of insolvency.[85] By making solvency a requirement of Rule 15c3-1, a broker-dealer that is insolvent would have to cease conducting business because section 15(c)(3) of the Exchange Act generally prohibits a broker-dealer from effecting any transaction in, or inducing or attempting to induce the purchase or sale of, any security in contravention of the Commission's financial responsibility rules (which include Rule 15c3-1).[86]

We also are proposing an amendment to the first sentence of paragraph (b)(1) of Rule 17a-11 that would require a broker-dealer meeting the definition of "insolvent" to provide immediate notice to the Commission, the firm's designated examining authority and, if applicable, the CFTC. This notice would assist regulators in taking steps to protect the insolvent firm's customers, including, if appropriate, notifying SIPC of the need to commence a SIPA liquidation.

We request comment on all aspects of these proposed amendments, including whether there are other insolvency events that should be captured in the definition.

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85 For example, the proposed definition incorporates concepts of insolvency in the US Bankruptcy Code and SIPA. See 11 U.S.C. 101; 15 U.S.C. 78eee(b)(1).

86 15 U.S.C. 78o.

4. Amendment to Rule Governing Orders Restricting Withdrawal of Capital From a Broker-Dealer

Paragraph (e) of Rule 15c3-1 places certain conditions on a broker-dealer when withdrawing capital.[87] For example, a broker-dealer must give the Commission two days notice before a withdrawal that would exceed 30% of the firm's excess net capital and two days notice after a withdrawal that exceeded 20% of that measure.[88] Paragraph (e) also restricts capital withdrawals that would have certain financial impacts on a broker-dealer such as lowering net capital below certain levels.[89] Finally, under the rule, the Commission may issue an order temporarily restricting a broker-dealer from withdrawing capital or making loans or advances to stockholders, insiders, and affiliates under certain circumstances.[90] The rule, however, limits such orders to withdrawals, advances, or loans that, when aggregated with all other withdrawals, advances, or loans on a net basis during a thirty calendar day period, exceed thirty percent of the firm's excess net capital.[91] The rule also requires that the Commission conclude, based on the facts and information available that a withdrawal, advance, or loan in excess of thirty percent of the broker-dealer's excess net capital may be detrimental to the financial integrity of the firm, or may unduly jeopardize the firm's ability to repay its customer claims or other liabilities which may cause a significant impact on the markets or expose the customers or creditors of the firm to

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[87] See 17 CFR 240.15c3-1(e).

[88] 17 CFR 240.15c3-1(e)(1).

[89] 17 CFR 240.15c3-1(e)(2).

[90] 17 CFR 240.15c3-1(e)(3).

[91] Id.

loss without taking into account the application of the SIPA.[92] The order may restrict such withdrawals, advances, or loans for a period of up to twenty business days.[93]

Paragraph (e) of Rule 15c3-1 was adopted in the aftermath of the failure of the investment bank holding company Drexel Burnham Lambert, Inc. ("Drexel").[94] At the time of its adoption, the Commission pointed out that Drexel, prior to its failure, withdrew substantial capital from its regulated broker-dealer subsidiary over a period of three weeks in the form of short term loans.[95] The withdrawals were made without notifying the Commission or the broker-dealer's designated examining authority.[96] Moreover, part of the broker-dealer's capital consisted of hard to price high yield bonds.[97] This made it difficult to determine the firm's actual net capital amount and, consequently, whether it was in capital compliance.[98]

Since the adoption of Rule 15c3-1(e) in 1991, the Commission only once has issued an order restricting a broker-dealer from withdrawing capital.[99] Specifically, on October 13, 2005, the Commission ordered the two broker-dealer subsidiaries of REFCO, Inc. – REFCO Securities,

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92 Id.

93 Id.

94 See Exchange Act Release No. 28927 (February 28, 1991), 56 FR 9124 (March 5, 1991).

95 Id.

96 Id.

97 Id.

98 Id.

99 See Exchange Act Release No. 52606 (October 13, 2005).

LLC and REFCO Clearing, LLC – to restrict capital withdrawals, advances, and loans.[100] The Commission issued the order after REFCO, Inc. announced that its financial statements for 2002 through 2005 should not be relied on and that a material unregulated subsidiary (REFCO Capital Markets, Ltd.) had ceased all activities for a 15-day period.[101]

As required under Rule 15c3-1(e), the Commission's order with respect to REFCO's broker-dealer subsidiaries only restricted capital withdrawals, loans and advances to the extent they would exceed 30% of the broker-dealer's excess net capital when aggregated with other such transactions over a 30-day period. The Commission and other securities regulators often discover that the books and records of a troubled broker-dealer are incomplete or inaccurate. This can make it difficult to determine the firm's actual net capital and excess net capital amounts. In such a case, an order that limits withdrawals to a percentage of excess net capital would be difficult to enforce as it would not be clear when that threshold had been reached. Given the circumstances, we believe the better approach is to remove the 30% of excess net capital limitation. This would simplify the orders by allowing the Commission to restrict all withdrawals, advances, and loans. All the other conditions in the rule would be preserved.

We request comment on all aspects of this proposed amendment.

5. Adjusted Net Capital Requirements

i. Amendment to Appendix A of Rule 15c3-1

We are proposing an amendment to Appendix A of Rule 15c3-1, which permits broker-dealers to employ theoretical option pricing models to calculate haircuts for listed options and

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100 See id.

101 Id.

related positions that hedge those options.[102] Non-clearing option specialists and market makers need not apply haircuts to their proprietary listed options positions, provided the broker-dealer carrying their account takes a charge to its own net capital based on the charge computed using the theoretical pricing model.[103] In 1997, the Commission adopted a temporary amendment to Appendix A that, by virtue of decreasing the range of pricing inputs to the model, effectively reduced the haircuts applied by the carrying firm with respect to non-clearing option specialist and market maker accounts.[104] The temporary amendment, which only applied to these types of accounts, was limited to major market foreign currencies and diversified indexes. The Commission made this relief – which is contained in paragraph (b)(1)(iv) of Appendix A[105] – temporary so the Commission could evaluate the effects of the reduced capital charges, particularly under conditions involving high levels of market volatility.

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102 17 CFR 240.15c3-1a.

103 17 CFR 240.15c3-1(c)(2)(x).

104 See Exchange Act Release No. 38248 (February 6, 1997), 62 FR 6474 (February 12, 1997). Under Appendix A to Rule 15c3-1, a broker-dealer calculating net capital charges for its options portfolios shocks the products in each portfolio (grouped by underlying instrument) at ten equidistant points along a potential market move range. The market move ranges for major market foreign currencies, high-capitalization diversified indexes, and non-high-capitalization diversified indexes are, respectively: +(-) 6%, +(-) 10% and +(-) 15%. The temporary rule lowered these market move ranges to respectively: +(-) 4½%, + 6% (-) 8% and +(-) 10% in terms of calculating haircuts for positions of non-clearing options specialists and market makers. See id.

105 17 CFR 240.15c3-1a(b)(1)(iv)(B).

The relief expired two years from its effective date. The Commission staff subsequently issued a no-action letter on January 13, 2000 continuing the relief.[106] Since the no-action letter was issued, there have been periods of significant volatility in the securities markets, including the markets for major market foreign currencies and high-capitalization and non-high-capitalization diversified indexes. These periods of volatility include the Russian debt crisis in 1998, the internet bubble and the September 11, 2001 terrorist attacks. Despite periods of substantial volatility, there have been no significant increases in the number of deficits in non-clearing option specialist and market-maker accounts, nor did the lower capital charges under paragraph (b)(1)(iv) result in excessive leverage. Consequently, we are proposing to amend paragraph (b)(1)(iv) of Appendix A to Rule 15c3-1 to make permanent the previously granted relief. We believe permitting the lower requirement with respect to these types of positions carried in non-clearing option specialist and market-maker accounts better aligns the capital requirements in Rule 15c3-1 with the risks associated with these positions and accounts.

We request comment on all aspects of this proposed amendment, including whether the lower market move ranges for positions held by non-clearing options specialists and market makers are appropriate and whether data or other information suggests that these lower ranges did result in an increase in the number of deficits in non-clearing option specialist and market-maker accounts or in excessive leverage on the part of these firms. Commenters are encouraged to provide data to support their views.

ii. Money Market Funds

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106 Letter from Michael Macchiaroli, Associate Director, Division of Market Regulation, Commission, to Richard Lewandowski, Vice President, Regulatory Division, The Chicago Board Options Exchange, Inc. (Jan. 13, 2000).

We are proposing an amendment that would reduce the "haircut" broker-dealers apply under Rule 15c3-1 for money market funds from 2% to 1% when computing net capital. In 1982, the Commission adopted a 2% haircut requirement for redeemable securities of an investment company registered under the Investment Company Act of 1940 that holds assets consisting exclusively of cash or money market instruments and which is known as a "money market fund."[107] The 2% haircut was adopted before the Commission adopted certain amendments to Rule 2a-7 under the Investment Company Act of 1940 (17 CFR 270.2a-7) that strengthened the risk limiting investment restrictions for money market funds.[108] Rule 2a-7 defines a money market fund generally as an investment company limited to investing in U.S. dollar denominated securities that present minimal credit risks and that are, at the time of acquisition, "eligible securities."[109] In particular, the rule requires that the securities purchased by a money market fund be short-term instruments of issuers that are deemed a low credit risk.[110] The rule also requires the fund to diversify its portfolio of securities.[111] Based on the enhancements to Rule 2a-7, as well as the historical stability of money market funds as investments, we are proposing to amend paragraph (c)(2)(vi)(D)(1) of Rule 15c3-1 to reduce the haircut on such funds from 2% to 1%. This amendment is designed to better align the net capital charge with the risk associated with holding a money market fund. A further amendment would

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107 Exchange Act Release No. 18737 (May 13, 1982), 47 FR 21759 (May 20, 1982). See 17 CFR 240.15c3-1(c)(2)(vi)(D)(1).

108 Investment Company Act Release No. 18005 (February 20, 1991), 56 FR 8113 (February 27, 1991).

109 17 CFR 270.2a-7.

110 See id.

111 Id.

clarify that a money market fund, for the purposes of paragraph (c)(2)(vi)(D)(1), is a fund described in Rule 2a-7.

We request comment on all aspects of this amendment, including on whether it is appropriate to reduce the haircut to 1% and, alternatively, whether the haircut for certain types of money market funds should be reduced to 0% as suggested by Federated in its petition to the Commission.[112] Commenters are encouraged to provide data to support their views.

F. Technical Amendments

Finally, we are proposing a number of technical amendments to these rules in order to, for example, update or correct citations to other regulations. These technical amendments include proposed amendments to the definitions of "fully paid securities," "margin securities," and "bank" in Rule 15c3-3.[113] Our proposed amendments are not intended to substantively change the meanings of these defined terms but, rather, to remove text that is superfluous or redundant. Consequently, we specifically seek comment on whether our proposed amendments to these definitions would substantively alter the meaning of "fully paid securities," "margin securities," and "bank" as those terms are defined in Rule 15c3-3. Commenters should describe how the amendment would result in a substantive change.

III. FURTHER REQUESTS FOR COMMENT

A. In General

We invite interested persons to submit written comments on any aspect of the proposed amendments, in addition to the specific requests for comments. Further, we invite comment on

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112 See Public Petition for Rulemaking No. 4-478 (April 3, 2003), as amended (April 4, 2005), available at http://www.sec.gov/rules/petitions/petn4-478.htm.

113 17 CFR 240.15c3-3(a)(3), (4), and (7) respectively.

other matters that might have an effect on the proposals contained in the release, including any competitive impact.

B. Requests for Comment on Certain Specific Matters

1. Early Warning Levels

The Capital Committee of the Securities Industry Association ("SIA") has proposed lowering the Rule 17a-11 early warning level for broker-dealers that carry over $10 billion in debits. Currently, under Rule 17a-11, a broker-dealer that computes its net capital requirement using the alternative standard must provide regulators with notice if their net capital level falls below 5% of aggregate debit items. The SIA contends that a broker-dealer with aggregate debit items exceeding $10 billion would not be approaching financial difficulty simply because its net capital falls to the 5% early warning threshold. The broker-dealer, because of the large amount of debits and corresponding capital requirement, would continue to hold sufficient net capital in the SIA's estimation. The SIA has suggested using a tiered approach in which the early warning level would be calculated by adding: (5% of the first $10 billion in debits) + (4% of the next $5 billion) + (3% of the next $5 billion) + (2.5% of all remaining debits).

We request comment on this proposal and note that the SROs would need to alter their early warning levels as well to make any such proposed amendment effective.

2. Harmonize Securities Lending and Repo Capital Charges

We also are considering whether to harmonize the net capital deductions required under paragraph (c)(2)(iv)(B) of Rule 15c3-1 for securities lending and borrowing transactions with the deductions required under paragraph (c)(2)(iv)(F) for securities repo transactions. Securities lending and borrowing transactions are economically similar to repo transactions. However, the need to take a deduction (or the size of the deduction) under Rule 15c3-1 may depend on whether the broker-dealer executes the transaction as a securities loan/borrow or repo transaction.[114] We are concerned that this has created an opportunity for regulatory arbitrage.

In order to eliminate this mismatch, we could make identical the securities loaned and repurchase agreement deductions and, similarly, the securities borrowed and reverse repurchase agreement deductions. We seek comment on the feasibility of such a proposal and on how it should be implemented.

3. Accounting for Third-Party Liens on Customer Securities Held at a Broker-Dealer

Under Rule 15c3-3, a broker-dealer is required to include as a "credit" item in the customer reserve formula the amount of any loan it receives that is collateralized by securities carried for the accounts of customers.[115] The credit item is intended to ensure that funds obtained through the use of customer securities are deployed to support customer transactions (e.g., to make margin loans) and not used in the broker-dealer's proprietary business.

In some cases, the customer's securities may be subject to a lien arising from a third-party loan that is not made to the broker-dealer (e.g., the loan is made directly to the customer). If the customer's securities are not moved to a pledge account in the name of the third-party lender, then the broker-dealer will continue to hold them in the name of the customer. As between the broker-dealer and the customer, the securities may be fully paid for and,

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114 Specifically, with respect to repurchase agreement and securities borrowed transactions, the required deductions only are triggered when the deficits exceed certain percentages. See 17 CFR 240.15c3-1(c)(2)(iv)(B) and (F). Conversely, with reverse repurchase agreement and securities loaned transactions, the deductions are triggered without regard to the size of the deficit.

115 17 CFR 240.15c3-3a, Item 2. A broker-dealer may finance margin loans to its customers by obtaining a bank loan that is secured by the customers' securities, which – because they are not "excess margin securities" – do not have to be in the control of the broker-dealer under Rule 15c3-3(b).

consequently, subject to the physical possession or control requirement of Rule 15c3-3. Moreover, if the broker-dealer became insolvent and was liquidated in a SIPA proceeding, the trustee could be placed in the situation of owing the securities both to the customer and to the third-party holding the lien. This could increase the costs of a SIPA liquidation, which is underwritten by the fund administered by SIPC.

The situation becomes even more complicated when the securities are subject to liens held by multiple creditors. The amount of the obligation to each creditor may change daily depending on market movements or other factors. In a SIPA proceeding, this could increase the number of parties with potentially competing claims for the securities, and thereby increase the complexity and costs of the liquidation.

For these reasons, we request comment on how third-party liens against customer fully paid securities carried by a broker-dealer should be treated under the financial responsibility rules, including Rule 15c3-3, Rule 17a-3 and Rule 17a-4. For example, should the broker-dealer be required to: (1) include the amount of the customer's obligation to the third-party as a credit item in the reserve formula; (2) move the securities subject to the lien into a separate pledge account in the name of the pledgee or pledges; or (3) record on its books and records and disclose to the customer the existence of the lien, identity of the pledgee(s), obligation of the customer, and amount of securities subject to the lien?

IV. PAPERWORK REDUCTION ACT

Certain provisions of the proposed amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). We have submitted the proposed amendments to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[116] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. The rules being amended – Rule 15c3-1, Rule 15c3-3, Rule 17a-3, Rule 17a-4 and Rule 17a-11 – contain currently approved collections of information under, respectively, OMB control numbers 3235-0200, 3235-0078, 3235-0033, 3235-0279 and 3235-0085.

A. Collections of Information under the Proposed Amendments

The proposed rule amendments contain recordkeeping and disclosure requirements that are subject to the PRA. In summary, the amendments would require a broker-dealer, under certain circumstances, to (1) disclose the principals and obtain certain agreements from the principals in a securities lending transaction where it performs settlement services if it wants to be considered an agent (as opposed to a principal) for the purposes of the net capital rule,[117] (2) obtain written permission from broker-dealer ("PAB") account holders to use their fully paid and excess margin securities,[118] (3) perform a PAB reserve computation,[119] (4) obtain written notification from a bank holding its PAB Special Reserve Account that the bank has received notice that the assets in the account are being held for the benefit of PAB account holders,[120] (5) enter into a written contract with a bank holding its PAB Special Reserve Accounts in which the bank agrees the assets in the account would not be used as security for a loan to the broker-dealer

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116 44 U.S.C. 3507(d); 5 CFR 1320.11

117 Proposed amendment revising paragraph (c)(2)(iv)(B) of Rule 15c3-1.

118 Proposed amendment adding paragraph (b)(5) to Rule 15c3-3.

119 Proposed amendment revising paragraph (e)(1) of Rule 15c3-3.

120 Proposed amendment revising paragraph (f) of Rule 15c3-3.

and would not be subject to a right, charge, security interest, lien, or claim of any kind in favor of the bank,[121] (6) obtain the affirmative consent of a customer before changing the terms under which the customer's free credit balances are invested,[122] (7) make and maintain records documenting internal controls to assist the broker-dealer in analyzing and managing market, risks arising from business activities,[123] (8) provide notice to the Commission and other regulatory authorities if the broker-dealer becomes insolvent,[124] and (9) provide notice to the Commission and other regulatory authorities if the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity reaches a certain threshold or, alternatively, provide regulatory authorities with a monthly report of the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity.[125]

B. Proposed Use of Information

The Commission and other regulatory authorities would use the information collected under the proposed amendment to Rule 15c3-1 and Rule 15c3-3 to determine whether the broker-dealer is in compliance with each rule. In particular, the record with respect to acting as agent in a securities loan transaction would assist examiners in verifying that the broker-dealer is properly accounting for securities loan deficits under Rule 15c3-1. The records with respect to the PAB accounts would assist examiners in verifying that the PAB accountholders had agreed to

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121 Id.

122 Proposed amendment adding paragraph (j) to Rule 15c3-3.

123 Proposed amendments adding paragraph (a)(24) to Rule 17a-3 and revising paragraph (e)(9) of Rule 17a-4.

124 Proposed amendment revising paragraph (b)(1) of Rule 17a-11.

125 Proposed amendment adding paragraph (c)(5) to Rule 17a-11.

permit the broker-dealer to use their securities, the broker-dealer had performed the PAB reserve computation and the bank holding the PAB Special Reserve Account had agreed to do so free of lien.

The Commission and other regulatory authorities would use the information collected under the proposed amendments to Rules 17a-3 and 17a-4 to determine whether the broker-dealer is operating in a manner that mitigates the risk it will fail as a result of failing to document internal controls.

The Commission and other regulatory authorities would use the information collected under the proposed amendments to Rule 17a-11 to identify a broker-dealer experiencing financial difficulty. This information would assist the Commission and other regulators in promptly taking appropriate steps to protect customers, creditors, and counterparties. In particular, a notice of insolvency would assist regulators in responding more quickly to a failing institution. The notices and reports with respect to securities lending and repos would assist regulators in identifying broker-dealers that are active in these transactions or suddenly take on large positions. This would assist in monitoring the systemic risk in the markets.

C. Respondents

The amendment to Rule 15c3-1 requiring a broker-dealer to make disclosures to, and obtain certain agreements from, securities lending principals only would apply to those firms that participate in the settlement of securities lending transactions as agents. We estimate that approximately 170 broker-dealers would be affected by this requirement.[126]

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126 This estimate is derived from FOCUS Reports filed by broker-dealers pursuant to Section 17 of the Exchange Act and Rule 17a-5 (17 CFR 240.17a-5).

The amendments to Rule 15c3-3 requiring a broker-dealer to perform a PAB reserve computation and to obtain certain agreements and notices related to its PAB accounts only would affect those firms that carry such accounts. We estimate that approximately 75 broker-dealers would carry such accounts.[127]

The amendment to Rule 15c3-3 requiring a broker-dealer to obtain the affirmative consent of a customer before changing the terms under which the customer's free credit balances are maintained only would apply to firms that carry free credit balances for customers. We estimate that approximately 256 broker-dealers carry customer accounts.[128]

The amendments to Rules 17a-3 and 17a-4 requiring a broker-dealer to make and maintain records documenting internal controls for analyzing and managing risks only would apply to firms that have more than $1,000,000 in aggregate credit items, or $20,000,000 in capital. Thus, its impact would be limited to the largest broker-dealers. Generally, the broker-dealers that would be required to document internal controls are exposed to all the risks identified in the proposed amendment. Accordingly, the number of respondents would equal the number of broker-dealers meeting the thresholds set forth in the amendment. We estimate that approximately 517 broker-dealers would meet at least one of these thresholds.[129]

The amendment to Rule 17a-11 would require a broker-dealer to provide the Commission with notice if it becomes subject to certain insolvency events only would affect a limited number

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127 Id.

128 Id.

129 Id.

of firms per year. We estimate that approximately six broker-dealers would become subject to one of these events in a given year.[130]

The amendment to Rule 17a-11 would require a broker-dealer to provide notice to the Commission if its securities borrowed or loan or securities repurchase or reverse repurchase activity reaches a certain threshold or, alternatively, provide monthly reports to securities regulators about such activities only would affect a limited number of firms per year. We estimate that approximately 11 broker-dealers would provide the notice and that 21 broker-dealers would opt to send the monthly reports in a given year.[131]

D. Total Annual Reporting and Recordkeeping Burden

As discussed in further detail below, we estimate the total recordkeeping burden resulting from these amendments would be approximately 373,938 annual hours,[132] 105,900 one-time hours,[133] and a one-time cost of $1,000,000 arising from the retention of outside counsel.

1. Securities Lending Agreements and Disclosures

The proposed amendment to Rule 15c3-1 would require a broker-dealer to make disclosures to, and obtain certain agreements from, securities lending principals in situations where the firm participates in the settlement of a securities lending transaction but wants to be

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130 This estimate is based on the Annual Report of the Securities Investor Protection Corporation ("SIPC"), which indicates that in recent years an average of six customer protection proceedings per year have been initiated with respect to SIPC members. A copy of the 2005 Annual Report can be obtained at: http://www.sipc.org/pdf/2005AnnualReport.pdf.

131 These estimates are derived from information filed by broker-dealers in FOCUS Report filings.

132 9,350 hours + 364,333 hours + 255 hours = 373,938 hours.

133 180 hours + 26,830 hours + 2,250 hours + 10,000 hours + 2,500 hours + 62,040 hours + 2,100 hours = 105,900 hours.

deemed an agent for purposes of Rule 15c3-1. We understand that most existing standard securities lending master agreements in use today already contain language requiring agent lenders to disclose principals and principals to agree not to hold the agents liable for a counterparty default and, consequently, the proposed amendment would be codifying industry practice. Thus, the standard agreement used by the vast majority of broker-dealers should contain the representations and disclosures required by the proposed amendment. However, a small percentage of broker-dealers may need to modify their standard agreements.

We estimate that 5% of the approximately 170 firms engaged in this business, or 9 firms, would not have used the standard agreements. We further estimate each of these firms would spend approximately 20 hours of employee resources updating their standard agreement template. Therefore, we estimate that the total one-time burden to the industry as a result of this proposed requirement would be approximately 180 hours.[134] We do not believe firms would incur costs arising from updating systems, purchasing software, or engaging outside counsel in meeting this proposed requirement but seek comment on that estimate.

2. PAB Customer Reserve Account Recordkeeping Requirements

This proposed amendment to Rule 15c3-3 would require a broker-dealer to perform a PAB reserve computation and obtain certain agreements and notices related to PAB accounts and, therefore, would impose recordkeeping burdens on a broker-dealer to the extent it: (1) has to perform a PAB computation; (2) chooses to use PAB securities and, therefore, needs to obtain agreements from PAB accountholders; and (3) opens a PAB reserve account at a new bank. The customer agreement requirement would be a one-time burden. It is standard for a broker-dealer

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134 9 broker-dealers x 20 hours per firm = 180 hours.

to enter into a written agreement with an accountholder concerning the terms and conditions under which the account would be maintained. Therefore, requiring a written agreement would not result in additional burden. Rather, additional burdens would arise from the need to amend existing agreements and the standard agreement template that would be used for future customers.

Based on FOCUS Report filings, we estimate that there are approximately 2,533 existing PAB customers and, therefore, broker-dealers would have to amend approximately 2,533 existing PAB agreements. We further estimate that, on average, a firm would spend approximately 10 hours of employee resources amending each agreement. We also estimate, based on FOCUS Reports, that approximately 75 broker-dealers carry PAB accounts and, therefore, these 75 firms would have to amend their standard PAB agreement template. We estimate a firm would spend, on average, approximately 20 hours of employee resources on this task. Therefore, we estimate the total one-time burden to the industry from these requirements would be approximately 26,830 total hours.[135] We do not believe firms would incur costs arising from updating systems, purchasing software, or engaging outside counsel in meeting these proposed requirements but seek comment on that estimate.

The proposed requirements to perform a PAB computation and obtain agreements and notices from banks holding PAB accounts would result in annual burdens based on the number of broker-dealers that hold PAB accounts and the number of times per year these broker-dealers open new PAB bank accounts. Currently, to obtain the relief provided in the PAIB Letter, broker-dealers are required to obtain the agreements and notices from the banks. We understand

135 (2,533 PAB customers x 10 hours per customer) + (75 firms x 20 hours per firm) = 26,830 hours.

that broker-dealers generally already obtain these agreements and notices. Therefore, we estimate there would be no additional burden imposed by this requirement but seek comment on this estimate.

The proposed amendment requiring a PAB computation would produce a one-time burden. Based on FOCUS Report filings, we estimate that approximately 75 broker-dealers would perform a PAB computation. These firms already perform a reserve computation for domestic broker-dealer customers under the PAIB letter. Nonetheless, we estimate these firms would spend, on average, approximately 30 hours of employee resources per firm updating their systems to implement changes that would be necessitated by our proposed amendment. Therefore, we estimate that the total one-time burden to the industry arising from this proposed requirement would be approximately 2,250 hours.[136]

The proposed amendment requiring a PAB computation also would produce an annual burden. Based on FOCUS Report filings, we estimate that approximately 71 broker-dealers would perform the PAB computation on a weekly basis and four broker-dealers would perform it on a monthly basis. We further estimate that a broker-dealer would spend, on average, approximately 2.5 additional hours to complete the Rule 15c3-3 reserve computation as a result of our proposed amendment. Therefore, we estimate that the total annual burden to the industry from this proposed requirement would be approximately 9,350 hours.[137] We do not believe firms would incur costs arising from purchasing software or engaging outside counsel in meeting these proposed requirements but seek comment on that estimate.

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136 75 broker-dealers x 30 hours per firm = 2,250 hours.

137 ([71 weekly filers] x [52 weeks] x [2.5 hours per computation]) + ([4 monthly filers] x [12 months] x [2.5 hours per computation]) = 9,350 total hours.

3. Affirmative Consent

This proposed amendment to Rule 15c3-3 would require a broker-dealer to obtain the affirmative consent of a new customer before changing the terms under which the customer's free credit balances are treated and provide notice to existing customers prior to changing how their free credit balances are treated. The broker-dealer also would be required to make certain disclosures.

This proposed requirement would result in one-time and annual burdens to the broker-dealer industry. We note, however, that the requirement only would apply to a firm that carries customer free credit balances and opts to have the ability to change how its customers' free credit balances are treated.

Based on staff experience, we estimate that 50 broker-dealers would choose to provide existing and new customers with the disclosures and notices required under the proposed amendment in order to have the ability to change how their customers' free credit balances are treated. We further estimate these firms would spend, on average, approximately 200 hours of employee resources per firm updating their systems (including processes for generating customer account statements) to incorporate changes that would be necessitated by our proposed amendment. Therefore, we estimate that the total one-time burden to the industry arising from this proposed requirement would be approximately 10,000 hours.[138]

We also estimate that these firms would consult with outside counsel in making these systems changes, particularly with respect to the language in the disclosures and notices. The Commission estimates that, on average, an outside counsel would spend, on average,

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[138] 50 broker-dealers x 200 hours per firm = 2,250.

approximately 50 hours assisting a broker-dealer in updating its systems for a one-time aggregate burden to the industry of 2,500 hours.[139] 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 these reasons, the Commission estimates that the average one-time cost to a broker-dealer would be approximately $20,000[140] and the one-time cost to the industry would be approximately $1,000,000.[141]

As for annual burden, we estimate these proposed requirements would impact 5% of the total broker-dealer customer accounts per year. Based on FOCUS Report filings, we estimate there are approximately 109,300,000 customer accounts and, consequently, 5% of the accounts (5,465,000 accounts per year) would be impacted. We further estimate that a broker-dealer would spend, on average, four minutes of employee resources to process an affirmative consent for new customers and a disclosure for existing customers. Therefore, we estimate that the annual burden to the industry arising from the requirement would be approximately 364,333 hours.[142]

4. Internal Control Recordkeeping Requirements

These proposed amendments to Rules 17a-3 and 17a-4 would require certain large broker-dealers to make and maintain records documenting internal controls that assist in

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[139] 50 broker-dealers x 50 hours per firm = 2,500 hours.

[140] $400 per hour x 50 hours = $20,000.

[141] 50 broker-dealers x $20,000 = $1,000,000.

[142] 5,465,000 accounts x 4 minutes/account = 364,333 hours.

analyzing and managing risks. The requirement would apply to broker-dealers that have more than $1,000,000 in customer credits or $20,000,000 in capital. This requirement would result in a one-time burden to the industry.

Based on FOCUS Report filings, we estimate there are approximately 517 broker-dealers that meet the applicability threshold of this amendment ($1,000,000 in credits or $20,000,000 in capital). Based on staff experience, we estimate that these larger broker-dealers generally already have documented the procedures and controls they have established to manage the risks arising from their business activities. Moreover, among these firms, the time per firm likely would vary depending on the size and complexity of the firm. For some firms, the burden may be close to 0 hours and for others it may be hundreds of hours. Taking this into account, we estimate that a broker-dealer would spend, on average, approximately 120 hours of employee resources augmenting its documented procedures to come into compliance with this proposed amendment. Therefore, we estimate the total one-time burden to the industry would be approximately 62,040 hours.[143]

We do not believe broker-dealers would incur costs arising from updating systems, purchasing software, or engaging outside counsel in meeting this proposed requirement but seek comment on that estimate.

5. Notice Requirements

The proposed amendments to Rule 17a-11 would require a broker-dealer to provide notice to the Commission and other regulatory authorities if the broker-dealer becomes subject to certain insolvency events, and notice to the Commission and other regulatory authorities if the

143 517 broker-dealers x 120 hours = 62,040 hours.

broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity reaches a certain threshold or, alternatively, provide regulatory authorities with a monthly report of the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity.

The notice requirements would result in irregular filings from a small number of broker-dealers. As noted above, SIPC's 2005 annual report indicates that in recent years an average of six broker-dealers per year have become subject to a liquidation proceeding under the Securities Investor Protection Act of 1970 (15 U.S.C. 78aaa et seq.) ("SIPA"). Accordingly, we estimate that approximately six insolvency notices would be sent per year and that a broker-dealer would spend, on average, approximately ten minutes of employee resources to prepare and send the notice. Therefore, we estimate that the total annual burden to the industry arising from this proposal would be approximately one hour.[144] Based on FOCUS Report filings, we estimate that approximately twelve stock loan/borrow notices would be sent per year. We further estimate that a broker-dealer would spend, on average, approximately ten minutes of employee resources to prepare and send the notice. Therefore, we estimate that the total annual burden to the industry arising from this proposal would be approximately two hours.[145]

Based on FOCUS Report filings, we estimate that 21 broker-dealers per year would submit the monthly stock loan/borrow report. We estimate each firm would spend, on average, approximately 100 hours of employee resources updating its systems to generate the report. Therefore, we estimate that the total one-time burden to the industry arising from this proposed

144 6 notices x 10 minutes per notice = 1 hour.

145 12 notices x 10 minutes per notice = 2 hours.

requirement would be approximately 2,100 hours.[146] As for annual burden, we estimate each firm would spend, on average, approximately one hour per month (or twelve hours per year) of employee resources to prepare and send the report. Therefore, we estimate the total annual burden arising from this proposal would be approximately 255 hours.[147]

We do not believe firms would incur costs arising from purchasing software or engaging outside counsel in meeting these proposed requirements but seek comment on this estimate.

E. Collection of Information Is Mandatory

These recordkeeping and notice requirements are mandatory with the exception of the option for a broker-dealer to provide a monthly notice of its securities lending activities to its designated examining authority in lieu of filing the notice required under the proposed amendment to Rule 17a-11.

F. Confidentiality

The information collected under the amendments to Rules 15c3-1, 15c3-3, 17a-3 and 17a-4 would be stored by the broker-dealers and made available to the various regulatory authorities as required in connection with examinations, investigations, and enforcement proceedings.

The information collected under the amendments to Rule 17a-11 would be generated from the internal records of the broker-dealers. It would be provided to the Commission and other regulatory agencies but not on a regular basis (except for the optional monthly reports).

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146 21 broker-dealers x 100 hours per firm = 2,100 hours.

147 21 broker-dealers x 12 hours per year or 252 hours.

The information provided to the Commission would be kept confidential to the extent permitted by law.

G. Record Retention Period

The proposed amendment to Rule 15c3-1 would require broker-dealers to make disclosures to principals and obtain agreements from principals with respect to securities lending transactions where the broker-dealer acts as agent. These records would have to be maintained for at least three years under paragraph (b)(7) of Rule 17a-4.[148] The retention period for the agreements also would depend on the length of time the relationship between the broker-dealer and the principal lasts.

The proposed amendments to Rule 15c3-3 would require broker-dealers to obtain written permission from a PAB customer if they want to use the customer's fully paid and excess margin securities and to obtain the affirmative consent of customers with respect to changing the terms under which free credit balances are maintained. These agreements would relate to the terms and conditions of the maintenance of the customer's account and, accordingly, fall within the record retention requirements of paragraph (c) of Rule 17a-4.[149] Under this paragraph, the records must be retained until six years after the closing of the customer's account. The amendments to Rule 15c3-3 also would require broker-dealers to obtain notices and contracts from the banks holding their PAB customer reserve accounts. In order to comply with Rule 15c3-3, broker-dealers would need to have these notices and contracts in place and documented. Accordingly, the

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[148] 17 CFR 240.17a-4(b)(7).

[149] 17 CFR 240.17a-4(c).

retention period for these records is, at a minimum, equal to the life of the PAB customer reserve account for which they are obtained.

The proposed amendments to Rules 17a-3 and 17a-4 would require broker-dealers to document various internal control systems, policies and guidelines. The amendments to Rule 17a-4 include the establishment of a retention period for these records, which would be until three years after the termination of the use of such system, policy or guideline.

The proposed amendments to Rule 17a-11 would require broker-dealers to provide notice or monthly reports to the Commission and other regulatory authorities under certain circumstances. These notices and reports would constitute communications relating to a broker-dealer's "business as such" and, therefore, would need to be retained for three years.[150]

H. Request for Comment

We request comment on the proposed collections of information in order to (1) evaluate whether the proposed collection of information is necessary for the 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, and (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.

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,

[150] 17 CFR 240.17a-4(b)(4).

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. S7-08-07. 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. S7-08-07, 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 AMENDMENTS

We are sensitive to the costs and benefits that result from Commission rules. We have identified certain costs and benefits of the proposed amendments and request comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis.[151] We seek comment and data on the value of the benefits identified. We also welcome comments on the accuracy of the cost estimates in each section of

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[151] For the purposes of this cost/benefit analysis, we are 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 and to account for the fact that a substantial portion of the work will be undertaken in New York. The salary information is derived from the SIA Report on Management and Professional Earnings in the Securities Industry 2005 ("SIA Management Report 2005"). The hourly costs derived from the SIA Management Report 2005, and referenced in this cost benefit section, are modified to account for an 1800-hour work week and multiplied by 5.35 to account for bonuses, firm size, employee benefits, and overhead.

this cost-benefit analysis, and request those commenters to provide data so we can improve these cost estimates.

We also seek estimates and views regarding these costs and benefits for particular types of market participants, as well as any other costs or benefits that may result from the adoption of these proposed rules.

A. Amendments to the Customer Protection Rule

1. Proprietary Accounts of Broker-Dealers

The proposed amendment to Rule 15c3-3 would require broker-dealers to perform a reserve calculation for the proprietary accounts ("PAB") of domestic and foreign broker-dealers and foreign banks acting as broker-dealers. It also would require them to obtain agreements from these broker-dealer customers with respect to the use of their fully paid and excess margin securities. Finally, it would require broker-dealers to obtain agreements and notices from the banks holding the PAB reserve deposits.

As discussed above, there is a disparity between the customer reserve requirements in Rule 15c3-3 and the treatment of customers in a liquidation proceeding under the Securities Investor Protection Act of 1970 ("SIPA").[152] Rule 15c3-3 requires broker-dealers to reserve the net amount of money they owe their customers. If the broker-dealer fails, this net amount is available to be returned to customers ahead of all other creditors. Moreover, if the failed broker-dealer is subject to a SIPA proceeding, this net amount becomes part of the estate of customer property, which is distributed pro rata to customers.

Foreign and domestic broker-dealers are not "customers" under Rule 15c3-3. Therefore, broker-dealers are not required to reserve the net amount of money owed to these entities.

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[152] 15 U.S.C. 78aaa et seq.

However, they are "customers" for the purposes of SIPA and, consequently, are entitled to a pro rata share of the estate of customer property. Thus, even if a failed broker-dealer properly reserved the net amount it owed its Rule 15c3-3 "customers," the estate of customer property nonetheless may be insufficient to return the money owed to these "customers" because broader definition of "customer" in SIPA entitles foreign and domestic broker-dealers to a pro rata share of the funds.

i. Benefits

Our proposed amendment would address this discrepancy by requiring broker-dealers to reserve for the net amount of money they owe other broker-dealers. This would benefit the other customers as well as the broker-dealer account holders by eliminating the inconsistency between Rule 15c3-3 and SIPA, which could decrease the estate of customer property in a SIPA liquidation. It also would minimize the risk that advances from the fund administered by the Securities Investor Protection Corporation ("SIPC") would be necessary to protect customer cash claims. We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

ii. Costs

The proposed requirements to perform a PAB computation and obtain agreements and notices from banks holding PAB accounts would result in one-time and annual costs to broker-dealers that hold PAB accounts. Under the no-action relief set forth in the PAIB Letter, these broker-dealers already are performing a reserve computation for domestic broker-dealer accounts and have obtained the necessary agreements and notices from the banks holding their PAIB reserve deposits. Therefore, the proposed amendments would result in incremental costs.

The proposed requirement to obtain written agreements from PAB customers in order to use their fully paid and excess margin securities would result in a one-time cost to the industry. As discussed above with respect to the Paper Work Reduction Act of 1995 ("PRA"), it is standard for broker-dealers to enter into written agreements with their broker-dealer customers concerning the terms and conditions under which the customers' accounts will be maintained. Therefore, requiring a written agreement should not result in additional costs. Rather, the one-time costs would arise from the need to amend existing agreements and the standard agreement template that would be used for future customers.

As discussed with respect to the PRA, based on FOCUS Report filings, we estimate that there are approximately 2,533 existing PAB customers and, therefore, broker-dealers would have to amend approximately 2,533 existing PAB agreements. We further estimate that, on average, a firm would spend approximately 10 hours of employee resources amending each agreement. We also estimate, based on FOCUS Reports, that approximately 75 broker-dealers carry PAB accounts and, therefore, these 75 firms would have to amend their standard PAB agreement template. We estimate a firm would spend, on average, approximately 20 hours of employee resources on this task. Therefore, as noted with respect to the PRA, we estimate the total one-time hourly burden to the industry from these requirements would be approximately 26,830 hours.[153] For the purposes of this cost analysis, we estimate this work would be undertaken by a broker-dealer's in-house attorneys. The SIA Management Report 2005 indicates that the average

153 (2,533 PAB customers x 10 hours per customer) + (75 broker-dealers x 20 hours per firm) = 26,830 hours.

hourly cost of an attorney is $327. Therefore, we estimate that there would be a one-time cost to the industry from these proposed requirements of approximately $8,773,410.[154]

As discussed with respect to the PRA, the requirement to perform a PAB computation also would produce a one-time burden to the extent the system for performing the calculation would need to be updated. Based on FOCUS Report filings, we estimate that approximately 75 broker-dealers would perform a PAB computation. These firms already perform a reserve computation for domestic broker-dealer customers under the PAIB letter. Nonetheless, we estimate these firms would spend, on average, approximately 30 hours of employee resources per firm updating their systems to implement changes that would be necessitated by our proposed amendment. With respect to the PRA, we estimate that the total one-time hourly burden to the industry arising from this proposed requirement would be approximately 2,250 hours.[155] For the purposes of the cost analysis, we estimate that this work would be undertaken by a Senior Programmer. The SIA Management Report 2005 indicates the average hourly cost of this position is approximately $268. Therefore, we estimate that there would be a one-time cost to the industry from the proposed requirement of approximately $603,000.[156]

As noted with respect to the PRA, the proposed requirement to perform a PAB computation would result in an annual hourly burden to the extent the new requirement would lengthen the time needed to complete the computation. Based on FOCUS Report filings, we estimate that approximately 71 broker-dealers would perform the PAB computation on a weekly basis and four broker-dealers would perform it on a monthly basis. We further estimate that a

154 $327 per hour x 26,830 hours = $8,773,410.

155 75 broker-dealers x 30 hours per firm = 2,250 hours.

156 $268 per hour x 2,250 hours = $603,000.

broker-dealer would spend, on average, approximately 2.5 additional hours to complete the Rule 15c3-3 reserve computation as a result of our proposed amendment. Therefore, as noted with respect to the PRA, we estimate that the total annual hourly burden to the industry from this proposed requirement would be approximately 9,350 hours.[157] For purposes of this cost analysis, we estimate that the responsibility for performing the PAB computation would be undertaken by a financial reporting manager. As noted above, the SIA Management Report 2005 indicates that the average hourly cost for a financial reporting manager is $278. Therefore, we estimate that the total annual cost to the industry resulting from these requirements would be approximately $2,599,300.[158]

As noted above, we request comment on these proposed cost estimates. In particular, we request comment on whether there would be additional costs to broker-dealers as a consequence of these proposals. For example, with respect to the PRA, we estimate that these requirements would not result in costs arising from purchasing software or engaging outside counsel. Therefore, we request comment on whether these requirements would result in such costs and, if so, how to quantify the costs. We also request comment on whether these proposals would impose costs on other market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

2. Banks Where Special Reserve Deposits May Be Held

The proposed amendment to Rule 15c3-3 would limit the amount of cash a broker-dealer could deposit at any one bank for the purposes of maintaining a required customer or PAB

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157 ([71 weekly filers] x [52 weeks] x [2.5 hours per computation]) + ([4 monthly filers] x [12 months] x [2.5 hours per computation]) = 9,350 total hours.

158 $278 per hour x 9,350 hours = $2,599,300.

reserve requirement and exclude customer and PAB reserve cash deposits at affiliated banks from counting towards the broker-dealer's reserve requirement.

i. Benefits

The intent of this proposed amendment is to prevent broker-dealers from concentrating customer related deposits that are large relative to the broker-dealer or the bank in order to limit the risk arising from a financial collapse and to prevent such deposits from being lost in a group-wide financial collapse. Concentration poses a risk that some or all of the deposit may be lost. Depending on the size of the deposit and the broker-dealer, a lost deposit could cause the broker-dealer to fail. If the broker-dealer fails and the deposit is not recovered, the SIPC fund likely would not recover advances from the fund made for the purpose of returning customer assets. Moreover, to the extent that customer losses exceeded the SIPA advance limits, customers would suffer permanent losses. The benefits that would be derived from this proposed amendment are an increased safeguarding of SIPC funds and customer assets.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

ii. Costs

We estimate that the costs resulting from this proposed amendment would be incremental. Specifically, we estimate that approximately 216 broker-dealers would have reserve deposit requirements.[159] A majority of these firms meet a substantial portion of their deposit requirement using qualified government securities as opposed to cash and, therefore,

[159] This estimate is based on FOCUS Report filings.

would not be impacted by this proposal. Moreover, to the extent that a broker-dealer's cash deposits exceed the limits, it could open up one or more accounts at different banks or, alternatively, use qualified securities to meet part of its deposit requirement.

In terms of quantifying costs, we estimate that, of the 216 firms with reserve deposit requirements, only 5%, namely 11, would need to open new bank accounts or substitute qualified securities for cash in an existing reserve account. We estimate that the responsibility for opening a new reserve bank account or substituting qualified securities for cash in an existing account would be undertaken by a Senior Treasury/Cash Management Manager. The SIA Management Report 2005 indicates that the average hourly cost of this position is $263. We estimate that the senior treasury/cash management manager would spend approximately 10 hours performing these changes. Therefore, we estimate that the average cost per firm to make these changes would be approximately $2,630.[160] For these reasons, we estimate that the total one-time cost to the industry would be approximately $28,930.[161]

As noted above, we request comment on these proposed cost estimates. In particular, we request comment on whether there would be additional costs to broker-dealers as a consequence of these proposals, such as costs arising from implementing systems changes, maintaining additional bank or securities accounts, and managing pools of qualified securities as opposed to a deposit of cash. We also request comment on whether these proposals would impose costs on other market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their cost estimates.

160 $263 per hour x 10 hours = $2,630.

161 11 broker-dealers x $2,630 = $28,930.

3. Expansion of the Definition of Qualified Securities to Include Certain Money Market Funds

The proposed amendment to Rule 15c3-3 would permit broker-dealers to deposit certain money market funds in the customer reserve account. This would benefit broker-dealers subject to the customer reserve requirements in Rule 15c3-3 by creating a deposit alternative to cash and United States Treasury securities. It would not result in any additional costs to broker-dealers.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

In addition, while we do not believe the proposal would result in costs to broker-dealers, we request comment on whether it would result in costs to other market participants, including broker-dealer customers, and banks. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

4. Allocation of Customers' Fully Paid and Excess Margin Securities to Short Positions

The proposed amendment to Rule 15c3-3 would require broker-dealers to obtain possession or control over fully paid or excess margin securities that allocate to a proprietary or customer short position.

i. Benefits

This proposed amendment would protect broker-dealer customers by requiring broker-dealers to reduce long customer positions to possession and control even if the positions may allocate to a customer or proprietary short position. The possession or control requirement seeks to ensure that customer securities are available to be returned in the event the broker-dealer fails. Therefore, in addition to broker-dealer customers, the proposal would benefit the SIPC fund to the extent it mitigates outlays from the fund to make advances to customers of a failed broker-dealer that cannot return all customer securities.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

ii. Costs

We estimate this proposed requirement would result in a one-time cost to firms that carry customer securities to update systems for complying with the possession and control requirements in Rule 15c3-3. Based on FOCUS Report filings, we estimate that approximately 350 broker-dealers carry customer securities. We further estimate these firms would spend, on average, approximately 40 hours of employee resources per firm updating their systems to implement changes that would be necessitated by our proposed amendment. For the purposes of this cost analysis, we estimate that this work would be undertaken by a Senior Programmer. The SIA Management Report 2005 indicates the average hourly cost of this position is approximately $268. Therefore, we estimate that the average cost per firm to make these changes would be approximately $10,720.[162] For these reasons, we estimate that the total one-time cost to the industry would be approximately $3,752,000.[163]

We believe the annual costs resulting from this amendment would be de minimis. The proposal could result in some broker-dealers borrowing securities to cover proprietary short positions rather than using customer securities. However, currently when broker-dealers use customer securities they are required to put a credit in the Rule 15c3-3 reserve formula equal to

162 $268 per hour x 40 hours = $10,720.

163 350 broker-dealers x $10,720 = $3,752,000.

the value of the securities. This credit item can result in higher reserve deposit requirements, which must be made using the broker-dealer's own capital. Thus, increased costs associated with having to borrow securities to cover a short position likely would be offset by decreased costs associated with devoting capital to customer reserve requirements.

As noted above, we request comment on these cost estimates. In particular, we request comment on whether there would be additional costs to broker-dealers as a consequence of these proposals. We also request comment on whether these proposals would impose costs on other market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

5. Requirement to Obtain Customers' Affirmative Consent

This proposed amendment to Rule 15c3-3 would require a broker-dealer to obtain the affirmative consent of a new customer in order to be able to change the terms under which the customer's free credit balances are treated and provide notice to existing customers prior to changing how their free credit balances are treated. The broker-dealer also would be required to make certain disclosures.

i. Benefits

Free credit balances constitute money that a broker-dealer owes its customers. Customers may maintain these balances at the broker-dealer in anticipation of future stock purchases. Generally, customer account agreements set forth how the broker-dealer will invest these balances. For example, the broker-dealer may sweep them into a money market fund or, alternatively, pay an amount of interest on the funds. This proposed amendment is designed to ensure that customers are provided meaningful notice if a broker-dealer seeks to change the terms under which their free credit balances are invested. This would provide the customers with an opportunity to opt out of the proposed change or re-direct their free credit balances.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

ii. Costs

As discussed above with respect to the PRA, based on staff experience, we estimate that 50 broker-dealers would choose to provide existing and new customers with the disclosures and notices required under the proposed amendment in order to have the flexibility to change how their customers' free credit balances are treated. We further estimate these firms would spend, on average, approximately 200 hours of employee resources per firm updating their systems (including processes for generating customer account statements) to incorporate changes that would be necessitated by our proposed amendment. For the purposes of this cost analysis, we estimate that this work would be undertaken by a Senior Programmer. The SIA Management Report 2005 indicates the average hourly cost of this position is approximately $268. Therefore, we estimate that the average cost per firm to make these changes would be approximately $53,600.[164] For these reasons, we estimate that the total one-time cost to the industry would be approximately $2,680,000.[165]

Also, as discussed above with respect to the PRA, we estimate that these firms would consult with outside counsel in making these systems changes, particularly with respect to the

164 $268 per hour x 200 hours = $53,600.

165 50 broker-dealers x $53,600 = $2,680,000.

language in the disclosures and notices. The Commission estimates that, on average, an outside counsel would spend approximately 50 hours assisting a broker-dealer in updating its systems for a one-time aggregate burden to the industry of 2,500 hours.[166] 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 these reasons, the Commission estimates that the average one-time cost to a broker-dealer for engaging outside counsel would be approximately $20,000[167] and the one-time cost to the industry would be approximately $1,000,000.[168]

As for annual burden, as discussed above with respect to the PRA, we estimate that this requirement would impact approximately 5,465,000 customer accounts in a given year. We further estimate that a broker-dealer would spend, on average, four minutes of employee resources to process an affirmative consent for new customers and a disclosure for existing customers. For the purposes of this cost analysis, we estimate that the responsibility for processing the affirmative consents would be undertaken by a compliance clerk. The SIA Report on Office Salaries in the Securities Industry 2005 ("SIA Report on Office Salaries") indicates that the average hourly cost of this position is $68. Additionally, we estimate the compliance clerk would spend approximately four minutes per consent and notice. Therefore, we estimate that the cost per account to process the affirmative consents and notices would be approximately

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166 50 broker-dealers x 50 hours per firm = 2,500 hours.

167 $400 per hour x 50 hours = $20,000.

168 50 broker-dealers x $20,000 = $1,000,000.

$4.50.[169] Therefore, the total annual cost to the industry would be approximately $24.5 million.[170]

As noted above, we request comment on these proposed cost estimates. In particular, we request comment on whether there would be additional costs to broker-dealers as a consequence of these proposals. We also request comment on whether these proposals would impose costs on other market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

6. Eliminating the 3% Reduction for Aggregate Debit Items

The proposed amendment to paragraph (a)(1)(ii)(A) of Rule 15c3-1 would eliminate the requirement that broker-dealers using the alternative standard reduce their Exhibit A – Item 10 debits by 3% in lieu of the 1% reduction applicable to basic method firms. This would benefit broker-dealers subject to the 3% reduction by potentially reducing the amount of their reserve deposit requirements and, thereby, freeing up capital. Based on FOCUS data, we estimate that broker-dealers in the aggregate currently carry approximately $550 billion in total credits and $380 billion in total debits. Moreover, we further estimate that the amount of credits and debits held by firms that are subject to the 1% reduction is insignificant and, consequently, for purposes of this cost analysis, assume that the $550 billion in credits and $380 billion in debits are held by firms subject to the 3% reduction.

Under the current requirement to reduce total debits by 3%, broker-dealers, in the aggregate, reduce the approximately $380 billion in total debits by $11.4 billion.[171] This

169 4 minutes x $68 per hour = $4.50.

170 5,465,000 consents/notices x $4.50 per consent/notice = $24,592,500.

decreases the amount of debits that can offset total credits from $380 billion to $368.6 billion. Based on our estimates, this potentially increases the industry-wide reserve requirement from approximately $170 billion[172] to $181.4 billion.[173] Under the proposed 1% reduction, broker-dealers, in the aggregate, would reduce the approximately $380 billion in total debits by $3.8 billion.[174] This would decrease the amount of debits that can offset credits from $380 billion to $376.2 billion. Based on our estimates, this would potentially increase the industry-wide reserve requirement from $170 billion[175] to $173.8 billion (as opposed to $181.4 billion).[176] Accordingly, our proposed amendment would result in a decrease in the industry-wide reserve requirement of approximately $7.6 billion, which broker-dealers could re-direct to other business activities.[177]

We do not anticipate any net costs to broker-dealers that would result from the proposed amendment, given that the benefits from the freed-up capital of potentially $7.6 billion would significantly offset any costs arising from making necessary systems changes to implement this proposed change to the customer reserve computation. However, it could result in costs to other market participants. Therefore, we request comment on whether it would result in such costs,

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171 $380 billion x 0.03% = $11.4 billion.

172 $550 billion - $380 billion = $170 billion.

173 $550 billion - $368.6 billion = $181.4 billion.

174 $380 billion x 0.01% = $3.8 billion.

175 $550 billion - $380 billion = $170 billion.

176 $550 billion - $376.2 billion = $173.8 billion

177 $11.4 billion - $3.8 billion = $7.6 billion.

including costs to broker-dealer customers and banks. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

6. Clarification Regarding Funds in Certain Commodity Accounts

The proposed amendment to paragraph (a)(8) of Rule 15c3-3 would clarify that broker-dealers need not treat funds in certain commodities accounts as "free credit balances" for purposes of the customer reserve formula. This would benefit broker-dealers that are registered as futures commission merchants by eliminating any ambiguity with respect to such accounts and avoiding situations where they unnecessarily increase reserve amounts. We do not anticipate the proposed amendment would result in any costs to broker-dealers and, as these funds are not protected under SIPA, would not expose the SIPC fund to increased liabilities.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

In addition, while we do not believe the proposal would result in costs to broker-dealers, we request comment on whether it would result in costs to other market participants, including broker-dealer customers, and banks. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

B. Portfolio Margining

There are two proposed amendments to accommodate SRO rules that permit broker-dealers to determine customer margin requirements using a portfolio-margining methodology. The first amendment would revise the definition of "free credit balances" in paragraph (a)(8) of Rule 15c3-3. The revision would expand the definition to include funds in a portfolio margin account relating to certain futures and futures options positions and the market value of futures options as of the filing date in a SIPA proceeding. The second amendment would add a debit line item to the customer reserve formula in Rule 15c3-3a consisting of margin posted by a broker-dealer to a futures clearing agency.

1. Benefits

The proposed amendments are designed to provide greater protection to customers with portfolio margin accounts. They would require broker-dealers to treat all cash balances in the accounts under the reserve computation provisions of Rule 15c3-3, which are designed to ensure that customer cash is available to be returned to customers in the event the broker-dealer fails. The proposed amendments also are designed to provide the protections of SIPA to these cash balances and to futures options in the accounts.

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.

2. Costs

The requirements imposed by the proposed amendments would be elective. They only would apply to broker-dealers choosing to offer their customers portfolio margin accounts with a cross-margin feature (i.e., the ability to hold futures and futures options in the account). We estimate that approximately thirty-three broker-dealers would elect to offer their customers portfolio margin accounts that would include futures and futures options.[178]

The proposed amendment to the definition of "free credit balances" in Rule 15c3-3 would require broker-dealers to include in the customer reserve formula credit balances related to

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178 This estimate is based on data from FOCUS Report filings.

futures positions in a portfolio margin account. The proposed amendment to add a line item to the debits in the customer reserve formula of Rule 15c3-3a would require broker-dealers to include the amount of customer margin required and on deposit at a futures clearing organization as a "debit" in the reserve formula. Accordingly, these proposed amendments would require changes to the systems broker-dealers use to compute and account for their customer reserve requirements. We assume that the responsibility for updating these systems will be undertaken by a Senior Programmer. The SIA Management Report 2005 indicates the average hourly cost of this position is approximately \$268. We estimate the senior programmer would spend approximately 130 hours to modify software to conform it to the requirements of the proposed amendments. Therefore, we estimate that the program and systems changes would result, on average, in a one-time cost of approximately \$34,840 on per broker-dealer.[179] For these reasons, we estimate the total one-time cost to the industry would be approximately \$1,149,720.[180]

As noted above, we request comment on these proposed cost estimates. In particular, we request comment on additional costs to broker-dealers that would arise from these proposals, such as system costs in addition to those discussed above (e.g., costs associated with purchasing new software and updates to existing software). We also request comment on whether these proposals would impose costs on other market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

C. Amendments With Respect to Securities Borrowed and Loaned and Repo Activities

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179 130 hours x \$268 = \$34,840.

180 33 broker-dealers x \$34,840 = \$1,149,720.

We are proposing amendments to strengthen the financial responsibility of broker-dealers engaging in a securities lending business. The proposed amendments would require broker-dealers to (1) disclose the principals and obtain certain agreements from the principals in a transaction where they provide settlement services in order to be considered an agent (as opposed to a principal) for the purposes of the net capital rule, and (2) provide notice to the Commission and other regulatory authorities if the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity reaches a certain threshold or, alternatively, provide regulatory authorities with a monthly report of the broker-dealer's securities borrowed and loan or securities repurchase/reverse repurchase activity.

1. Benefits

The proposed amendments are intended to strengthen the financial responsibility of broker-dealers engaged in a securities lending or repo business and to assist securities regulators in monitoring such activities. This would assist securities regulators in responding to situations where a broker-dealer was in financial difficulty due to a large securities lending or repo position. This would help prevent significant losses to the firm's customers and other broker-dealers, and reduce financial system risk.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

2. Costs

i. Requirements to Avoid Principal Liability

As discussed with respect to the PRA, we understand that most existing standard securities lending master agreements in use today already contain language requiring agent lenders to disclose principals and for principals to agree not to hold the agents liable for a counterparty default. Thus, the standard agreement used by the vast majority of broker-dealers should contain the representations and disclosures required by the proposed amendment. However, a small percentage of broker-dealers may need to modify their standard agreements. As discussed with respect to the PRA, we estimate that approximately nine broker-dealers would need to amend their securities lending agreements to include the required provision and that they would each spend, on average, approximately 20 hours in making the changes. We estimate that the responsibility for changing the language in the securities lending master agreement template would be undertaken collectively by an associate general counsel and attorney. The SIA Management Report 2005 indicates that the average hourly cost of these positions respectively is $431 for the associate general counsel and $327 for the attorney. We estimate that, on average, the attorney would spend 16 hours changing the template and the associate general counsel would spend four hours overseeing the project. Therefore, we estimate that the one-time cost to make these changes would be, on average, $6,956 per firm.[181] For these reasons, we estimate the total one-time cost to the industry would be approximately $62,604.[182]

As noted above, we request comment on these proposed cost estimates. In particular, we request comment on additional costs to broker-dealers that would arise from these proposals, such as costs arising from making systems changes. We also request comment on whether these proposals would impose costs on other market participants, including broker-dealer customers.

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181 ([16 hours] x [$327 per hour]) + ([4 hours] x [$431 per hour]) = $6,956.

182 9 broker-dealers x $6,956 = $62,604.

Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

ii. Notices or Monthly Reports

The proposed amendment to Rule 17a-11 would require broker-dealers engaged in securities lending or repurchase activities to either: (1) file a notice with the Commission and their designated examining authority whenever the total money payable against all securities loaned, subject to a reverse repurchase agreement or the contract value of all securities borrowed or subject to a repurchase agreement exceeds 2500% of tentative net capital; or, alternatively, (2) file a monthly report on their securities lending and repurchase activities with their designated examining authority.

As discussed with respect to the PRA, based on FOCUS Report filings, we estimate that approximately twelve notices per year would be sent pursuant to this proposed amendment. We further estimate that a broker-dealer would spend, on average, approximately ten minutes of employee resources to prepare and send the notice. Therefore, we estimate that the costs to the industry associated with this requirement would be de minimis.

As for the monthly reports, we estimated with respect to the PRA that approximately 21 broker-dealers would choose the option under the proposed rule of filing the reports.
We also estimated with respect to the PRA that each firm would spend, on average, approximately 100 hours of employee resources updating its systems to generate the report. For the purposes of this cost analysis, we assume that the responsibility for updating these systems would be undertaken by a Senior Programmer. The SIA Management Report 2005 indicates the average hourly cost of this position is approximately $268. Therefore, we estimate that the systems changes would result, on average, in a one-time cost of approximately $26,800 per

broker-dealer.[183] For these reasons, we estimate the total one-time cost to the industry would be approximately $562,800.[184]

As for the annual costs of generating and filing the monthly report, we estimated with respect to the PRA that a broker-dealer would spend, on average, approximately one hour per month (or twelve hours per year) of employee resources to generate and send the report. We assume the responsibility for generating and filing the monthly report would be undertaken by a junior stock loan manager. The SIA Management Report 2005 indicates the average hourly cost for this position is $208. We further estimate that a junior stock loan manager would spend, on average, approximately one hour per month compiling and filing this report for an average monthly cost of $208. Therefore, we estimate the cost to file the reports would be approximately $2,496 per firm.[185] For these reasons, we estimate the total annual cost to the industry would be approximately $52,416.[186]

As noted above, we request comment on these proposed cost estimates. In particular, we request comment on additional costs to broker-dealers that would arise from these proposals. We also request comment on whether these proposals would impose costs on other market participants, including persons active the securities lending and repo markets. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

D. Documentation of Risk Management Procedures

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183 100 hours x $268 = $26,800.

184 21 broker-dealers x $26,800 = $562,800.

185 ([1 hour] x [$208 per hour]) x 12 months = $2,496.

186 21 broker-dealers x $2,496 = $52,416.

We are proposing amendments to the broker-dealer books and records rules that would require certain large broker-dealers to document in writing the procedures and guidelines they use for managing risk. The proposed amendments do not require broker-dealers to implement procedures. Rather, they require the documentation of procedures that have been established by the broker-dealer.

1. Benefits

These proposed amendments would require large broker-dealers to document the controls they have implemented to address the risks they face as a result of their business activities. This would benefit the firms by mitigating the risk of financial loss or collapse and their customers by mitigating the risk of losses associated with a firm's failure or an employee's improper activities. Moreover, by strengthening the internal processes of the broker-dealers, these proposed amendments would benefit market participants and reduce systemic financial risk. In addition, by making the documented controls a required record, securities regulators would have better access to them. This would assist regulators in monitoring the risks faced by broker-dealers and understanding the controls they implement to address the risks.

We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

2. Costs

These proposed amendments would apply to a limited number of broker-dealers, namely, those firms with more than $1 million in customer credits or $20 million in capital. Thie proposed requirement would result in a one-time cost to some of these firms to the extent they had established procedures that had not been documented. We believe, generally, that most of these firms have documented their established risk management controls and procedures. For these reasons, we estimated with respect to the PRA that the one-time hourly burden to meet the requirements of these proposed rules would range from 0 hours for some firms and to hundreds of hours for other firms. Taking this into account, we estimated with respect to the PRA that a broker-dealer would spend, on average, approximately 120 hours of employee resources augmenting its documented procedures to come into compliance with this proposed amendment.

For the purposes of this cost analysis, we estimate that the responsibility for documenting the risk management procedures and controls a broker-dealer has established would be coordinated by an attorney working with operations specialists from the various risk management departments in the firm. We further estimate that the project would be overseen by an associate general counsel. The SIA Management Report 2005 indicates the average hourly costs of these positions respectively are approximately $431 for an associate general counsel, $327 for an attorney and $144 for an operations specialist. We estimate that the attorney would spend 40 hours compiling and documenting the procedures, the operations specialists collectively would spend 70 hours working with the attorney, and the associate general counsel would spend ten hours overseeing the project. Therefore, we estimate that the average one-time cost per firm to comply with these proposed amendments would be $27,470.[187] We estimated with respect to the PRA that these amendments would apply to approximately 517 broker-dealers. For these reasons, we estimate that the total one-time cost to the industry would be approximately $14,201,990.[188]

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[187] ([40 hours] x [$327 per hour]) + ([70 hours] x [$144 per hour]) + ([10 hours] x [$431 per hour]) = $27,470.

[188] 517 broker-dealers x $27,470 = $14,201,990.

As noted above, we request comment on these proposed cost estimates. In particular, we request comment on additional costs to broker-dealers that would arise from these proposals, such as costs arising from making changes to systems and costs associated with maintaining these records. We also request comment on whether these proposals would impose costs on other market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

E. Amendments to the Net Capital Rule

1. Requirement to Add Back Certain Liabilities to Net Worth and Treat Certain Capital Contributions as Liabilities

These proposed amendments to Rule 15c3-1 would require a broker-dealer to add back to net worth, when calculating net capital, liabilities assumed by a third-party if the third-party did not have the financial wherewithal to pay the liabilities. The proposed amendments also would require a broker-dealer to treat as liabilities capital contributions where the investor has the option to withdraw the capital at any time.

i. Benefits

These proposed amendments to Rule 15c3-1 would assist investors and regulators by requiring broker-dealers to provide a more accurate picture of their financial condition. This would permit regulators to react more quickly if a firm experiences financial difficulty. This would benefit customers of a troubled broker-dealer as well as its counterparties and, accordingly, reduce systemic risk in the securities markets. We request comment on available metrics to quantify these benefits and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

ii. Costs

These proposed amendments would apply to all broker-dealers. However, the requirements only would impact a few broker-dealers, namely those that have sought to shift their liabilities to a third-party that lacks the resources – independent of the broker-dealer – to assume the liabilities or those that provide investors with options to withdraw capital. We believe the vast majority of broker-dealers either do not seek to transfer responsibility for their liabilities to a third-party or, if they do so, rely on a third-party that has the financial resources – independent of the assets and revenue of the broker-dealer – to pay the obligations as they become due. We also believe that most broker-dealers do not accept capital contributions under agreements permitting the investor to withdraw the capital at any time.

FOCUS Report filings indicate that approximately 702 broker-dealers report having no liabilities. For the purposes of this analysis, we conservatively estimate that the proposed amendment would impact all of these firms. Requiring these broker-dealers to book liabilities would decrease the amount of equity capital held by the firms and in some cases may require them to obtain additional capital. The majority of broker-dealers reporting no liabilities are introducing broker-dealers that have a $5,000 minimum net capital requirement. The reported average for total aggregate liabilities of introducing broker-dealers is $280,354 per firm. Therefore, conservatively estimating that the 702 broker-dealers would have to each raise $280,354 in additional capital as result of the proposed requirement, the total aggregate amount of additional capital that would need to be raised would be $196,808,508.[189] We further estimate

[189] 702 broker-dealers x $280,354 = $196,808,508.

that the cost of capital is approximately 5%.[190] Therefore, we estimate that the total annual cost to the industry would be approximately $10 million.[191]

We estimate that amendments requiring broker-dealers to treat certain capital contributions as liabilities should not result in significant additional costs. Generally, broker-dealers do not enter into agreements permitting an owner to withdraw capital at any time. To the extent some firms may have engaged in this practice, they could have to pay more for capital. Conservatively, we estimate that no more than $100 million in capital at broker-dealers is subject to such agreements. Assuming an incremental cost of capital of 2.5%, we estimate that the proposed amendment would result in an annual cost of approximately $2.5 million.[192]

As noted above, we request comment on these proposed cost estimates. In particular, we request comment on additional costs to broker-dealers that would arise from these proposals. We also request comment on whether these proposals would impose costs on other market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

2. Account for Excess Fidelity Bond Deductibles

This proposed amendment would require broker-dealers to deduct from net capital, with regard to fidelity bonding requirements prescribed by a broker-dealer's examining authority, the excess of any deductible amount over the maximum amount permitted by self-regulatory organization rules.

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190 We estimate this generally would be the cost to a broker-dealer to obtain a subordinated loan that meets requirements of Rules 15c3-1 and 15c3-1d (17 CFR 240.15c3-1d).

191 $196,809,000 x 5% = $9,840,300.

192 $100,000,000 x 2.5% = $2,500,000.

i. **Benefits**

Self-regulatory organization rules relating to fidelity bonding requirements provide safeguards with respect to the financial responsibility and related practices of broker-dealers. This proposed amendment would clarify that broker-dealers subject to capital charges under self-regulatory organization rules for excess fidelity bond deductibles also should include such deductions when determining net capital for purposes of Rule 15c3-1.[193] This would help in ensuring that broker-dealers do not exceed regulatory limitations for fidelity bond deductibles.

ii. **Costs**

This proposed amendment would codify in a Commission rule capital charges that broker-dealers are currently required to take pursuant to the rules of various self-regulatory organizations. The proposed amendment would not impose additional costs on broker-dealers with respect to the purchasing or carrying of fidelity bond coverage. Nor would the proposed amendment cause broker-dealers to incur additional costs in determining or reporting excess deductible amounts over the maximum amount permitted. Broker-dealers already make such determinations under self-regulatory organization rules, and the manner in which such excesses are typically reported (i.e., through periodic FOCUS and other reports) would remain the same. For these reasons, we believe any costs arising from this proposed amendment would be de minimis.

As noted above, we request comment on this cost estimate. In particular, we request comment on whether there would be any costs to broker-dealers as a consequence of this proposal. We also request comment on whether this proposal would impose costs on other

193 17 CFR 240.15c3-1.

market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

3. Broker-Dealer Solvency Requirement

This proposed amendment to Rule 15c3-1 would require broker-dealers to cease doing a securities business if they become subject to certain insolvency events. The companion amendment to Rule 17a-11 would require such broker-dealers to provide notice of their insolvency to regulatory authorities.

i. Benefits

The proposed amendment to Rule 15c3-1 would benefit the securities markets by removing risks associated with having a financially unstable firm continue to operate. For example, the broker-dealer would not be able to take on new customers and place their assets at risk of being lost in its financial collapse or frozen in a liquidation proceeding. Furthermore, the broker-dealer would not be able to enter into proprietary transactions with other broker-dealers and place them or clearing agencies at risk of counterparty default. The broker-dealer's existing customers also would benefit in that ceasing a securities business would assist in preserving any remaining capital of the firm, which could be used to facilitate on orderly liquidation.

The proposed amendment to Rule 17a-11 also would benefit the securities markets in that it would provide regulators with the opportunity to take steps to protect customers and counterparties at the onset of the insolvency. These steps could include facilitating the transfer of customer accounts to a solvent broker-dealer and monitoring the liquidation of proprietary positions.

ii. Costs

For the most part, the proposed amendments would have no impact on existing broker-dealers. Should a broker-dealer become subject to an insolvency proceeding, it would incur the cost of sending notice of that fact to the Commission and its designated examining authority. We believe this would be a rare occurrence and, accordingly, with respect to the PRA estimated it would happen approximately six times a year. For these reasons, we estimate that any costs arising from this proposed amendment would be de minimis.

As noted above, we request comment on this cost estimate. In particular, we request comment on whether there would be costs to broker-dealers as a consequence of this proposal. We also request comment on whether this proposal would impose costs on other market participants, including broker-dealer customers. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

4. Order Restricting Withdrawal of Capital From a Broker or Dealer Amendment

This proposed amendment to Rule 15c3-1(e) would eliminate the qualification on Commission orders restricting withdrawals, advances and unsecured loans made by broker-dealers that limits the order to instances when recent withdrawals, advances or loans, in the aggregate, exceed thirty percent of the broker-dealer's excess net capital.

i. Benefits

The proposed amendment to Rule 15c3-1 would benefit the securities markets by protecting customers and counterparties of a financially stressed broker-dealer. For example, the broker-dealer would not be able to make an unsecured loan to a stockholder or withdraw equity capital while the order was outstanding, thereby preserving the assets and liquidity of the broker-dealer and enabling the Commission and its staff to examine the broker-dealer's financial condition, net capital position and the risk exposure to the customers and creditors of the broker-dealer to ensure the financial integrity of the firm.

ii. Costs

The current rule permitting the Commission to restrict withdrawals of capital from a financially distressed broker-dealer was adopted in 1991.[194] Based on this experience with the rule, we estimate that the proposed amendment would result in no or de minimis costs to broker-dealers.

As noted above, we request comment on this cost estimate. In particular, we request comment on whether there would be costs to broker-dealers as a consequence of this proposal. We also request comment on whether this proposal would impose costs on other market participants. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

5. Adjusted Net Capital Requirements

These proposed amendments would adjust required charges for broker-dealers under Rule 15c3-1. The adjustments would better align the net capital requirements of affected firms with the risks Rule 15c3-1 seeks to mitigate. The amendments are relaxing existing requirements and, therefore, would not result in costs to broker-dealers. Moreover, because they seek to better match capital requirements with actual risk, they should not have an adverse impact on the financial strength of broker-dealers.

i. Calculating Theoretical Pricing Charges

The proposed amendment to paragraph (b)(1)(vi) of Rule 15c3-1a would make permanent the reduced net capital requirements that apply to listed option positions in major

194 See Exchange Act Release No. 28927 (February 28, 1991), 56 FR 9124 (March 5, 1991).

market foreign currencies and high-capitalization and non-high-capitalization diversified indexes in non-clearing option specialist and market maker accounts. This would benefit the broker-dealers that have been calculating charges under the temporary relief granted by the Commission staff. Because broker-dealers are already operating under the temporary relief, we believe the amendment would not result in any costs.

We request comment on available metrics to quantify the benefits identified above and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

In addition, we request comment on whether the proposal would result in costs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

ii. Reduced Haircut on Money Market Funds

Reducing the money market funds haircut from 2% to 1% would benefit all broker-dealers in that it will make it less costly, in terms of capital allocation, to hold these investments. We do not believe the proposed amendment would result in any costs.

We request comment on available metrics to quantify the benefits identified above and any other benefits the commenter may identify. Commenters are requested to identify sources of empirical data that could be used for the metrics they propose.

In addition, we request comment on whether the proposal would result in costs. Commenters should identify the metrics and sources of any empirical data that support their costs estimates.

F. Total Estimates Costs

Given the estimates set forth above, the total one-time estimated cost to the industry resulting from these rule proposals would be approximately $32,814,454[195] and the total estimated annual cost to the industry resulting from these rule proposals would be approximately $39,651,716.[196]

VI. CONSIDERATION OF BURDEN ON COMPETITION, AND PROMOTION OF EFFICIENCY, COMPETITION, AND CAPITAL FORMATION

Section 3(f) of the Exchange Act requires the Commission, whenever it engages in rulemaking and must consider or determine if an action is necessary or appropriate in the public interest, to consider if the action will promote efficiency, competition, and capital formation.[197] In addition, Section 23(a)(2) of the Exchange Act requires the Commission, when adopting rules under the Exchange Act, to consider the impact that any such rule would have on competition.[198] 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 proposed amendments are intended to promote efficiency, competition, and capital formation. They should not have any anti-competitive effects.

The Commission requests comment on whether the proposed amendments are likely to promote efficiency, competition, and capital formation.

A. Amendments to the Customer Protection Rule

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195 $8,773,410 + $603,000 + $28,930 + 3,752,000 + 2,680,000 + 1,000,000 + $1,149,720 + $62,604 + 562,800 + $14,201,990 = 32,814,454.

196 $2,599,300 + $24,500,000 + $52,416 + $10,000,000 + $2,500,000 = $39,651,716.

197 15 U.S.C. 78c(f).

198 15 U.S.C. 78w(a)(2).

The proposed amendments to the customer protection rule respecting PAB accounts,[199] cash deposits at special reserve bank accounts,[200] allocation of short positions,[201] and the treatment of free credit balances[202] are designed to protect and preserve customer property held at broker-dealers. These protections would reduce the risks to individual investors and, thereby, promote participation in the securities markets. Also, by strengthening requirements designed to protect customer property, they would mitigate potential exposure of the fund administered by the Securities Investor Protection Corporation ("SIPC") that is used to make advances to customers whose securities or cash are unable to be returned by a failed broker-dealer. The amendments reducing the debit reduction for alternative standard firms from 3% to 1% and clarifying that funds in certain commodities accounts need not be treated as "free credit balances" would free up capital and, in the latter case, clarify an ambiguity in Rule 15c3-3.[203] These results would promote capital formation and increase efficiency. The amendment expanding the definition of qualified securities would reduce operational burdens associated with holding securities in the customer reserve account and, thereby, promote efficiency.[204]

B. Portfolio Margining Amendments

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199 See section II.A.1 of this release.

200 See section II.A.2 of this release.

201 See section II.A.4 of this release.

202 See section II.A.5.i of this release.

203 See sections II.A.6 and II.A.7 of this release.

204 See section II.A.3 of this release.

The proposed amendments to accommodate portfolio margining[205] would promote greater efficiency, competition and capital formation. They are designed to provide portfolio margin customers with greater protection through the reserve requirements of Rule 15c3-3 and SIPA. This, in turn, would make portfolio margining more attractive to investors. Portfolio margining can significantly reduce customer margin requirements for offsetting positions involving securities and futures products, which in turn reduces the costs of trading such products. Moreover, portfolio margining promotes competition and better price discovery across securities and futures products by allowing customers to offset a position assumed in one market with a product traded on another market.

C. Securities Lending and Borrowing Amendments

The proposed amendment requiring broker-dealers to disclaim principal liability in securities lending transactions to avoid certain capital charges under Rule 15c3-1[206] is consistent with the goal of promoting efficiency and competition in the marketplace. This proposed amendment would help eliminate the legal uncertainty among counterparties as to the role played by market participants in such transactions and clarify the nature of the services that securities lending intermediaries provide their counterparties. The proposed amendment to Rule 17a-11[207] to require a broker-dealer to provide notice if its securities lending or repo transactions reach a certain threshold, or alternatively provide its DEA with a monthly report, is designed to enhance the monitoring of these activities by securities regulators and, thereby, protect broker-dealer

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205 See section II.B of this release.

206 See section II.C of this release.

207 Id.

customers and counterparties from the impact of a financial collapse. This would strengthen the securities markets and make them more attractive to investors.

D. Documentation of Risk Management Procedures

The proposed amendments to Rules 17a-3 and 17a-4[208] requiring firms to document their risk management controls and procedures are designed to reduce the risks inherent to the business of operating as a broker-dealer and, thereby, enhance a broker-dealer's financial soundness. This would strengthen the securities markets making them more attractive to investors.

E. Amendments to the Net Capital Rule

The proposed amendments to Rule 15c3-1 (1) requiring a broker-dealer to account for certain liabilities or treat certain capital contributions as liabilities,[209] (2) requiring a broker-dealer to account for certain excess fidelity bond deductibles,[210] (3) requiring an insolvent broker-dealer to cease conducting a securities business and provide notice under the proposed amendment to Rule 17a-11,[211] (4) eliminating the qualification on Commission orders restricting withdrawals, advances, and unsecured loans to instances where recent withdrawals, advances or loans, in the aggregate, exceed thirty percent of the broker-dealer's excess net capital,[212] (5)

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208 See section II.D of this release.

209 See section II.E.1 of this release.

210 See section II.E.2 of this release.

211 See section II.E.3 of this release.

212 See section II.E.4 of this release.

making permanent the reduced net capital requirements under Appendix A for market makers,[213] and (6) lowering the haircut for money market funds,[214] are consistent with promoting efficiency and competition in the market place.

A broker-dealer that fails to account for liabilities that depend on the broker-dealer's assets and revenues and accepts temporary capital is obscuring its true financial condition. This interferes with the process by which regulators monitor the financial condition of broker-dealers and, thereby, impedes their ability to take proactive steps to minimize the harm to customers, counterparties and clearing agencies resulting from a broker-dealer failure.

Requiring broker-dealers to take net capital charges for excess fidelity bond deductibles imposed under self-regulatory organization rules would promote efficiency by providing certainty as to the applicability of such rules for purposes of Rule 15c3-1. Because fidelity bond requirements provide a safeguard with regard to broker-dealer financial responsibility, the proposed amendment would enhance competition through the operation of more financially sound firms.

The continued operation of an insolvent broker-dealer or the withdrawal of capital from a broker-dealer that may jeopardize such broker-dealer's financial integrity poses financial risk to its customers, counterparties and the securities industry clearance organizations. These risks increase costs.

The elimination of the limitation on Commission orders restricting capital withdrawals from a financially troubled broker-dealer would provide greater protection to customers and counterparties of the firm and securities industry clearance organizations. While such orders

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213 See section II.E.5.i of this release.

214 See section II.E.5.ii of this release.

would be infrequent, when issued they would lower costs to these entities associated with having an outstanding obligation from the troubled broker-dealer.

The proposed amendments to the net capital rule that would reduce the amount of net capital certain broker-dealers must maintain would improve efficiency and competition and promote capital formation by allowing firms to employ such capital in other areas of their business activities. They also would lower the costs of capital for broker-dealers.

VII. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[215] we must advise the OMB as to whether the proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in (1) an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease), (2) a major increase in costs or prices for consumers or individual industries, or (3) significant adverse effect on competition, investment or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. We request comment on the potential impact of each of the proposed amendments 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,[216] regarding the

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215 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).

216 5 U.S.C. 603.

proposed amendments to Rules 15c3-1, 15c3-1a, 15c3-2, 15c3-3, 15c3-3a, 17a-3, 17a-4, and 17a-11 under the Exchange Act.

We encourage 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 amendments. Comments should specify the costs of compliance with the proposed amendments, and suggest alternatives that would accomplish the goals of the amendments. 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 amendments. Comments should be submitted to the Commission at the addresses previously indicated.

A. Amendments to the Customer Protection Rule

1. Reasons

The proposed amendment that would require broker-dealers to perform a reserve computation for domestic and foreign broker-dealer accounts is responding to a disparity between Rule 15c3-3 and the SIPA. The proposed amendment that would require broker-dealers to limit the amount of cash deposited in a reserve account at any individual bank and exclude cash deposited with a parent or subsidiary bank is responding to the fact that some firms are concentrating such deposits or placing them at risk of group-wide financial collapses. The proposed amendment that would expand the definition of qualified securities is intended to provide broker-dealers with another option with respect to assets that can be deposited into the customer reserve account. The proposed amendment that would require broker-dealers to obtain possession and control of customers' fully paid and excess margin securities allocated to a short position is responding to the fact that some firms are permitting these positions to accumulate, which puts customers at risk. The proposed amendment that would require broker-dealers to provide certain notices and disclosures before changing the terms and conditions under which the broker-dealer treats customer free credit balances is intended to help assure that the use of customer free credit balances accords with customer preferences. The proposed amendment lowering the aggregate debit item reduction from 3% to 1% is responding to the dramatic increase in debit items accumulating at broker-dealers. The proposed amendment clarifying that funds in certain commodities accounts are not to be treated as "free credit balances" is intended to remove uncertainty with respect to their treatment.

2. Objectives

Most of the proposed amendments to Rule 15c3-3 are intended to strengthen the protections afforded to customer assets held at a broker-dealer. The intended result of the proposed amendments is to minimize the risk that customer assets will be lost, tied-up in a liquidation proceeding, or held in a manner that is inconsistent with a customer's expectations. The proposed amendment expanding the definition of qualified security is intended to lower operational burdens of broker-dealers. The proposed amendment eliminating the 3% reduction is intended to better align the requirement to reduce debits with the credit risk being addressed by the requirement. The proposed amendment clarifying the treatment of funds in certain commodities accounts is intended to remove an ambiguity in the rule.

3. Legal Basis

Pursuant to the Exchange Act and, particularly, Section 15, 15 U.S.C. 78o.

4. Small Entities Subject to the Rule

Paragraph (c)(1) of Rule 0-10[217] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d);[218] and is not affiliated with any person (other than a natural person) that is not a small business or small organization.

The Commission estimates there are approximately eight broker-dealers that performed a customer reserve computation pursuant to Rule 15c3-3 and were "small" for the purposes Rule 0-10.[219]

5. Reporting, Recordkeeping, and other Compliance Requirements

The proposed amendments would (1) require broker-dealers to perform a reserve computation for domestic and foreign broker-dealer accounts, (2) limit the amount that a broker-dealer may deposit in a reserve account at any individual bank in the form of cash, (3) require broker-dealers to obtain possession and control of customers' fully paid and excess margin securities allocated to a short position by borrowing equivalent securities within a specified period of time, (4) require broker-dealers to obtain an affirmative consent from a customer before changing the terms and conditions under which the broker-dealer holds credit balances related to the customer, and (5) lower the aggregate debit reduction.

6. Duplicative, Overlapping or Conflicting Federal Rules

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217 17 CFR 240.0-10(c)(1).

218 17 CFR 240.17a-5(d).

219 This estimate is based on FOCUS Report filings.

We believe that there are no federal rules that duplicate, overlap or conflict with the proposed amendments.

7. Significant Alternatives

Pursuant to section 3(a) of the RFA,[220] 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 thereof, for small entities.

Given the negligible impact these amendments would have on small entities, we do 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 thereof. 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 amendments as the amendments already propose performance standards and do not dictate for entities of any size any particular design standards (e.g., technology) that must be employed to achieve the objectives of the proposed amendments.

8. Request for Comments

We encourage the submission of comments to any aspect of this portion of the IRFA. Comments should specify costs of compliance with the proposed amendment and suggest alternatives that would accomplish the objective of the proposed amendments.

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220 5 U.S.C. 603(c).

B. Portfolio Margining Amendments

1. Reasons

The CBOE and the NYSE rules permit broker-dealers to determine customer margin requirements using a portfolio margin methodology and permit cross-margining; namely, the inclusion in the portfolio margin account of futures and futures options on broad-based securities indices. These proposed amendments are designed to provide portfolio margin customers with protection for futures positions carried in their securities accounts.

2. Objectives

These proposed amendments are designed to provide customers with futures and futures options in a portfolio margin account with SIPA protections.

3. Legal Basis

Pursuant to the Exchange Act and, particularly, section 15.[221]

4. Small Entities Subject to the Rule

Paragraph (c)(1) of Rule 0-10[222] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d);[223] and is not affiliated with any person (other than a natural person) that is not a small business or small organization.

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221 15 U.S.C. 78o

222 17 CFR 240.0-10(c)(1).

223 17 CFR 240.17a-5(d).

The Commission estimates there are approximately eight broker-dealers that performed a customer reserve computation pursuant to Rule 15c3-3 and were "small" for the purposes of Rule 0-10.[224]

5. Reporting, Recordkeeping, and other Compliance Requirements

These proposed amendments would (1) revise the definition of "free credit balances" in Rule 15c3-3 to include funds in a portfolio margin account relating to certain futures and futures options positions and the market value of futures options as of the filing date in a SIPA proceeding, and (2) add a debit line item to the customer reserve formula in Rule 15c3-3a consisting of margin posted by a broker-dealer to a futures clearing agency.

6. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no federal rules that duplicate, overlap or conflict with the proposed amendments.

7. Significant Alternatives

Pursuant to Section 3(a) of the RFA,[225] 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 thereof, for small entities.

Given the negligible impact this amendment would have on small entities, we do not believe it is necessary or appropriate to establish different compliance or reporting requirements

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224 This estimate is based on FOCUS Report filings.

225 5 U.S.C. 603(c).

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 thereof.

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 amendments as the amendments already propose performance standards and do not dictate for entities of any size any particular design standards (e.g., technology) that must be employed to achieve the objectives of the proposed amendments.

8. Request for Comments

We encourage the submission of comments to any aspect of this portion of the IRFA. Comments should specify costs of compliance with the proposed amendment and suggest alternatives that would accomplish the objective of the proposed amendments.

C. Securities Lending, Borrowing, and Repurchase/Reverse Repurchase Amendments

1. Reasons

In 2001, MJK Clearing, a broker-dealer with a substantial number of customer accounts, failed when it could not meet its securities lending obligations. This failure has highlighted the risks associated with securities lending and the economically similar repurchase and reverse repurchase agreements and the need to manage those risks.

2. Objectives

These proposed amendments are intended to strengthen the documentation controls broker-dealers employ to manage their securities lending and borrowing and securities repurchase and reverse repurchase activities and to enhance regulatory monitoring. The intended result of the amendments is to minimize the risk that a firm would fail as a result of inadequate controls over its securities lending and borrowing securities repurchase and reverse repurchase activities.

3. Legal Basis

Pursuant to the Exchange Act and, particularly, Sections 15 and 17 thereof, 15 U.S.C. 78o and 78q.

4. Small Entities Subject to the Rule

Paragraph (c)(1) of Rule 0-10[226] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d);[227] and is not affiliated with any person (other than a natural person) that is not a small business or small organization.

The Commission estimates that none of the broker-dealers that engage in securities lending and borrowing or securities repurchase and reverse repurchase activity are "small" for the purposes Rule 0-10.[228] Therefore, the proposed amendments should not impact on "small" broker-dealers.

5. Reporting, Recordkeeping, and Other Compliance Requirements

These proposed amendments would require broker-dealers to (1) disclose the principals and obtain certain agreements from the principals in a transaction where they provide settlement

226 17 CFR 240.0-10(c)(1).

227 17 CFR 240.17a-5(d).

228 This estimate is based on FOCUS Report filings.

services in order to be considered an agent (as opposed to a principal) for the purposes of the net capital rule, and (2) provide notice to the Commission and other regulatory authorities if the broker-dealer's securities lending or repo activity reaches a certain threshold or, alternatively, provide regulatory authorities with a monthly report of the broker-dealer's securities lending and repo activity.

6. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no federal rules that duplicate, overlap or conflict with the proposed amendments.

7. Significant Alternatives

Pursuant to Section 3(a) of the RFA,[229] 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 thereof, for small entities.

As noted above, we estimate that this proposed amendment would have no impact on small entities. Thus, we do 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; use performance rather than design standards, or any part thereof.

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

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[229] 5 U.S.C. 603(c).

proposed amendments as the amendments already propose performance standards and do not dictate for entities of any size any particular design standards (e.g., technology) that must be employed to achieve the objectives of the proposed amendments.

8. Request for Comments

We encourage the submission of comments to any aspect of this portion of the IRFA. Comments should specify costs of compliance with the proposed amendment and suggest alternatives that would accomplish the objective of the proposed amendments.

D. Documentation of Risk Management Procedures

1. Reasons

Requiring certain large broker-dealers to document their risk management procedures would assist firms in ensuring adherence to their established risk controls and regulators in reviewing the controls.

2. Objectives

These proposed amendments are intended to strengthen the controls certain large broker-dealers employ to manage risk. The intended result of these proposed amendments is to lower systemic risk in the securities industry by enhancing risk management.

3. Legal Basis

Pursuant to the Exchange Act and, particularly, Sections 15 and 17 thereof, 15 U.S.C. 78o and 78q.

4. Small Entities Subject to the Rule

Paragraph (c)(1) of Rule 0-10[230] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d);[231] and is not affiliated with any person (other than a natural person) that is not a small business or small organization.

The Commission estimates that none of the broker-dealers that would be subject to this proposed amendment would be "small" for the purposes Rule 0-10.[232] Therefore, these amendments should not have any impact on "small" broker-dealers.

5. Reporting, Recordkeeping, and Other Compliance Requirements

These proposed amendments would require broker-dealers to document any controls, procedures and guidelines they use for managing risk. The proposed amendments do not require broker-dealers to implement procedures. Rather, they require the documentation of any procedures that are being used.

6. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no federal rules that duplicate, overlap or conflict with the proposed amendments.

7. Significant Alternatives

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230 17 CFR 240.0-10(c)(1).

231 17 CFR 240.17a-5(d).

232 This estimate is based on FOCUS Report filings.

Pursuant to section 3(a) of the RFA,[233] 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 thereof, for small entities.

As noted above, these proposed amendments would have no impact on "small" broker-dealers. Thus, we do 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 thereof.

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 amendments as the amendments already propose performance standards and do not dictate for entities of any size any particular design standards (e.g., technology) that must be employed to achieve the objectives of the proposed amendments.

8. Request for Comments

We encourage the submission of comments to any aspect of this portion of the IRFA. Comments should specify costs of compliance with the proposed amendment and suggest alternatives that would accomplish the objective of the proposed amendments.

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[233] 5 U.S.C. 603(c).

E. Amendments to the Net Capital Rule

1. Limitations on Withdrawal of Capital, Solvency, Expense Sharing, Temporary Capital and Fidelity Bond Deductions

i. Reasons

Some broker-dealers have excluded from their regulatory financial reports certain liabilities that have been shifted to third-parties that lack the resources – independent of the assets and revenue of the broker-dealer – to pay the liabilities or have utilized infusions of temporary capital. These practices obscure the true financial condition of the broker-dealer and, thereby, impede the ability of regulators to take proactive steps to reduce the harm to customers, counterparties and clearing agencies that may result from the broker-dealer's failure.

Currently, broker-dealers are required to take net capital charges pursuant to self-regulatory organization rules relating to fidelity bond deductions, but Rule 15c3-1 does not explicitly incorporate such charges for purposes of computing net capital.

In the past several years, a number of broker-dealers have sought to obtain protection under the bankruptcy laws while still engaging in a securities business. Permitting an insolvent broker-dealer to continue to transact a securities business endangers its customers and counterparties and places clearance organizations at risk.

An important goal of the Commission is to protect the financial integrity of the broker-dealer so that if the firm must liquidate it may do so in an orderly fashion. Allowing a withdrawal of capital that may jeopardize the financial integrity of a broker-dealer exposes customers and creditors of the broker-dealer to unnecessary risk.

ii. Objectives

The objective of these proposed amendments is to reduce systemic risk to the securities industry associated with the failure of the broker-dealer.

iii. Legal Basis

Pursuant to the Exchange Act and, particularly, Sections 15 and 17 thereof, 15 U.S.C. 78o and 78q.

iv. Small Entities Subject to the Rule

Paragraph (c)(1) of Rule 0-10[234] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared pursuant to Rule 17a-5(d);[235] and is not affiliated with any person (other than a natural person) that is not a small business or small organization.

The Commission estimates that there are approximately 915 broker-dealers that are "small" for the purposes Rule 0-10.[236] These proposed amendments would apply to all "small" broker-dealers in that they would be subject to the requirements in the proposed amendments.

v. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would require an insolvent broker-dealer to cease conducting a securities business and provide the securities regulators with notice of its insolvency. They also would require broker-dealers to add back certain liabilities and treat certain capital as a

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[234] 17 CFR 240.0-10(c)(1).

[235] 17 CFR 240.17a-5(d).

[236] This estimate is based on FOCUS Report filings.

liability, as well as require broker-dealers to deduct from net capital, with regard to fidelity bonding requirements, the excess of any deductible amount over the maximum amount permitted by self-regulatory organization rules. Finally, under the proposed amendment to the rule on Commission orders restricting withdrawals of capital, a broker-dealer subject to an order would not be permitted to withdraw any capital.

vi. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no federal rules that duplicate, overlap or conflict with the proposed amendments.

vii. Significant Alternatives

Pursuant to section 3(a) of the RFA,[237] 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 thereof, for small entities.

Given the minimal impact these amendments will have on small entities, we do 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 thereof.

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 amendments as the amendments already propose performance standards and do not

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[237] 5 U.S.C. 603(c).

dictate for entities of any size any particular design standards (e.g., technology) that must be employed to achieve the objectives of the proposed amendments.

viii. Request for Comments

We encourage the submission of comments to any aspect of this portion of the IRFA. Comments should specify costs of compliance with the proposed amendment and suggest alternatives that would accomplish the objective of the proposed amendments.

2. Adjusted Net Capital Requirements

i. Reasons

The Commission's experience over the past several years in overseeing the capital requirements of broker-dealers indicates that certain capital charges may be adjusted downward without impairing the goal of the net capital rule. These proposed amendments are a result of this experience.

ii. Objective

The proposed amendments are intended to better align the capital requirements with the risks these requirements are designed to address.

iii. Legal Basis

Pursuant to the Exchange Act and, particularly, Sections 15 and 17 thereof, 15 U.S.C. 78o and 78q.

iv. Small Entities Subject to the Rule

Paragraph (c)(1) of Rule 0-10[238] states that the term "small business" or "small organization," when referring to a broker-dealer, means a broker or dealer that had total capital (net worth plus subordinated liabilities) of less than $500,000 on the date in the prior fiscal year

[238] 17 CFR 240.0-10(c)(1).

as of which its audited financial statements were prepared pursuant to Rule 17a-5(d);[239] and is not affiliated with any person (other than a natural person) that is not a small business or small organization.

The Commission estimates that there are approximately 915 broker-dealers that were "small" for the purposes Rule 0-10.[240] The amendment to Appendix A of Rule 15c3-1 likely should have no, or little, impact on "small" broker-dealers, since most, if not all, of these firms do not carry non-clearing option specialist or market maker accounts. The reduction of the haircut for money market funds from 2% to 1% could impact all "small" firms, since they may hold these securities as part of their net capital.

v. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed amendments would (1) make permanent a temporary rule that reduced the haircut for non-clearing options specialist and market maker accounts under Appendix A, and (2) lower the haircut for money market funds from 2% to 1%. As noted, we estimate that generally only the second proposed amendment would affect "small" broker-dealers.

vi. Duplicative, Overlapping or Conflicting Federal Rules

We believe that there are no federal rules that duplicate, overlap or conflict with the proposed amendments.

vii. Significant Alternatives

239 17 CFR 240.17a-5(d).

240 This estimate is based on FOCUS Report filings.

Pursuant to section 3(a) of the RFA,[241] 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 thereof, for small entities.

Given the deregulatory impact of these amendments, we do 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 thereof.

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 amendments as the amendments already propose performance standards and do not dictate for entities of any size any particular design standards (e.g., technology) that must be employed to achieve the objectives of the proposed amendments.

viii. Request for Comments

We encourage the submission of comments to any aspect of this portion of the IRFA. Comments should specify costs of compliance with the proposed amendment and suggest alternatives that would accomplish the objective of the proposed amendments.

[241] 5 U.S.C. 603(c).

IX. STATUTORY AUTHORITY

The Commission is proposing amendments to Rules 15c3-1, 15c3-3, 17a-3, 17a-4 and 17a-11 under the Exchange Act pursuant to the authority conferred by the Exchange Act, including Sections 15, 17, 23(a) and 36.[242]

Text of Proposed Rule

List of Subjects

17 CFR Part 240

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 general authority for Part 240 is revised to read 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 and 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

* * * * *

2. Section 240.15c3-1 is amended by:

a. Revising the first sentence of the introductory text of paragraph (a);

b. Revising paragraph (a)(1)(ii)(A);

242 15 U.S.C. 78o, 78q. 78w and 78mm.

c. Removing from paragraph (a)(6)(iii)(A) the text "paragraph (c)(2)(x)(A)(1) through (9) of this section" and in its place adding the text "Appendix A (§240.15c3-1a)";

d. Revising the introductory heading of paragraph (c)(2)(i);

e. Adding paragraphs (c)(2)(i)(F) and (G);

f. Revising paragraphs (c)(2)(iv)(B), (c)(2)(iv)(E), and (c)(2)(vi)(D)(1);

g. Adding paragraph (c)(2)(xiv) before the undesignated heading;

h. Adding paragraph (c)(16) and an undesignated heading;

i. Revising paragraph (e)(3)(i); and

j. Removing from the second sentence in paragraph (e)(3)(ii) the text "The hearing" and in its place adding the text "A hearing on an order temporarily prohibiting the withdrawal of capital".

The revisions and additions read as follows:

§ 240.15c3-1 Net capital requirements for brokers or dealers.

(a) Every broker or dealer shall at all times have and maintain net capital no less than the greater of the highest minimum requirement applicable to its ratio requirement under paragraph (a)(1) of this section, or to any of its activities under paragraph (a)(2) of this section, and shall otherwise not be "insolvent" as that term is defined in paragraph (c)(16) of this section. * * *

* * * * *

(1)(i) * * *

(ii) * * *

(A) Make the computation required by §240.15c3-3(e) and set forth in Exhibit A, §240.15c3-3a, on a weekly basis;

* * * * *

(c) * * *

(2) * * *

(i) Adjustments to net worth related to unrealized profit or loss, deferred tax provisions, and certain liabilities.* * *

* * * * *

(F) Subtracting from net worth any liability or expense relating to the business of the broker-dealer for which a third party has assumed the responsibility, unless the broker or dealer can demonstrate that the third-party has adequate resources independent of the broker-dealer to pay the liability or expense.

(G) Subtracting from net worth any contribution of capital to the broker or dealer:

(1) Under an agreement that provides the investor with the option to withdraw the capital; or

(2) That is intended to be withdrawn within a period of one year unless the withdrawal has been approved in writing by the Examining Authority for the broker or dealer. Any withdrawal of capital made within one year of its contribution to the broker or dealer is presumed to be subject to this deduction.

* * * * *

(iv) * * *

(B) All unsecured advances and loans; deficits in customers' and non-customers' unsecured and partly secured notes; deficits in omnibus credit accounts maintained in compliance with the requirements of 12 CFR 220.7(f) of Regulation T under the Act, or similar accounts carried on behalf of another broker or dealer, after application of calls for margin, marks to the market or other required deposits that are outstanding 5 business days or less;

deficits in customers' and non-customers' unsecured and partly secured accounts after application of calls for margin, marks to market or other required deposits that are outstanding 5 business days or less, except deficits in cash accounts as defined in 12 CFR 220.8 of Regulation T under the Act for which not more than one extension respecting a specified securities transaction has been requested and granted, and deducting for securities carried in any of such accounts the percentages specified in paragraph (c)(2)(vi) of this section or Appendix A, §240.15c3-1a; the market value of stock loaned in excess of the value of any collateral received therefore; receivables arising out of free shipments of securities (other than mutual fund redemptions) in excess of $5,000 per shipment and all free shipments (other than mutual fund redemptions) outstanding more than 7 business days, and mutual fund redemptions outstanding more than 16 business days; and any collateral deficiencies in secured demand notes as defined in Appendix D, §240.15c3-1d; a broker or dealer that participates in a loan of securities by one party to another party shall be deemed a principal for the purpose of the deductions required under this section, unless the broker or dealer has fully disclosed the identity of each party to the other and each party has expressly agreed in writing that the obligations of the broker or dealer shall not include a guarantee of performance by the other party and that such party's remedies in the event of a default by the other party shall not include a right of setoff against obligations, if any, of the broker or dealer.

* * * * *

(E) <u>Other deductions</u>. All other unsecured receivables; all assets doubtful of collection less any reserves established therefore; the amount by which the market value of securities failed to receive outstanding longer than thirty (30) calendar days exceeds the contract value of such fails to receive; the funds on deposit in a "segregated trust account" in accordance with 17 CFR

270.27d-1 under the Investment Company Act of 1940, but only to the extent that the amount on deposit in such segregated trust account exceeds the amount of liability reserves established and maintained for refunds of charges required by sections 27(d) and 27(f) of the Investment Company Act of 1940; and cash and securities held in a securities account at another broker-dealer if the other broker-dealer does not treat the account, and the assets therein, in compliance with paragraphs (b)(5) and (e) of §240.15c3-3; Provided, That any amounts deposited in special reserve bank accounts established for the exclusive benefit of customers or PAB accounts pursuant to §240.15c3-3(e) and clearing deposits shall not be deducted.

* * * * *

(vi) * * *

(D)(<u>1</u>) In the case of redeemable securities of an investment company registered under the Investment Company Act of 1940, which assets consist of cash or money market instruments and which is described in §270.2a-7 of this Chapter, the deduction shall be 1% of the market value of the greater of the long or short position.

* * * * *

(xiv) <u>Deduction from net worth for excess deductible amounts related to fidelity bond coverage</u>. Deducting, with respect to fidelity bond coverage, the excess of any deductible amount over the maximum deductible amount permitted by the Examining Authority for the broker or dealer.

* * * * *

Insolvent

(16) A broker or dealer is insolvent for the purposes of this section if the broker-dealer:

(i) Is the subject of any bankruptcy, equity receivership proceeding or any other proceeding to reorganize, conserve, or liquidate such broker or dealer or its property whether commenced voluntarily or involuntarily or is applying for the appointment or election of a receiver, trustee, or liquidator or similar official for such broker or dealer or its property;

(ii) Has made a general assignment for the benefit of creditors;

(iii) Is insolvent within the meaning of section 101 of title 11 of the United States Code, or is unable to meet its obligations as they mature, and has made an admission to such effect in writing or in any court or before any agency of the United States or any State; or

(iv) Is unable to make such computations as may be necessary to establish compliance with this section.

* * * * *

(e) * * *

(3)(i) Temporary restrictions on withdrawal of net capital. The Commission may by order restrict, for a period of up to twenty business days, any withdrawal by the broker-dealer of equity capital or unsecured loan or advance to a stockholder, partner, sole proprietor, member, employee or affiliate if the Commission, based on the information available, concludes that such withdrawal, advance or loan may be detrimental to the financial integrity of the broker or dealer, or may unduly jeopardize the broker or dealer's ability to repay its customer claims or other liabilities which may cause a significant impact on the markets or expose the customers or creditors of the broker or dealer to loss without taking into account the application of the Securities Investor Protection Act of 1970.

* * * * *

3. Section 240.15c3-1a is amended by:

a. Removing paragraph (b)(1)(iv)(B); and

b. Redesignating paragraphs (b)(1)(iv)(A), (b)(1)(iv)(A)(1), (b)(1)(iv)(A)(2), and (b)(1)(iv)(A)(3) as paragraphs (b)(1)(iv), (b)(1)(iv)(A), (b)(1)(iv)(B), and (b)(1)(iv)(C) respectively.

4. Section 240.15c3-2 is removed and reserved.

5. Section 240.15c3-3 is amended by:

a. Removing from paragraph (a)(1), third sentence, the citation "220.19" and in its place adding the citation "220.12";

b. In paragraph (a)(1)(iii), revising the phrase "(15 U.S.C. 78aaa et seq.)" to read "(15 U.S.C. 78aaa et seq.) (SIPA)";

c. Revising paragraphs (a)(3), (a)(4), (a)(6), (a)(7) and (a)(8);

d. Adding paragraph (a)(16);

e. Removing from paragraph (b)(3)(iv) the text "the Securities Investor Protection Act of 1970" and in its place adding the text "SIPA";

f. Removing from paragraph (b)(4)(i)(C) the text "the Securities Investor Protection Act of 1970" and in its place adding the text "SIPA";

g. Adding paragraph (b)(5);

h. Removing from paragraph (c)(2) the text "special omnibus" and in its place adding the text "omnibus credit" and removing the text "section 4(b) of Regulation T under the Act (12 CFR 220.4(b))" and in its place adding the text "section 7(f) of Regulation T (12 CFR 220.7(f))";

i. Removing the period at the end of paragraph (d)(3) and in its place adding "; or";

j. Redesignating paragraph (d)(4) as paragraph (d)(5);

k. Adding a new paragraph (d)(4);

l. Revising paragraphs (e) and (f);

m. Revising the first sentence in paragraph (g);

n. Removing from the first sentence of paragraph (i) the text "reserve bank account" and in its place adding the text "Reserve Bank Accounts";

o. Adding paragraph (j);

p. Revising paragraph (l)(2);

q. Removing from the last sentence in paragraph (m) the text "special omnibus" and in its place adding the text "omnibus credit" and removing the text "section 4(b) of Regulation T [12 CFR 220.4(b)]" and in its place adding "section 7(f) of Regulation T (12 CFR 220.7(f))"; and

r. Removing from the first sentence in paragraph (n) the cite "paragraphs (d)(2) and (3)" and its place adding the cite "paragraphs (d)(2), (3) and (4)".

The revisions and additions read as follows:

§ 240.15c3-3 Customer protection – reserves and custody of securities.

(a) * * *

(3) The term <u>fully paid securities</u> shall include all securities carried for the account of a customer unless such securities are purchased in a transaction for which the customer has not made full payment.

(4) The term <u>margin securities</u> shall mean those securities carried for the account of a customer in a margin account as defined in section 4 of Regulation T (12 CFR 220.4), as well as securities carried in any other account (such accounts hereinafter referred to as "margin accounts") other than the securities referred to in paragraph (a)(3) of this section.

* * * * *

(6) The term qualified security shall mean:

(i) A security issued by the United States or guaranteed by the United States with respect to principal or interest; and

(ii) A redeemable security of an unaffiliated investment company registered under the Investment Company Act of 1940 and described in §270.2a-7 of this chapter that:

(A) Has assets consisting solely of cash and securities issued by the United States or guaranteed by the United States with respect to principal and interest;

(B) Agrees to redeem fund shares in cash no later than the business day following a redemption request by a shareholder; and

(C) Has net assets (assets net of liabilities) equal to at least 10 times the value of the fund shares held by the broker-dealer in the customer reserve account required under paragraph (e) of this section.

(7) The term bank shall mean a bank as defined in section 3(a)(6) of the Act and shall also mean any building and loan, savings and loan or similar banking institution subject to supervision by a Federal banking authority. With respect to a broker or dealer who maintains his principal place of business in Canada, the term bank shall also mean a Canadian bank subject to supervision by a Canadian authority.

(8) The term free credit balances shall mean liabilities of a broker or dealer to customers which are subject to immediate cash payment to customers on demand, whether resulting from sales of securities, dividends, interest, deposits or otherwise, excluding, however, funds in commodity accounts which are segregated in accordance with the Commodity Exchange Act or in a similar manner, or which are funds carried in a proprietary account as that term is defined in

regulations under the Commodity Exchange Act. The term free credit balances also shall include such liabilities carried in a securities account pursuant to a self-regulatory organization portfolio margining rule approved by the Commission under section 19(b) of the Act ("SRO portfolio margining rule"), including daily marks to market, and proceeds resulting from closing out futures contracts and options thereon, and, in the event the broker-dealer is the subject of a proceeding under SIPA, the market value as of the "filing date" as that term is defined in SIPA (15 U.S.C. 78lll(7)) of any long options on futures contracts.

* * * * *

(16) The term PAB account means a proprietary securities account of a broker or dealer (which includes a foreign broker or dealer, or a foreign bank acting as a broker or dealer), but shall not include an account where the account owner is a guaranteed subsidiary of the carrying broker or dealer, the account owner guarantees all liabilities and obligations of the carrying broker or dealer, or the account is a delivery-versus-payment account or a receipt-versus-payment account.

(b) * * *

(5) A broker or dealer shall not be required to obtain and thereafter to maintain the physical possession or control of securities carried for a PAB account, provided that the broker or dealer has obtained the written permission of the account owner to use the securities in the ordinary course of its securities business.

* * * * *

(d) * * *

(4) Securities included on his books or records as a proprietary short position or as a short position for another person, excluding positions covered by paragraph (m) of this section, for

more than 10 business days (or more than 30 calendar days if the broker or dealer is a market maker in the securities), then the broker or dealer shall, not later than the business day following the day on which the determination is made, take prompt steps to obtain physical possession or control of such securities.

* * * * *

(e) <u>Special reserve bank accounts for the exclusive benefit of customers and PAB accounts</u>.

(1) Every broker or dealer shall maintain with a bank or banks at all times when deposits are required or hereinafter specified "Special Reserve Bank Account for the Exclusive Benefit of Customers" (hereinafter referred to as the <u>Reserve Bank Account</u>) and a "Special Reserve Bank Account for Brokers and Dealers (hereinafter referred to as the <u>PAB Reserve Bank Account</u>, and together with the <u>Reserve Bank Account</u>, the <u>Reserve Bank Accounts</u>), each of which shall be separate from the other and from any other bank account of the broker or dealer. Such broker or dealer shall at all times maintain in the Reserve Bank Accounts, through deposits made therein, cash and/or qualified securities in amounts computed in accordance with the formula attached as Exhibit A, as applied to customer and PAB accounts respectively.

(2) With respect to each computation required pursuant to paragraph (e)(1) of this section, it shall be unlawful for any broker or dealer to accept or use any of the amounts under items comprising Total Credits under the formula referred to in paragraph (e)(1) of this section except for the specified purposes indicated under items comprising Total Debits under the formula, and, to the extent Total Credits exceed Total Debits, at least the net amount thereof shall be maintained in the Reserve Bank Accounts pursuant to paragraph (e)(1) of this section.

(3) (i) Computations necessary to determine the amount required to be deposited in Reserve Bank Accounts as specified in paragraph (e)(1) of this section shall be made weekly, as of the close of the last business day of the week, and the deposit so computed shall be made no later than one hour after the opening of banking business on the second following business day; provided, however, a broker or dealer which has aggregate indebtedness not exceeding 800 per centum of net capital (as defined in §240.15c3-1 or in the capital rules of a national securities exchange of which it is a member and exempt from §240.15c3-1 by paragraph (b)(2) of that section) and which carries aggregate customer funds (as defined in paragraph (a)(10) of this section), as computed at the last required computation pursuant to this section, not exceeding $1,000,000, may in the alternative make the computation monthly, as of the close of the last business day of the month, and, in such event, shall deposit not less than 105 per centum of the amount so computed no later than one hour after the opening of banking business on the second following business day.

(ii) If a broker or dealer, computing on a monthly basis, has, at the time of any required computation, aggregate indebtedness in excess of 800 per centum of net capital, such broker or dealer shall thereafter compute weekly as aforesaid until four successive weekly computations are made, none of which were made at a time when his aggregate indebtedness exceeded 800 per centum of his net capital.

(iii) Any broker or dealer that does not carry the accounts of a "customer" as defined by this section or conduct a proprietary trading business may make the computation to be performed with respect to PAB accounts under paragraph (e)(1) of this section monthly rather than weekly. If a broker or dealer performing the computation with respect to PAB accounts under paragraph (e)(1) of this section on a monthly basis is, at the time of any required computation, required to deposit additional cash or qualified securities in the PAB Special Reserve Account, the broker or dealer shall thereafter perform the computation required with respect to PAB accounts under paragraph (e)(1) of this section weekly until four successive weekly computations are made, none of which is made at a time when the broker or dealer was required to deposit additional cash or qualified securities in the PAB Special Reserve Account.

(iv) Computations in addition to the computations required in this section, may be made as of the close of any business day, and the deposits so computed shall be made no later than one hour after the opening of banking business on the second following business day.

(v) The broker or dealer shall make and maintain a record of each such computation made pursuant to this section or otherwise and preserve each such record in accordance with §240.17a-4.

(4) If the computation performed under paragraph (e)(3) of this section with respect to PAB accounts results in a deposit requirement, the requirement may be satisfied to the extent of any excess debit in the computation performed under paragraph (e)(3) of this section with respect to customer accounts of the same date. However, a deposit requirement resulting from the computation performed under paragraph (e)(3) of this section with respect to customer accounts cannot be satisfied with excess debits from the computation performed under paragraph (e)(3) of this section with respect to PAB accounts.

(5) In determining whether a broker or dealer maintains the minimum deposits required under this section, the broker or dealer shall exclude the total amount of any cash deposited with a parent or affiliate bank. The broker or dealer also shall exclude cash deposited with a non-parent and non-affiliated bank to the extent that:

(i) The amount of the deposit exceeds 50% of the broker-dealer's excess net capital, based on the broker-dealer's most recently filed FOCUS report; or

(ii) The amount of the deposit exceeds 10% of the bank's equity capital as reported by the bank in its most recent Call Report or Thrift Financial Report.

(f) Notification of banks.

A broker or dealer required to maintain the Reserve Bank Accounts prescribed by this section or who maintains a Special Account referred to in paragraph (k) of this section shall obtain and preserve in accordance with §240.17a-4 a written notification from each bank in which he has his Reserve Bank Accounts or Special Account that the bank was informed that all cash and/or qualified securities deposited therein are being held by the bank for the exclusive benefit of customers of the broker or dealer (or, in the case of the PAB Special Reserve Account, for the benefit of brokers or dealers) in accordance with the regulations of the Commission, and are being kept separate from any other accounts maintained by the broker or dealer with the bank, and the broker or dealer shall have a written contract with the bank which provides that the cash and/or qualified securities shall at no time be used directly or indirectly as security for a loan to the broker or dealer by the bank and, shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank or any person claiming through the bank.

(g) Withdrawals from the reserve bank accounts.

A broker or dealer may make withdrawals from his Reserve Bank Accounts if and to the extent that at the time of the withdrawal the amount remaining in each Reserve Bank Account is not less than the amount then required by paragraph (e) of this section. * * *

* * * * *

(j) Treatment of free credit balances.

(1) It shall be unlawful for a broker or dealer to accept or use any free credit balance carried for the account of any customer of the broker or dealer unless such broker or dealer has established adequate procedures pursuant to which each customer for whom a free credit balance is carried will be given or sent, together with or as part of the customer's statement of account, whenever sent but not less frequently than once every three months, a written statement informing the customer of the amount due to the customer by the broker or dealer on the date of the statement, and that the funds are payable on demand of the customer.

(2) It shall be unlawful for a broker or dealer to convert, invest, or otherwise transfer to another account or institution, free credit balances held in a customer's account except as provided in paragraphs (j)(2)(i), (ii) and (iii).

(i) A broker or dealer is permitted to convert, invest, or otherwise transfer to another account or institution, free credit balances in a customer's account only upon a specific order, authorization, or draft from the customer, and only in the manner, and under the terms and conditions, specified in the order, authorization, or draft.

(ii) A broker or dealer is permitted to transfer free credit balances held in the account of a customer opened on or after the effective date of this paragraph to either a money market mutual fund product as described in §270.2a-7 of this chapter or an interest bearing account at a bank without a specific order, authorization or draft for each such transfer, provided:

(A) The customer has previously affirmatively consented to such treatment of the free credit balances after being notified of the different general types of money market mutual fund and bank account products in which the broker or dealer may transfer the free credit balances and the applicable terms and conditions that will apply if the broker or dealer changes the product or type of product in which free credit balances are transferred;

(B) The broker or dealer provides the customer on an ongoing basis with all disclosures and notices regarding the investment and deposit of free credit balances as required by the self-regulatory organizations for which the broker or dealer is a member;

(C) The broker or dealer provides notice to the customer as part of the customer's quarterly statement of account that the money market mutual funds or bank deposits to which the free credit balances have been transferred can be liquidated on the customer's demand and held as free credit balances; and

(D) The broker or dealer provides the customer with at least 30 calendar days notice before the free credit balances will begin being transferred to a different product, different product type, or into the same product but under materially different terms and conditions. The notice must describe the new money market fund, bank deposit type, or terms and conditions, and how the customer can notify the broker or dealer if the customer chooses not to have the free credit balances transferred to the new product or product type, or under the new terms and conditions.

(iii) A broker or dealer is permitted to transfer free credit balances that are held or will accumulate in the account of a customer opened before the effective date of this paragraph to either a money market mutual fund product as described in §270.2a-7 of this chapter or an interest bearing account product at a bank without a specific order, authorization or draft for each such transfer, provided:

(A) The broker or dealer provides the customer on an ongoing basis with all disclosures and notices regarding the investment and deposit of free credit balances as required by the self-regulatory organizations for which the broker or dealer is a member;

(B) The broker or dealer provides notice to the customer as part of the customer's quarterly statement of account that the money market mutual funds or bank deposits to which the free credit balances have been transferred can be liquidated on the customer's demand and held as free credit balances; and

(C) The broker or dealer provides the customer with at least 30 calendar days notice before the free credit balances will begin being transferred to a different product, different product type, or into the same product but under materially different terms and conditions. The notice must describe the new money market fund, bank deposit type, or terms and conditions, and how the customer can notify the broker or dealer if the customer chooses not to have the free credit balances transferred to the new product or product type, or under the new terms and conditions.

* * * * *

(l) * * *

(2) Margin securities upon full payment by such customer to the broker or dealer of his indebtedness to the broker or dealer; and, subject to the right of the broker or dealer under Regulation T (12 CFR 220) to retain collateral for his own protection beyond the requirements of Regulation T, excess margin securities not reasonably required to collateralize such customer's indebtedness to the broker or dealer.

* * * * *

6. Section 240.15c3-3a is revised to read as follows:

§ 240.15c3-3a Exhibit A – Formula for determination of customer and PAB account reserve requirements of brokers and dealers under § 240.15c3-3.

	Credits	Debits
1. Free credit balances and other credit balances in customers' security accounts.		

	(See Note A).......................................	$XXX	....
2.	Monies borrowed collateralized by securities carried for the account of customers (See Note B)...	XXX	....
3.	Monies payable against customers' securities loaned (See Note C)................	XXX	....
4.	Customers' securities failed to receive (See Note D)..	XXX	....
5.	Credit balances in firm accounts which are attributable to principal sales to customers.	XXX	....
6.	Market value of stock dividends, stock splits and similar distributions receivable outstanding over 30 calendar days...........	XXX	....
7.	Market value of short security count difference over 30 calendar days old.........	XXX	....
8.	Market value of short securities and credits (not to be offset by longs or by debits) in all suspense accounts over 30 calendar days.	XXX	....
9.	Market value of securities which are in transfer in excess of 40 calendar days and have not been confirmed to be in transfer by the transfer agent or the issuer during the 40 days..	XXX	....
10.	Debit balances in customers' cash and margin accounts excluding unsecured accounts and accounts doubtful of collection. (See Note E)..........................	....	XXX
11.	Securities borrowed to effectuate short sales by customers and securities borrowed to make delivery on customers' securities failed to deliver........................	....	XXX
12.	Failed to deliver of customers' securities not older than 30 calendar days...............	....	XXX
13.	Margin required and on deposit with the Options Clearing Corporation for all option contracts written or purchased in customer and PAB accounts. (See Note F).........................	....	XXX
14.	Margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Act		

(15 U.S.C. 78q-1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) related to the following types of positions written, purchased or sold in customer accounts: (1) security futures products and (2) futures contracts (and options thereon) carried in a securities account pursuant to an SRO portfolio margining rule (See Note G)	....	XXX
Total credits....................................	....	....
Total debits.....................................	....	....
15. Excess of total credits (sum of items 1-9) over total debits (sum of items 10-14) required to be on deposit in the "Reserve Bank Account" (§240.15c3-3(c)). If the computation is made monthly as permitted by this section, the deposit shall be not less than 105% of the excess of total credits over total debits.	....	XXX

Notes Regarding the Customer Reserve Computation

Note A. Item 1 shall include all outstanding drafts payable to customers which have been applied against free credit balances or other credit balances and shall also include checks drawn in excess of bank balances per the records of the broker or dealer.

Note B. Item 2 shall include the amount of options-related or security futures product-related Letters of Credit obtained by a member of a registered clearing agency or a derivatives clearing organization which are collateralized by customers' securities, to the extent of the member's margin requirement at the registered clearing agency or derivatives clearing organization. Item 2 shall also include the amount of such Letters of Credit related to other futures contracts (and options thereon) carried in a securities account pursuant to an SRO portfolio margining rule.

Note C. Item 3 shall include in addition to monies payable against customers' securities loaned the amount by which the market value of securities loaned exceeds the collateral value received from the lending of such securities.

Note D. Item 4 shall include in addition to customers' securities failed to receive the amount by which the market value of securities failed to receive and outstanding more than thirty (30) calendar days exceeds their contract value.

Note E. (1) Debit balances in margin accounts shall be reduced by the amount by which a specific security (other than an exempted security) which is collateral for margin accounts exceeds in aggregate value 15 percent of all securities which collateralize all margin accounts receivable; provided, however, the required reduction shall not be in excess of the amounts of the debit balance required to be excluded because of this concentration rule. A specified security is deemed to be collateral for a margin account only to the extent it represents in value not more than 140 percent of the customer debit balance in a margin account.

(2) Debit balances in special omnibus accounts, maintained in compliance with the requirements of Section 7(f) of Regulation T (12 CFR 220.7(f)) or similar accounts carried on behalf of another broker or dealer, shall be reduced by any deficits in such accounts (or if a credit, such credit shall be increased) less any calls for margin, mark to the market, or other required deposits which are outstanding 5 business days or less.

(3) Debit balances in customers' cash and margin accounts included in the formula under Item 10 shall be reduced by an amount equal to 1 percent of their aggregate value.

(4) Debit balances in cash and margin accounts of household members and other persons related to principals of a broker or dealer and debit balances in cash and margin accounts of affiliated persons of a broker or dealer shall be excluded from the Reserve Formula, unless the broker or dealer can demonstrate that such debit balances are directly related to credit items in the formula.

(5) Debit balances in margin accounts (other than omnibus accounts) shall be reduced by the amount by which any single customer's debit balance exceeds 25% (to the extent such amount is greater than $50,000) of the broker-dealer's tentative net capital (i.e., net capital prior to securities haircuts) unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the Reserve

Formula. Related accounts (e.g., the separate accounts of an individual, accounts under common control or subject to cross guarantees) shall be deemed to be a single customer's accounts for purposes of this provision.

If the registered national securities exchange or the registered national securities association having responsibility for examining the broker or dealer ("designated examining authority") is satisfied, after taking into account the circumstances of the concentrated account including the quality, diversity, and marketability of the collateral securing the debit balances of margin accounts subject to this provision, that the concentration of debit balances is appropriate, then such designated examining authority may grant a partial or plenary exception from this provision. The debit balance may be included in the reserve formula computation for five business days from the day the request is made.

(6) Debit balances of joint accounts, custodian accounts, participation in hedge funds or limited partnerships or similar type accounts or arrangements of a person who would be excluded from the definition of customer ("noncustomer") with persons included in the definition of customer shall be included in the Reserve Formula in the following manner: if the percentage ownership of the non-customer is less than 5 percent then the entire debit balance shall be included in the formula; if such percentage ownership is between 5 percent and 50 percent then the portion of the debit balance attributable to the non-customer shall be excluded from the formula unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the formula; or if such percentage ownership is greater that 50 percent, then the entire debit balance shall be excluded from the formula unless the broker or dealer can demonstrate that the debit balance is directly related to credit items in the formula.

Note F. Item 13 shall include the amount of margin deposited with the Options Clearing Corporation to the extent such margin is represented by cash, proprietary qualified securities and letters of credit collateralized by customers' securities.

Note G. (a) Item 14 shall include the amount of margin required and on deposit with a clearing agency registered with the Commission under section 17A of the Act (15 U.S.C. 78q-1) or a derivatives clearing organization registered with the Commodity Futures Trading Commission under section 5b of the Commodity Exchange Act (7 U.S.C. 7a-1) for customer accounts to the extent that the margin is represented by cash, proprietary qualified securities, and letters of credit collateralized by customers' securities.

(b) Item 14 shall apply only if the broker or dealer has the margin related to security futures products or futures (and options thereon) carried in a securities account pursuant to an approved SRO portfolio margining program on deposit with:

(1) A registered clearing agency or derivatives clearing organization that:

(i) Maintains the highest investment-grade rating from a nationally recognized statistical rating organization; or

(ii) Maintains security deposits from clearing members in connection with regulated options or futures transactions and assessment power over member firms that equal a combined total of at least $2 billion, at least $500 million of which must be in the form of security deposits. For the purposes of this Note G, the term "security deposits" refers to a general fund, other than margin deposits or their equivalent, that consists of cash or securities held by a registered clearing agency or derivative clearing organization; or

(iii) Maintains at least $3 billion in margin deposits; or

(iv) Does not meet the requirements of paragraphs (b)(1)(i) through (b)(1)(iii) of this Note G, if the Commission has determined, upon a written request for exemption by or for the benefit of the broker or dealer, that the broker or dealer may utilize such a registered clearing agency or derivatives clearing organization. The Commission may, in its sole discretion, grant such an exemption subject to such conditions as are appropriate under the circumstances, if the Commission determines that such conditional or unconditional exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors; and

(2) A registered clearing agency or derivatives clearing organization that, if it holds funds or securities deposited as margin for security futures products or portfolio margin account futures in a bank, as defined in section 3(a)(6) of the Act (15 U.S.C. 78c(a)(6)), obtains and preserves written notification from the bank at which it holds such funds and securities or at which such funds and securities are held on its behalf. The written notification shall state that all funds and/or securities deposited with the bank as margin (including customer security futures products and portfolio margin account futures margin), or held by the bank and pledged to such registered clearing agency or derivatives clearing agency as margin, are being

held by the bank for the exclusive benefit of clearing members of the registered clearing agency or derivatives clearing organization (subject to the interest of such registered clearing agency or derivatives clearing organization therein), and are being kept separate from any other accounts maintained by the registered clearing agency or derivatives clearing organization with the bank. The written notification also shall provide that such funds and/or securities shall at no time be used directly or indirectly as security for a loan to the registered clearing agency or derivatives clearing organization by the bank, and shall be subject to no right, charge, security interest, lien, or claim of any kind in favor of the bank or any person claiming through the bank. This provision, however, shall not prohibit a registered clearing agency or derivatives clearing organization from pledging customer funds or securities as collateral to a bank for any purpose that the rules of the Commission or the registered clearing agency or derivatives clearing organization otherwise permit; and

(3) A registered clearing agency or derivatives clearing organization establishes, documents, and maintains:

(i) Safeguards in the handling, transfer, and delivery of cash and securities;

(ii) Fidelity bond coverage for its employees and agents who handle customer funds or securities. In the case of agents of a registered clearing agency or derivatives clearing organization, the agent may provide the fidelity bond coverage; and

(iii) Provisions for periodic examination by independent public accountants; and

(iv) A derivatives clearing organization that, if it is not otherwise registered with the Commission, has provided the Commission with a written undertaking, in a form acceptable to the Commission, executed by a duly authorized person at the derivatives clearing organization, to the effect that, with respect to the clearance and settlement of the customer securities futures products and portfolio margin account futures of the broker or dealer, the derivatives clearing organization will permit the Commission to examine the books and records of the derivatives clearing organization for compliance with the requirements set forth in § 240.15c3-3a, Note G (b)(1) through (3).

(c) Item 14 shall apply only if a broker or dealer determines, at least annually, that the registered clearing agency or derivatives clearing organization with which the broker or dealer has on deposit margin related to securities future products or portfolio margin account futures meets the conditions of this Note G.

Notes Regarding the PAB Reserve Computation

Note 1. Broker-dealers should use the formula in Exhibit A for the purposes of computing the PAB reserve requirement substituting the term "brokers or dealers" for the term "customers."

Note 2. Any credit (including a credit applied to reduce a debit) that is included in the computation required by §240.15c3-3 with respect to customer accounts (the "customer reserve computation") may not be included as a credit in the computation required by §240.15c3-3 with respect to PAB accounts (the "PAB reserve computation").

Note 3. Note E(1) to §240.15c3-3a shall not apply to the PAB reserve computation.

Note 4. Note E(3) to §240.15c3-3a which reduces debit balances by 1% shall not apply to the PAB reserve computation.

Note 5. Commissions receivable and other receivables of another broker or dealer from the broker or dealer (excluding clearing deposits) that are otherwise allowable assets under §240.15c3-1 shall not be included in the PAB reserve computation, provided the amounts have been clearly identified as receivables on the books and records of the other broker or dealer and as payables on the books of the broker or dealer. Commissions receivable and other receivables of another broker or dealer from the broker or dealer that are otherwise non-allowable assets under §240.15c3-1 and clearing deposits of another broker or dealer may be included as "credit balances" for purposes of the PAB reserve computation, provided the commissions receivable and other receivables are subject to immediate cash payment to the other broker or dealer and the clearing deposit is subject to payment within 30 days.

Note 6. Credits included in the PAB reserve computation that result from the use of securities held for a PAB account ("PAB securities") that are pledged to meet intra-day margin calls in a cross-margin account established between The Options Clearing Corporation and any regulated commodity exchange may be reduced to the extent that the excess margin held by the other clearing corporation in the cross-margin relationship is used the following business day to replace the PAB securities that were previously pledged. In addition, balances resulting from a portfolio margin account that are segregated pursuant to

Commodity Futures Trading Commission regulations need not be included in the PAB reserve computation.

Note 7. Deposits received prior to a transaction pending settlement which are $5 million or greater for any single transaction or $10 million in aggregate may be excluded as credits from the PAB reserve computation if such balances are placed and maintained in a separate PAB Reserve Account by 12 noon Eastern Time on the following business day. Thereafter, the money representing any such deposits may be withdrawn to complete the related transactions without performing a new PAB reserve computation.

Note 8. A credit balance resulting from a PAB reserve computation may be reduced by the amount that items representing such credits are swept into money market funds or mutual funds of an investment company registered under the Investment Company Act of 1940 on or prior to 10 a.m. Eastern Time on the deposit date provided that the credits swept into any such fund are not subject to any right, charge, security interest, lien, or claim of any kind in favor of the investment company or the broker or dealer. Any credits that have been swept into money market funds or mutual funds must be maintained in the name of a particular broker or for the benefit of another broker.

Note 9. Clearing deposits required to be maintained at registered clearing agencies may be included as debits in the PAB reserve computation to the extent the percentage of the deposit, which is based upon the clearing agency's aggregate deposit requirements (e.g., dollar trading volume), that relates to the proprietary business of other brokers and dealers can be identified.

Note 10. A broker or dealer that clears PAB accounts through an affiliate or third party clearing broker must include these PAB account balances and the omnibus PAB account balance in its PAB reserve computation.

7. Section 240.17a-3 is amended by adding paragraph (a)(23) and to read as follows:

§ 240.17a-3 Records to be made by certain exchange members, brokers and dealers.

(a) * * *

(23) A record documenting the internal risk management controls established and maintained by the member, broker or dealer to assist it in analyzing and managing the risks

associated with its business activities, Provided, That the records required by this paragraph (a)(23) need only be made if the member, broker or dealer has more than:

(i) $1,000,000 in aggregate credit items as computed under §240.15c3-3a; or

(ii) $20,000,000 in capital, which includes debt subordinated in accordance with §240.15c3-1d.

* * * * *

8. Section 240.17a-4 is amended by:

a. Removing from paragraph (b)(1) the citation "§ 240.17a-3(f)" and its place adding the citation "§ 240.17a-3(g)";

b. Removing from paragraph (b)(9) the citation "§ 240.15c3-3(d)(4)" and in its place adding the citation "§ 240.15c3-3(d)(5)"; and

c. Adding paragraph (e)(9).

The addition reads as follows:

§ 240.17a-4 -- Records to be preserved by certain exchange members, brokers and dealers.

* * * * *

(e) * * *

(9) All records required pursuant to paragraph (a)(23) of § 240.17a-3 until three years after the termination of the use of the system of controls or procedures documented therein.

* * * * *

9. Section 240.17a-11 is amended by:

a. Revising the first sentence of paragraph (b)(1);

b. Removing from the introductory text of paragraph (c) the text "or (c)(4)" and in its place adding the text "(c)(4) or (c)(5)"; and

c. Adding paragraph (c)(5).

The revision and addition read as follows:

§ 240.17a-11, Notification provisions for brokers and dealers

* * * * *

(b)(1) Every broker or dealer whose net capital declines below the minimum amount required pursuant to §240.15c3-1, or is insolvent as that term is defined in paragraph (c)(16) of §240.15c3-1, shall give notice of such deficiency that same day in accordance with paragraph (g) of this section. * * *

* * * * *

(c) * * *

(5) If a computation made by a broker or dealer pursuant to §240.15c3-1 shows that the total amount of money payable against all securities loaned or subject to a repurchase agreement or the total contract value of all securities borrowed or subject to a reverse repurchase agreement is in excess of 2500 percent of its tentative net capital; provided, however, that for purposes of this leverage test transactions involving government securities, as defined in section 3(a)(42) of the Act (15 U.S.C. 78c(a)(42), shall be excluded from the calculation; provided further, however, that a broker or dealer shall not be required to send the notice required by this paragraph if it submits a monthly report of its securities lending and borrowing and repurchase and reverse

repurchase activity (including the total amount of money payable against securities loaned or subject to a repurchase agreement and the total contract value of securities borrowed or subject to a reverse repurchase agreement) to its designated examining authority.

* * * * *

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: March 9, 2007

T-1A

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 55452 / March 13, 2007

Admin. Proc. File No. 3-11062r

In the Matter of the Application of

CALVIN DAVID FOX
P.O. Box 7900
Jupiter, Florida 33468

For Review of Disciplinary Action Taken by the

NEW YORK STOCK EXCHANGE, INC.

ORDER DENYING REQUEST FOR RECONSIDERATION

On November 30, 2006 we dismissed the appeal of Calvin David Fox from disciplinary action by the New York Stock Exchange, Inc. ("NYSE" or "Exchange") because Fox had failed to file a timely request that the Board of Directors of the NYSE review the hearing panel decision and, consequently, failed to exhaust the remedies provided by the Exchange before appealing to the Commission. 1/ On December 11, 2006, Fox filed a Motion for Reconsideration of the November 30, 2006 Order ("the Order").

Rule of Practice 470 governs our consideration of Fox's motion. 2/ Reconsideration is an extraordinary remedy designed to correct manifest errors of law or fact or permit the introduction of newly discovered evidence. 3/

1/ Calvin David Fox, Securities Exchange Act Rel. No. 54840 (Nov. 30, 2006), __ SEC Docket ____.

2/ 17 C.F.R. § 201.470.

3/ See Philip A. Lehman, Securities Exchange Act Rel. No. 54991 (Dec. 21, 2006) __ SEC Docket ____ (Order Denying Request for Reconsideration).

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Fox argues that the Order contains errors of fact and of law and reaches an erroneous conclusion that Fox filed his request for review by the Board of Directors after the time specified by the NYSE rules had expired. For the first time, Fox disputes the factual premise upon which that conclusion is based: that the Exchange mailed the hearing panel decision to Fox on March 31, 2006. He does not, however, introduce newly discovered evidence in support of this claim. Rather, Fox speculates that, because the March 31, 2006 date on the envelope in which the hearing panel decision was mailed is from a postage meter, the NYSE could have stamped it on that date but placed it in the mail on a subsequent date. This speculation, however, is countered by the description given by counsel for the NYSE of the NYSE's settled procedure of mailing letters on the same day that they are stamped by the postage meter. In the absence of evidence that this practice was not followed, we see no reason to disturb our earlier finding that the hearing panel decision was mailed on March 31, 2006.

Before filing this motion for reconsideration, Fox did not contest the date of mailing of the hearing panel decision. Instead, Fox argued that service of the hearing panel decision was not effective until delivery. The Order rejects Fox's service-on-delivery theory as inconsistent with the applicable NYSE rules. Fox reiterates a variation of that legal argument in the instant motion, asserting that service by certified mail is not effective until delivered. Fox offers his interpretation of the Commission's Rules and a definition from Black's Law Dictionary in support of his position. Neither of these is relevant to the interpretation of the clear language of NYSE Rule 476(d) which states that "[s]ervice shall be deemed effective . . . by leaving [the document] either at the respondent's last known office address during business hours or respondent's last place of residence as reflected in Exchange records, or upon mailing same to the respondent at the aforesaid office address or place of residence." 4/ We find that neither Fox's factual assertions nor his legal argument provide any reason for reconsidering the November 30, 2006 Order.

Accordingly, IT IS ORDERED that Petitioner's Motion to Reconsider be, and it hereby is, denied.

By the Commission.

Nancy M. Morris
Secretary

4/ NYSE Rule 476(d). Rule 476(e) provides that hearing panel decisions are to be served as provided in Rule 476(d) which applies to service of Charge Memoranda.

SECURITIES AND EXCHANGE COMMISSION
(Release Nos. 33-8786, 34-55456; File No. 4-515)

Roundtable on Interactive Data: Creating Interactive Data to Serve Investors

AGENCY: Securities and Exchange Commission.

ACTION: Notice of roundtable meeting.

SUMMARY: On Monday, March 19, 2007, the Securities and Exchange Commission will hold a roundtable discussion on creating interactive data to serve investors. The event begins with remarks from SEC Chairman Cox and an address by Vanguard Group Chairman and CEO John J. Brennan on the use of interactive data by public companies and mutual funds to improve disclosure for individual investors. Following Mr. Brennan's remarks, John W. White, Director of the Commission's Division of Corporation Finance, will discuss the use of interactive data to create better disclosure documents. The roundtable will also feature a panel discussion on the benefits, including potential cost savings, of preparing financial reports using interactive data written in a computer language called XBRL. Panelists will include executives at public companies currently providing investors with interactive data on a test basis as part of the SEC's voluntary filing program. The panel will be moderated by Chicago Sun-Times personal finance columnist Terry Savage. Richard Bennett, Chief Executive Officer of The Corporate Library, will provide closing remarks and discuss the significance of interactive data for corporate governance.

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The roundtable will take place at the Commission's headquarters at 100 F Street, NE, Auditorium, Room L-002, Washington, DC at 10:00 a.m. The public is invited to observe the roundtable discussions. Seating is available on a first-come, first-serve basis.

FOR FURTHER INFORMATION CONTACT: Brigitte Lippmann at (202) 551-3713.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

March 13, 2007

/ ' ..

Commissioner Atkins Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55466 / March 14, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12591

In the Matter of **Banc of America Securities LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b)(4) 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 Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Banc of America Securities LLC ("Respondent" or "BAS").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which Respondent admits, Respondent consents to the issuance of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Order").

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III.

FACTS

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

A. Respondent

Banc of America Securities LLC is a broker-dealer registered with the Commission since March 22, 1990 (File No. 8-42263) and is the successor-in-interest to NationsBanc Montgomery Securities. BAS is a subsidiary of Bank of America Corporation and, during 1999 through 2001, had its principal offices in San Francisco, California; New York, New York; and Charlotte, North Carolina. BAS is a member of the New York Stock Exchange, the National Association of Securities Dealers and other national securities exchanges.

B. Summary

During the period January 1999 through December 2001, BAS violated the antifraud and internal controls provisions of the federal securities laws in connection with its issuance of research. First, BAS lacked policies and procedures to prevent the misuse by the firm and its employees of material nonpublic information concerning the content and timing of its research reports. Second, BAS issued materially false and misleading research on three different companies.[2]

BAS failed to establish, maintain and enforce written policies and procedures reasonably designed to detect and prevent the misuse of material nonpublic information concerning the firm's equity research. Specifically, BAS's policies and procedures regarding the handling and dissemination of its nonpublic equity research were not reasonably designed to prevent the potential misuse of that information by the firm and its employees. BAS also permitted its Marketing Director for Equity Research to have access to and communications with the firm's research analysts without establishing additional policies and procedures to protect against the potential misuse of material nonpublic research information and without maintaining or enforcing the policies that were already in place. As a result, in at least two instances, BAS position traders improperly received access to material nonpublic information concerning forthcoming research reports and established proprietary positions in those securities prior to the release of the research to the firm's customers. BAS therefore willfully violated Section 15(f) of the Exchange Act.

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

[2] This matter stems from an investigation that resulted in a prior Commission enforcement action. In March 2004, the Commission issued an order finding that BAS violated the recordkeeping and access requirements of the federal securities laws by repeatedly failing promptly to furnish documents requested by the staff, providing misinformation concerning the availability and production status of such documents, and engaging in dilatory tactics that delayed the investigation. The firm was censured and ordered to pay a $10 million civil penalty. *See In the Matter of Banc of America Securities LLC*, Exchange Act Release No. 49386 (Mar. 10, 2004).

During 1999 through 2001, BAS also employed business practices that linked research and investment banking and incentivized research analysts to support the firm's investment banking efforts. In so doing, BAS fostered an environment in which BAS investment bankers inappropriately influenced analysts, who were charged with producing objective research. BAS failed adequately to manage the conflicts of interest created by its practices. As a result, BAS published equity research reports on three companies which did not reflect the true views of the research analyst covering the security. By engaging in this conduct, BAS violated Section 15(c) of the Exchange Act and Rule 15c1-2(a) thereunder.

C. BAS Failed to Establish, Maintain and Enforce Written Policies and Procedures to Prevent the Misuse of Material Nonpublic Information Regarding Equity Research

During 1999 through 2001, BAS experienced a breakdown in its internal controls designed to detect and prevent the misuse of material nonpublic information concerning forthcoming equity research. As set forth below, BAS failed to establish, maintain, and enforce: (i) adequate controls over the release and dissemination of its research; (ii) effective written policies governing access to and use of information concerning forthcoming research by the firm's traders; and (iii) policies and procedures regarding the BAS Marketing Director's access to information concerning forthcoming research. As a result, BAS did not establish, maintain, and enforce policies and procedures reasonably designed to detect and prevent the misuse of material nonpublic information by the firm and its employees.[3]

1. The Firm's Breakdown in Internal Controls

a. BAS Failed to Adopt Adequate Controls Over the Dissemination and Release of Its Research

During the relevant period, BAS maintained written policies pursuant to which information concerning forthcoming BAS research, which had not yet been published, disseminated or released to the public, was deemed to be material nonpublic information. The firm's written policies also required BAS to "fairly" and "simultaneously" disseminate BAS research to its customers. These policies were designed to prevent the misuse and selective disclosure of the firm's research information and to ensure that research was available to all customers at or about the same time.

To achieve simultaneous dissemination, the firm adopted policies restricting access to research prior to its simultaneous release to the firm's sales and trading force and the firm's customers. For example, the firm's written policies prohibited analysts from sharing information concerning "forthcoming reports" with anyone outside of the research department, including BAS sales and trading associates. The policy prohibited analysts from disclosing the "timing, status, or content" of a research report prior to its release, except to members of research management, supervisory analysts and compliance personnel. After BAS research was reviewed

[3] In 2002, BAS moved its equities trading business to New York and closed its equities trading platform in San Francisco. Most of the senior managers for the firm's San Francisco equities trading business left the firm prior to or at the time of the move.

by supervisory analysts and approved by research management, it was disseminated at regularly scheduled sales meetings. The sales force was prohibited from leaving these meetings prior to their conclusion. At the end of the meetings, the sales force was free to contact customers to inform them of the new research, and the reports were simultaneously released to the firm's customers, employees, and various third-party vendors via the firm's computer systems. This system was designed to ensure that BAS sales and trading employees and firm customers had access to copies of the research reports at roughly the same time.

Contrary to the firm's stated policies, during 1999 through 2001, BAS sales and trading employees were on multiple occasions able to obtain access to forthcoming BAS research before the simultaneous release of the research. Through various distribution channels, BAS sales and trading employees received advance access to forthcoming material research changes, including upgrades and downgrades.[4] At the same time, BAS did not provide clear or effective written policies and procedures as to how its employees were permitted to use that information in a lawful manner. In addition, BAS failed adequately to establish procedures to track the actual release times for its equity research. BAS therefore could not effectively monitor or investigate for potential misuse of that information because it was unable accurately to determine when its material nonpublic research information became public. Accordingly, BAS failed to maintain and enforce its written research dissemination policies and failed to implement procedures to control the access to and the release of its research.

b. BAS Failed to Adopt Effective Written Policies and Procedures Governing Its Traders' Access to Forthcoming Research

Prior to mid-1999, BAS did not maintain an information wall between its equity research and trading departments. BAS traders received advance access to material nonpublic research information but were required to keep such information confidential until after its release.[5] The policy prohibited the firm's traders from establishing or accumulating proprietary positions while unreleased research changes were pending. This trading prohibition continued until the information had been released to customers and was "reflected in the price of the stock." In approximately mid-1999, BAS changed its policy and erected an information wall between the research and trading departments. Under the new policy, BAS traders were not permitted to have advance access to material nonpublic research information except in limited circumstances. BAS traders were thus free to continue to trade notwithstanding that research changes were pending, provided that they did not have advance access to the research information. BAS did not promptly reduce this new policy to writing and failed effectively to implement the change.[6] In light of the breakdown in the firm's research dissemination policies and procedures, discussed

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4 For example, prior to formal release of the firm's research, BAS regularly disseminated to its sales and trading personnel various electronic and hard copy documents that summarized its forthcoming research. BAS also broadcast its sales meetings, at which forthcoming material research changes were discussed, to the trading floor prior to the formal release of the research.

5 Under this policy, BAS position traders were "over the wall" and analysts were required to inform them of pending research changes.

6 As a result, BAS has been unable precisely to determine when the policy officially changed.

above, the firm's failure to effectively implement this new policy heightened the potential for misuse of the firm's material nonpublic research information by the firm's traders.

c. BAS Failed to Adopt Specific Policies and Procedures to Address the Multiple Roles of Its Marketing Director

In mid-2000, BAS established within its institutional sales department a new position titled Director of Marketing. The new Marketing Director's responsibilities included: (i) branding the firm's analysts and obtaining a broader distribution of the firm's research, (ii) supervising the firm's morning sales meeting, (iii) providing guidance to the firm's analysts concerning research positioning, and (iv) organizing the firm's non-deal roadshows. In these various roles, the Marketing Director acted as a liaison between the firm's sales and research departments and served as a "sounding board" for the firm's analysts. The Marketing Director thus had frequent personal interaction with the firm's analysts, assisted them with shaping their research coverage, and, as a result, routinely came into possession of material nonpublic information concerning forthcoming BAS research. At the same time, the Marketing Director was the primary conduit for the dissemination of public market and firm-generated information (or 'Sales Chatter') to the Sales and Trading Departments. From his location on the firm's trading floor, the Marketing Director also had contact with, and regularly provided trading advice to, the firm's position traders. In addition, BAS knew that the Marketing Director was one of the most active personal traders at the firm. BAS failed to establish specific policies and procedures to address the conflicts created by the multiple roles and activities performed by the firm's Marketing Director; to the extent policies existed to address them, BAS failed adequately to enforce and maintain them.

2. <u>BAS Proprietary Positions in Advance of Research</u>

By late 1999, BAS was aware that there were significant weaknesses in the firm's information wall dividing research from sales and trading. Nevertheless, BAS failed to establish new policies to address these problems or to enforce and maintain the policies that existed. As a result of these breakdowns in the firm's internal controls, in at least two instances, BAS established proprietary positions in stocks in advance of the issuance of research.

In January 2000, BAS and a number of its employees and customers traded ahead of the firm's upgrade of PLX Technology, Inc. ("PLXT"). On or about January 11 or 12, 2000, the firm's Head of Technology Sales learned that the firms' semiconductor analyst intended to upgrade PLXT. He communicated this information to the firm's PLXT trader. Several BAS employees placed orders to buy PLXT shares and the firm's trader filled these orders and established a long position in PLXT in the firm's account. BAS issued the analyst's PLXT research report before the market opened on January 13, 2000. PLXT's stock price increased in response to the upgrade, and the firm made a profit on its PLXT position. Despite the firm's proprietary PLXT position in advance of the upgrade, BAS failed to conduct a review of the firm's PLXT trading.

In June 2001, BAS traded ahead of the firm's downgrade of Cree, Inc. ("CREE"). On June 11, 2001, prior to the market open, one of the firm's semiconductor analysts sought approval to downgrade CREE to a Buy from a Strong Buy. A BAS trader became aware of the forthcoming downgrade and sent an e-mail to a BAS customer warning him, "Don't buy any CREE, news pending from here. Will let you know when it comes." When the downgrade was approved but not yet disseminated, the trader e-mailed his customer that the firm had just downgraded CREE. The firm's CREE trader also became aware of the forthcoming downgrade and positioned the firm's proprietary account to profit from the pending research. Later that morning, the research report was officially disseminated. CREE's stock price declined. Despite the firm's CREE short position prior to the downgrade, BAS failed to conduct a review of the firm's CREE trading.

D. BAS Published False Equity Research Reports

1. Background

a. BAS Analysts Were Subjected to Conflicts of Interest

BAS's research analysts provided BAS's customers and the public with reports on various public companies and industries. BAS distributed its research directly to its customers through its sales force and third-party vendors.[7] The firm held out its analysts as providing independent and objective analysis, ratings, and recommendations upon which investors could rely in reaching investment decisions. BAS's research policies required that all research opinions should be "devoid of actual and potential conflicts of interest." Nevertheless, during 1999 through 2001, BAS intertwined research with investment banking and rewarded analysts for their support of investment banking activities.[8] BAS's failure to address the conflicts of interest that compromised the independence and objectivity of the firm's analysts resulted in the publication of research reports on three companies that did not reflect the analysts' true views.

b. BAS Research Rating System

Each BAS research report included an investment rating that purportedly reflected the analyst's objective opinion of the relative attractiveness of a stock for investors. In early 1999, BAS utilized a three-tier rating system of Buy, Hold, and Sell. In mid-1999, BAS changed to a five-tier system of Strong Buy, Buy, Market Perform, Underperform, and Sell. Under both systems, ratings were required to be predicated on an analysis of a stock's expected 12-month return (based upon an established target price) versus the market.

During 1999 through 2001, BAS analysts rarely rated companies an Underperform and almost never a Sell, in part to avoid aggravating current or prospective investment banking

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7 BAS also from time to time communicated its research directly to the media.

8 Among other things, BAS expected analysts to (i) develop investment banking business from public and private companies in their sectors, (ii) solicit business from prospective clients at pitch meetings, and (iii) support the firm's trading volume for issuers that were current or prospective investment banking clients. BAS considered investment banking contributions, among other factors, when evaluating analyst performance and determining analyst compensation. BAS investment bankers also often participated in the analyst performance review process.

clients.[9] BAS recognized the imbalance in the use of its ratings under the three-tier rating system and changed to the five-tier system to try to address it. Nevertheless, even after BAS changed to a five-tier system, the firm continued to have an imbalance in its ratings and maintained a de facto three-tier system. As of June 2001, BAS had more than 700 companies under coverage, yet it had no Sell ratings and only three Underperform ratings (less than 1%). BAS closely monitored its research by reviewing and approving reports prior to publication and by tracking analysts' stock recommendation performance. On occasion, BAS received complaints concerning its research from certain BAS employees, issuers, and customers. Thus, during the relevant period, BAS was aware of questions about whether its research was inconsistent with the firm's rating system, the analysts' views, or the performance and prospects of covered companies.

2. <u>BAS Published False Equity Research Reports on Three Companies</u>

BAS published materially false and misleading research reports on three companies that did not reflect the analysts' true views: Intel Corporation ("Intel"); TelCom Semiconductor, Inc. ("TelCom"); and E-Stamp Corporation ("E-Stamp").

a. Intel

BAS initiated coverage of Intel, a leading semiconductor chip manufacturer, with a Buy rating in August 1999. Intel was not a BAS investment banking client. BAS upgraded Intel to a Strong Buy in November 1999 and maintained that rating throughout 1999 and most of 2000. On September 13, 2000, at a time when most semiconductor analysts were bullish on semiconductor industry stocks, BAS's semiconductor analyst downgraded Intel and Advanced Micro Devices, Inc. ("AMD") from Strong Buy to Market Perform. After these early morning "double" downgrades, which cited negative demand indications, Intel's stock price dropped almost 5% in pre-market trading. Other semiconductor stocks also declined, including Elantec Semiconductor, Inc. ("Elantec"), a BAS investment banking client, which dropped more than 3% in pre-market trading.[10]

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9 For example, shortly after initiating positive coverage of an Internet retailer in 1999, the firm's analyst informed several investment bankers that BAS had a chance to "develop a relationship" with the company due to positive conversations he had had with company management. The analyst subsequently downgraded the company to a Market Perform rating in part because of the company's poor Q3 1999 performance. The analyst noted in the report that the stock then traded at more than $10 above his 12-month target price. That same day, another BAS analyst told the analyst that his rating was too high given the target price and asked how a Market Perform rating could be justified when the target price suggested a -12% return over 12 months. The analyst responded: "Because we are in the investment banking business. It will go out verbally from our sales force that this stock should be sold." Notwithstanding the analyst's private belief that the stock should be sold, BAS maintained its Market Perform rating.

10 Elantec manufactured analog circuits for a variety of markets. In July 2000, BAS solicited a role in Elantec's anticipated follow-on offering. The firm's semiconductor industry analyst participated in the Elantec pitch meeting and offered to provide positive research. (BAS did not at the time provide research coverage on Elantec.) In August 2000, BAS was selected to participate in Elantec's follow-on offering as one of several co-managers.

The analyst informed the firm's investment bankers on September 12 that he was planning to downgrade Intel. After the downgrades were released, the BAS investment banker responsible for the firm's Elantec relationship commented about the downgrades to another BAS banker, stating: "A downgrade to buy would at least have given us some wiggle room." During the next few days, the firm's Elantec banker contacted the analyst and expressed concern that the downgrades would negatively impact the firm's ability to successfully complete Elantec's upcoming follow-on offering. He also pressured the analyst not to issue further negative semiconductor industry reports until after the completion of the Elantec deal, for which BAS was acting as a co-manager. During this period, the semiconductor analyst, who had been brought "over the wall" for the offering, actively participated in the marketing of the Elantec transaction and learned it would be priced on September 19 after the market close.

In the pre-market hours of September 19, less than a week after the downgrades, the analyst upgraded Intel and AMD one level to Buy ratings. That day, Intel's stock price increased 8% and Elantec's stock price increased more than $3 or almost 5%. After the close of trading, the Elantec follow-on offering was priced. BAS earned more than $1.3 million in fees on the deal. The next day, the analyst e-mailed the firm's Marketing Director and asked: "now that intel's up, should we go back to a Hold?"

b. TelCom

Between January and October 2000, BAS initiated and maintained positive research coverage of TelCom, an investment banking client. The maintenance of a positive research rating on TelCom, during a period when TelCom's stock price dropped almost 50%, was inconsistent with the analyst's privately-expressed views.

TelCom manufactured analog circuits for a variety of markets. BAS's predecessor participated in TelCom's 1995 IPO. On January 13, 2000, at the urging of the firm's investment bankers, BAS initiated coverage of TelCom. BAS's initial research report carried a Buy rating and a $25 target price. During the next several months, BAS did not publish additional reports, but maintained its Buy rating. In March 2000, TelCom made a secondary offering in which BAS was awarded a small participation. On June 21, in response to an inquiry about TelCom from the firm's TelCom trader, the analyst replied:

> I am ashamed to say that ever since we were left on the last secondary I've gone to sleep on this one, which I only picked up because our (now departed) bankers told me to. Frankly, unless you tell me otherwise, I'd just as soon drop them. On the other hand, the semi upcycle we're in is by far the biggest I've seen and it should keep sweeping the refuse along with it – that's how I'd classify [TelCom]. Definitely, lower rung of the ladder.

Later that same day, the analyst advised a senior BAS investment banker that he wanted to drop coverage of TelCom. The banker asked the analyst to delay dropping coverage while he confirmed whether a new BAS investment banker had a relationship with the company that might open the door to future investment banking business. The analyst acceded to the banker's wishes, and BAS maintained its Buy rating in reports issued on June 22 and on July 24.

On August 14, BAS's TelCom trader e-mailed news that a competing investment banking firm, which had been a key TelCom underwriter, had downgraded TelCom. The analyst replied: "This should reopen the door for us… no coverage drop here…." Three days later, BAS reiterated its TelCom Buy rating. Just a week later, the analyst once again privately disparaged TelCom and expressed a desire to cease coverage. A BAS institutional sales person e-mailed the analyst for a second time with TelCom questions, and the analyst replied:

> can't hide, can I? I've been hoping these question[s] would go away. Why? Because [TelCom] is a crappy company with suspect management and I'd just as soon drop them…. Now, there's no doubt that management is trying to dress the company up to be sold, but that's as good as it gets, I'm afraid. I'd rather not have to "recommend" them to a real client, so now maybe you can understand why I've been ducking the issue.

The sales person responded: "Enough said…I appreciate the honesty and we will look elsewhere…" BAS publicly maintained its positive TelCom coverage as the company's stock price continued to drop.

On October 19, with the stock trading at around $10 per share, an associate analyst suggested to the analyst that BAS downgrade or drop coverage of TelCom. The analyst replied: "I don't mind dropping coverage but let's see what [the firm's investment bankers] wish to do first." The next day, BAS lowered its estimates but once again maintained its Buy rating in a report on TelCom's Q3 2000 financial results, which were negative and below estimates. Several days later, on October 25, BAS downgraded TelCom to a Market Perform rating in a semiconductor industry report that downgraded virtually the entire semiconductor sector.

c. E-Stamp

E-Stamp made products that allowed customers to purchase postage via the Internet. BAS acted as a co-manager for E-Stamp's 1999 IPO, earning more than $2 million in fees. Following the IPO, BAS initiated coverage of E-Stamp with a Buy rating and a $30 target price. BAS's Internet retail analyst and an associate analyst were responsible for covering the company. E-Stamp was never profitable and was delisted from the Nasdaq Stock Market less than two years after its IPO. Between November 1999 and August 2000, as E-Stamp's stock price declined from over $22 per share to around $1 per share, BAS maintained its Buy rating on the stock and failed to lower its $30 target price.

On January 19, 2000, BAS published a detailed E-Stamp report maintaining its Buy rating and $30 target price. Several days later, on January 27, a BAS employee asked the analyst whether E-Stamp was "worth a look" and the analyst responded: "Hold off on it." During the next several months, E-Stamp failed to meet its financial projections and its stock price sunk to below $4 per share. Contrary to the analyst's negative views and the company's dismal financial performance, BAS maintained its E-Stamp Buy rating in two reports. Though the BAS rating system required all Buy-rated stocks to be based on target prices, in each of these reports, BAS failed to publish a target price or disclose any change to its previously published $30 target.

On July 20, with the stock trading below $2 per share, E-Stamp announced its Q2 2000 results, which included substantial losses and a significant business model revision. Following this announcement, the associate analyst wrote to a relative concerning E-Stamp: "just had a thoroughly [expletive deleted] company chunk numbers once again and totally change their business model. nice." Hours later, contrary to those negative views and the company's dim prospects, BAS once more maintained its E-Stamp Buy rating, but did not publish a target price. Two weeks later, the analyst sought permission from investment bankers to drop coverage of E-Stamp. The responsible banker replied: "Please, before officially dropping we should talk... My concern is potential market perception that we are kicking our .Com clients when they are down...." The analyst acceded to the request of the banker and continued E-Stamp coverage. During the next week, the analyst e-mailed the banker several times to encourage him to contact E-Stamp and authorize the coverage drop. BAS maintained its E-Stamp Buy rating for several more weeks.

On August 25, BAS bankers informed E-Stamp that BAS intended to drop coverage. E-Stamp management, upset at the decision, complained to the firm's research director, who then contacted the analyst and suggested moving E-Stamp into coverage-in-transition as an alternative to dropping coverage. The analyst responded:

> ...this thing [E-stamp] is terminal. ...I wrote more research than the lead manager, we kept a Buy on the stock (and shouldn't have) all the way through it. We've done more than our share. They have missed every quarter by a mile and now have completely changed the model. I told [E-Stamp's CEO] that it only complicates the situation that we [have] a Buy on the stock. At a minimum, that should be reduced. Not really an option at this point, however, because it makes us look that much worse. ...I'll do whatever you like but do not want to take up anymore of your time. I vote for dropping.

Shortly thereafter, BAS dropped coverage of E-Stamp.

3. "Ratings Reset" Week

By mid-2001, BAS was concerned that its research ratings and price targets were either inconsistent with the analysts' views or unrealistic in light of changes that had occurred in the securities markets.[11] As a result, BAS administered a firm-wide research rating adjustment. On July 24, BAS announced "BAS Ratings Reset Week" to the research department as an amnesty program pursuant to which analysts would have an opportunity to reset their ratings to more accurately reflect their views or current market conditions. BAS did not publicly announce the program and did not inform its customers. BAS told analysts the reset would take place over an entire week in order "to avoid a massive rush of rating changes all at once" and to keep the changes "way below the radar scope." Beginning August 13, and continuing for at least a week, BAS analysts reduced ratings, target prices, and earnings estimates as part of the firm's reset week. Nonetheless, the reset project did not correct the firm's research problems. In the following months, concern was expressed within BAS that many of its ratings and target prices

[11] For example, in January 2001, BAS was aware that more than 120 Buy and Strong Buy rated stocks required greater than 50% appreciation to reach the firm's target price, more than 70 stocks required 100% appreciation, and at least 16 required over 300% appreciation.

still were unrealistic.[12] Accordingly, throughout the relevant period, BAS was aware of problems with its research and failed adequately to address them.

IV.

LEGAL ANALYSIS

A. Section 15(f) of the Exchange Act

Section 15(f) of the Exchange Act requires broker-dealers to establish, maintain and enforce written policies and procedures reasonably designed, taking into consideration the nature of the broker's or dealer's business, to prevent the misuse, in violation of the federal securities laws, of material, nonpublic information by such broker or dealer or any of its employees or associated persons. Congress enacted Section 15(f) as part the Insider Trading and Securities Fraud Enforcement Act of 1988 ("ITSFEA") in an effort to strengthen the internal controls of broker-dealers. H.R. Rep. No. 910, 100th Cong., 2nd Sess. (1988). Section 15(f) is intended to protect against a broad range of potential market violations, including insider trading and broker-dealer front running.

The internal controls requirements imposed by Section 15(f) are essential to protect against the risk of misuse of material nonpublic information and to further the Commission's mission to protect investors and maintain market integrity. The securities industry has long been aware of the need for effective compliance policies to guard against the risk of misuse of material nonpublic information, and the need to tailor those policies to the specific activities of the individual firm. *See, e.g., In re Goldman Sachs & Co.*, Exchange Act Release No. 48436 (Sept. 4, 2003); *In re Guy P. Wyser-Pratte*, Exchange Act Release No. 44283 (May 9, 2001); *In re Gabelli & Co. and Gamco Investors, Inc.*, Exchange Act Release No. 35057 (Dec. 8, 1994) (a broker-dealer must establish and enforce procedures that expressly address issues raised by an associated person who has access to material nonpublic information while at the same time performs multiple employment responsibilities). The mere establishment of policies and procedures alone is not sufficient to prevent the misuse of material nonpublic information. It also is necessary to implement measures to monitor compliance with and enforcement of those policies and procedures. *See, e.g., In the Matter of Morgan Stanley & Co. Inc. and Morgan Stanley DW Inc.*, Exchange Act Release No. 54047 (June 27, 2006) (firm established certain written policies and procedures to prevent the misuse of material nonpublic information by the firm or persons associated with it, but failed to maintain and enforce them and to conduct any surveillance of a massive number of accounts and securities).

BAS's policies and procedures were not reasonably designed, given the nature of its business, to prevent the misuse of material nonpublic information. The firm failed to maintain adequate controls over the dissemination and public release of its material nonpublic research

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12 Approximately one month after reset week, BAS learned that more than 126 Strong Buy and Buy rated stocks still required greater than 100% appreciation to reach the firm's target prices, and at least 21 stocks required more than 250% appreciation. More than six months later, a senior supervisory analyst complained to the firm's Research and Compliance Directors that the firm's ratings and target prices were still "unrealistic."

information. BAS lacked adequate controls to track the actual release time for its research and thus was unable to accurately monitor for potential misuse of that information. BAS also failed to establish and maintain written policies governing the firm's position traders' access to and use of the firm's material nonpublic research information. The Marketing Director's multiple responsibilities, extensive personal trading, and position straddling the firm's research information wall presented a significant risk that he and others could misuse the firm's material nonpublic information. BAS failed to establish any specific policies and procedures regarding the Marketing Director's possession and use of material nonpublic research information other than the firm's general requirements that were applicable to all employees. Furthermore, when confronted with indications of potentially violative trading, BAS either failed reasonably to enforce the firm's policies and procedures to protect against the misuse of the firm's research information, or failed to act at all. Accordingly, BAS willfully violated Section 15(f) of the Exchange Act.

B. Section 15(c) of the Exchange Act and Rule 15c1-2(a) Thereunder

Section 15(c)(1)(A) of the Exchange Act prohibits brokers and dealers from using "any manipulative, deceptive, or other fraudulent device or contrivance" in connection with securities transactions. Exchange Act Rule 15c1-2(a) defines the phrase "manipulative, deceptive, or other fraudulent device or contrivance" as "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person." Among the conduct prohibited by these provisions is the making of any untrue statement of a material fact or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading. Congress enacted the antifraud provisions "to provide for the establishment of a mechanism of regulation among over-the-counter brokers and dealers ... to prevent acts and practices inconsistent with just and equitable principles of trade." H.R. Rep. No. 2307, 75th Cong., 3d Sess. (1938).

Violations of the antifraud provisions require the misstatements or omissions concern material facts. *See Basic, Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988) (quoting *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). A fact is material if there is a substantial likelihood that a reasonable investor would consider it important in making an investment decision. *See TSC Industries*, 426 U.S. at 449. The scienter requirement is the same for Section 15(c)(1) violations as for violations of Section 10(b). *SEC v. Dowdell*, 2002 WL 424595 at *6 (W.D. Va. March 14, 2002); *In the Matter of Fundamental Portfolio Advisors, Inc., et al.*, Exchange Act Release No. 48177 (July 15, 2003).

During 1999 through 2001, BAS published research reports regarding Intel, TelCom, and E-Stamp that were unduly influenced by investment banking considerations and failed to disclose the analysts' actual, negative views concerning the companies. By publishing research reports that were contrary to the privately held views of its analysts, BAS violated Section 15(c) of the Exchange Act and Rule 15c1-2(a) thereunder.

V.

Based on the foregoing, the Commission finds that BAS willfully violated Sections 15(c) and 15(f) of the Exchange Act and Rule 15c1-2(a) thereunder.

VI.

UNDERTAKINGS

A. Section 15(f) Undertakings

BAS undertakes to:

1. Retain, at BAS's expense and within thirty (30) days of the issuance of this Order, a qualified independent consultant (the "Consultant") not unacceptable to the staff to conduct a comprehensive review of BAS' policies, practices and procedures to prevent the misuse of material nonpublic information concerning BAS research, to determine the adequacy of such policies, practices and procedures under Section 15(f) of the Exchange Act, and to prepare a Report, referenced below, reviewing the adequacy of BAS' current policies, practices, and procedures and making recommendations regarding how BAS should modify or supplement the policies, practices, and procedures to prevent the misuse of material nonpublic information in compliance with Section 15(f). BAS shall provide a copy of the engagement letter detailing the Consultant's responsibilities to Kara N. Brockmeyer, Assistant Director, Division of Enforcement, U.S. Securities and Exchange Commission, 100 F Street, N.E., Washington, DC, 20549-8549;

2. Cooperate fully with the Consultant, including providing the Consultant with access to its files, books, records, and personnel as reasonably requested for the above-mentioned review, and obtaining the cooperation of its employees or other persons under its control;

3. Require the Consultant to report to the Commission staff on his/her activities as the staff shall request;

4. Permit the Consultant to engage such assistance, clerical, legal or expert, as necessary and at reasonable cost, to carry out his/her activities, and the cost, if any, of such assistance shall be borne exclusively by Respondent;

5. Within one hundred and fifty (150) days of the issuance of this Order, unless otherwise extended by the staff for good cause, BAS shall require the Consultant to complete the review and prepare a written Report that: (i) evaluates the adequacy under Section 15(f) of the Exchange Act of BAS' policies, practices, and procedures to prevent the misuse of material nonpublic information concerning BAS research; and (ii) makes any recommendations about modifications thereto or additional or supplemental procedures deemed necessary to remedy any deficiencies described in the Report. The Consultant shall provide

the Report simultaneously to both the Commission staff (at the address set forth above) and Respondent. BAS shall afford the Consultant the option to seek an extension of time to submit the Report by making a written request to the staff at the address set forth above, a copy of which the Consultant shall provide to Respondent;

6. Within one hundred and twenty (120) days of BAS' receipt of the Report, BAS shall adopt and implement all recommendations set forth in the Report; provided, however, that as to any recommendation that BAS considers to be, in whole or in part, unduly burdensome or impractical, BAS may submit in writing to the Consultant and the staff (at the address set forth above), within sixty (60) days of receiving the Report, an alternative policy, practice, or procedure designed to achieve the same objective or purpose. BAS and the Consultant shall then attempt in good faith to reach an agreement relating to each recommendation that BAS considers to be unduly burdensome or impractical and the Consultant shall reasonably evaluate any alternative policy, practice, or procedure proposed by Respondent. Such discussion and evaluation by BAS and the Consultant shall conclude within ninety (90) days after BAS' receipt of the Report, whether or not BAS and the Consultant have reached an agreement. Within fourteen (14) days after the conclusion of the discussion and evaluation by BAS and the Consultant, BAS shall require that the Consultant inform BAS and the staff (at the address set forth above) of his/her final determination concerning any recommendation that BAS considers to be unduly burdensome or impractical. BAS shall abide by the determinations of the Consultant and, within sixty (60) days after final agreement between BAS and the Consultant or final determination by the Consultant, whichever occurs first, BAS shall adopt and implement all of the recommendations that the Consultant deems appropriate;

7. Within fourteen (14) days of BAS' adoption of all of the recommendations that the Consultant deems appropriate, BAS shall certify in writing to the Consultant and the staff (at the address set forth above) that BAS has adopted and implemented all of the Consultant's recommendations and that BAS has established policies, practices, and procedures pursuant to Section 15(f) of the Exchange Act that are consistent with the findings of this Order;

8. BAS may apply to the staff for an extension of the deadlines described above before their expiration, and upon a showing of good cause by Respondent, the staff may, in its sole discretion, grant such extensions for whatever time period it deems appropriate;

9. To ensure the independence of the Consultant, BAS shall not have the authority to terminate the Consultant without prior written approval of the Commission's staff, and shall compensate the Consultant and persons engaged to assist the Consultant for services rendered pursuant to this Order at their reasonable and customary rates;

10. BAS shall require the 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 Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with BAS or any of their present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the 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 Consultant in the performance of his/her duties under this Order shall not, without the prior written consent of the staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with BAS, or any of their 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;

11. BAS agrees to certify in writing to the staff (at the address set forth above), in the second year following the issuance of this Order, that BAS has established and continues to maintain policies, practices, and procedures pursuant to Section 15(f) of the Exchange Act that are consistent with the findings of this Order.

B. <u>Research Undertakings</u>

BAS has informed the staff of the Commission that it has implemented policies and procedures relating to its equity research and investment banking operations to ensure compliance with the terms of Addendum A to this Order, which is incorporated herein with the same force and effect as if fully set forth in the Order.

BAS undertakes to:

1. Within 30 days from the date of the issuance of this Order: (i) conduct a review of the implementation and effectiveness of the firm's policies and procedures relating to its equity research and investment banking operations to ensure compliance with all terms of Addendum A, and (ii) provide a written report to the staff of the Commission setting forth its findings and its recommendations regarding any revisions or improvements to the firm's policies and procedures necessary or appropriate to ensure compliance with all terms of Addendum A ("the Report"); and

2. Within 30 days from the date of the Report: (i) adopt and implement all recommendations of the Report, and (ii) certify that the firm's policies and procedures relating to its equity research and investment banking operations ensure compliance with all terms of Addendum A.

VII.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions specified in Respondent Banc of America Securities LLC's Offer.

ACCORDINGLY, IT IS HEREBY ORDERED THAT:

A. Pursuant to Section 21C of the Exchange Act, Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 15(c) and 15(f) of the Exchange Act and Rule 15c1-2(a) promulgated thereunder;

B. Respondent is censured pursuant to Section 15(b)(4) of the Exchange Act;

C. Respondent shall comply with the undertakings enumerated in Section VI above;

D. Respondent shall, within ten days of the entry of this Order, pay a civil money penalty in the amount of $6,000,000 for its violations of Section 15(f) of the Exchange Act, and shall pay disgorgement in the amount of $10,000,000 and a civil money penalty in the amount of $10,000,000 for its violations of Section 15(c) of the Exchange Act. Such payments shall be: (i) made by United States postal money order, certified check, bank cashier's check or bank money order; (ii) made payable to the U.S. Securities and Exchange Commission; (iii) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (iv) submitted with a cover letter that identifies BAS as the Respondent in this proceeding and includes the file number of this proceeding, a copy of which cover letter and money order or check shall be sent to Kara N. Brockmeyer, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington DC, 20549-8549;

E. Pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, a Fair Fund is created for the disgorgement and penalties referenced in Section VII.D above (the "Distribution Fund"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that it shall not, after offset or reduction in any Related Investor Action based on Respondent's payment of disgorgement in this action, argue that it is entitled to, nor shall it further benefit by offset or reduction of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the United States Treasury or to a Fair Fund, as the Commission directs. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding;

F. The Distribution Fund shall be deposited at the Bureau of Public Debt for investment in government obligations. The Distribution Fund shall be distributed pursuant to a distribution plan (the "Distribution Fund Plan") developed by an administrator (the "Distribution Fund Administrator") appointed by the Commission pursuant to the Commission's Rules on Fair Fund and Disgorgement Plans, 17 C.F.R. 201.1101, et seq. (Rule 1101 through Rule 1106). The Distribution Fund shall be utilized to pay any taxes on income earned by the Distribution Fund. Under no circumstances shall any part of the Distribution Fund be returned to Respondent;

G. Respondent shall pay all fees, costs, and expenses related to the development and implementation of the Distribution Fund Plan, including all fees, costs and expenses incurred by the Distribution Fund Administrator in connection with and incidental to the performance of his duties under this Order and any further applicable orders of the Commission; and all fees, costs, and expenses of any persons engaged to assist the Distribution Fund Administrator. The Distribution Fund Administrator shall on a quarterly basis submit invoices to Respondent, with copies sent to the Commission staff, indicating the amount of the payment due, the deadline for payment, and the instruction for transmitting the payment. Respondent shall promptly submit payments to the Distribution Fund Administrator upon receipt of such invoices from the Distribution Fund Administrator;

H. The Distribution Fund is deemed a qualified settlement fund by the Internal Revenue Service and may incur tax obligations under Treasury Regulation §1.468B-1(e). A tax administrator will be appointed by Commission staff to fulfill such obligation (the "Tax Administrator"). Respondent and the Distribution Fund Administrator shall cooperate with the Tax Administrator to see that all tax payments are timely made. Respondent shall pay all fees, costs, and expenses of the Tax Administrator, including all fees costs and expenses incurred by the Tax Administrator in connection with the preparation of tax returns and/or seeking IRS rulings. Respondent shall promptly submit payments to the Tax Administrator upon notice from the Tax Administrator as to the amount of the payment due, the deadline for payment, and the instruction for transmitting the payment;

I. Respondent shall cooperate with the Distribution Fund Administrator, including upon request, providing the following non-privileged documents, records, and information to the Distribution Fund Administrator: (1) research reports issued by Respondent during the relevant period identified in this Order; (2) documents, records, and information relating to customers' equity securities transactions with or through Respondent, including but not limited to account statements, order tickets, confirmations, and related documents, records and information; and (3) such other documents, records, and information as are necessary for the Distribution Fund Administrator to carry out his duties. Respondent shall cooperate in arranging for interviews of Respondent's employees to explain to the Distribution Fund Administrator and otherwise assist the Distribution Fund Administrator in understanding such documents, records, and information and the distribution of such reports. Respondent shall take such actions as the Distribution Fund Administrator may require (including, but not limited to, providing any notices to any of Respondent's present or former customers that the Distribution Fund Administrator deems appropriate) to ensure proper implementation of the Distribution Fund Plan. Respondent shall indemnify, defend, and hold harmless the Distribution Fund Administrator, his agents, and his attorneys from and against liabilities, claims, and demands, whether civil, administrative, or investigative, judgments, fines, and amounts paid in settlement, and costs and expenses (including attorneys' fees), arising from or relating to any act or omission to act in the course of performing his duties, except and to the extent that a court of competent jurisdiction finds that such person acted criminally, or in bad faith, or with gross negligence, or with reckless disregard of his duties, or in a manner that he knew was contrary to the terms of this Order or any further applicable order of the Commission; and

J. For a period of three years from the effective date of this Order or such shorter or longer period as the Commission may order, Respondent, its officers, directors, agents, affiliates, servants, employees, attorneys, and those persons in active concert or participation with them, and each of them, are hereby enjoined from destroying, mutilating, concealing, altering, or disposing of (a) any research concerning any issuers referenced in Section III above distributed by Respondent during the relevant period identified in this Order; (b) documents sufficient to identify all customers who bought or sold equity securities of such issuers during the relevant period identified in the Order (the "Transactions"), including but not limited to documents sufficient to identify the dates, amounts, and prices of the Transactions; (c) documents sufficient to identify which customers received which research concerning such issuers distributed by Respondent during the relevant period identified in the Order; (d) order entry information sufficient to identify whether the Transactions were solicited by Respondent; and (e) any and all written (including electronic) communication, including communications to and from customers and intra-firm communications, relating to Respondent's investment banking and equity research operations concerning such issuers during the relevant period identified in the Order; *provided, however*, that Respondent need not retain duplicate identical copies of public documents filed with the Commission or any other regulatory authority.

By the Commission.

Nancy M. Morris
Secretary

Addendum

Addendum A

Research Undertakings

BAS shall comply with the following undertakings:

I. Separation of Research and Investment Banking

1. Reporting Lines. Research and Investment Banking will be separate units with entirely separate reporting lines within the firm – i.e., Research will not report directly or indirectly to or through Investment Banking. For these purposes, the head of Research may report to or through a person or persons to whom the head of Investment Banking also reports, provided that such person or persons have no direct responsibility for Investment Banking or investment banking activities.

   a. As used throughout this Addendum, the term "firm" means the Respondent, Respondent's successors and assigns (which, for these purposes, shall include a successor or assign to Respondent's investment banking and research operations), and their affiliates, other than "exempt investment adviser affiliates."

   b. As used throughout this Addendum, the term "exempt investment adviser affiliate" means an investment adviser affiliate (including, for these purposes, a separately identifiable department or division that is principally engaged in the provision of investment advice to managed accounts as governed by the Investment Advisers Act of 1940 or investment companies under the Investment Company Act of 1940) having no officers (or persons performing similar functions) or employees in common with the firm (which, for purposes of this Section I.1.b., shall not include the investment adviser affiliate) who can influence the activities of the firm's Research personnel or the content of the firm's research reports; provided that the firm (i) maintains and enforces written policies and procedures reasonably designed to prevent the firm, any controlling persons, officers (or persons performing similar functions), or employees of the firm from influencing or seeking to influence the activities of Research personnel of, or the content of research reports prepared by, the investment adviser affiliate; (ii) obtains an annual independent assessment of the operation of such policies and procedures; and (iii) does not furnish to its customers research reports prepared by the investment adviser affiliate or otherwise use such investment adviser affiliate to do indirectly what the firm may not do directly under this Addendum.

   c. As used throughout this Addendum, the term "Investment Banking" means all firm personnel engaged principally in investment banking activities, including the solicitation of issuers and structuring of public offering and other investment banking transactions. It also includes all firm personnel who are directly or indirectly supervised by such persons and all personnel who directly or indirectly supervise such persons, up to and including Investment Banking management.

d. As used throughout this Addendum, the term "Research" means all firm personnel engaged principally in the preparation and/or publication of research reports, including firm personnel who are directly or indirectly supervised by such persons and those who directly or indirectly supervise such persons, up to and including Research management.

e. As used throughout this Addendum, the term "research report" means any written (including electronic) communication that is furnished by the firm to investors in the U.S. and that includes an analysis of the common stock, any security convertible into common stock, or any derivative thereof, including American Depositary Receipts (collectively, "Securities"), of an issuer or issuers and provides information reasonably sufficient upon which to base an investment decision; provided, however, that a "research report" shall not include:

i. the following communications, if they do not include (except as specified below) an analysis, recommendation or rating (e.g., buy/sell/hold, under perform/market perform/outperform, underweight/market weight/overweight, etc.) of individual securities or issuers:

1) reports discussing broad-based indices, such as the Russell 2000 or S&P 500 index;

2) reports commenting on economic, political or market (including trading) conditions;

3) technical or quantitative analysis concerning the demand and supply for a sector, index or industry based on trading volume and price;

4) reports that recommend increasing or decreasing holdings in particular industries or sectors or types of securities; and

5) statistical summaries of multiple companies' financial data and broad-based summaries or listings of recommendations or ratings contained in previously-issued research reports, provided that such summaries or listings do not include any analysis of individual companies; and

ii. the following communications, even if they include information reasonably sufficient upon which to base an investment decision or a recommendation or rating of individual securities or companies:

1) an analysis prepared for a current or prospective investing customer or group of current or prospective investing customers by a registered salesperson or trader who is (or group of registered salespersons or traders

who are) not principally engaged in the preparation or publication of research reports; and

2) periodic reports, solicitations or other communications prepared for current or prospective investment company shareholders (or similar beneficial owners of trusts and limited partnerships) or discretionary investment account clients, provided that such communications discuss past performance or the basis for previously made discretionary investment decisions.

f. As used throughout this Addendum, the term "technical research report" means any written (including electronic) communication that is furnished by the firm to investors in the U.S. and that includes an analysis of the Securities of an issuer or issuers, that is based solely on prices and trading volume and not on the issuer's financial information, business prospects, or contact with issuer management, and that provides information reasonably sufficient upon which to base an investment decision.

g. As used throughout this Addendum, the term "quantitative research report" means any written (including electronic) communication that is furnished by the firm to investors in the U.S. and that includes an analysis of the Securities of an issuer or issuers, that relies solely on the systematic application of statistical or numerical techniques to publicly available data, that does not include a qualitative assessment of an issuer's business prospects or contact with issuer management, and that provides information reasonably sufficient upon which to base an investment decision.

h. As used throughout this Addendum, the term "Institutional Customer" means an entity other than a natural person having at least $10 million invested in securities in the aggregate in its portfolio and/or under management.

i. As used throughout this Addendum the term "Small Institutional Customer" means an entity other than a natural person having less than $10 million and more than $1 million invested in securities in the aggregate in its portfolio and/or under management.

2. Legal/Compliance. Research will have its own dedicated legal and compliance staff, who may be a part of the firm's overall compliance/legal infrastructure.

3. Budget. For the firm's first fiscal year following the issuance of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Order") against Respondent and thereafter, Research budget and allocation of Research expenses will be determined by the firm's senior management (e.g.,

CEO/Chairman/management committee, other than Investment Banking personnel) without input from Investment Banking and without regard to specific revenues or results derived from Investment Banking, though revenues and results of the firm as a whole may be considered in determining Research budget and allocation of Research expenses. On an annual basis thereafter, the Audit Committee of the firm's holding/parent company (or comparable independent persons/group without management responsibilities) will review the budgeting and expense allocation process with respect to Research to ensure compliance with this requirement.

4. Physical Separation. Research and Investment Banking will be physically separated. Such physical separation will be reasonably designed to prevent the intentional and unintentional flow of information between Research and Investment Banking.

5. Compensation. Compensation of professional Research personnel will be determined exclusively by Research management and the firm's senior management (but not including Investment Banking personnel) using the following principles:

   a. Investment Banking will have no input into compensation decisions.

   b. Compensation may not be based directly or indirectly on Investment Banking revenues or results; provided, however, that compensation may relate to the revenues or results of the firm as a whole.

   c. A significant portion of the compensation of anyone principally engaged in the preparation of research reports (as defined in this Addendum) that he or she is required to certify pursuant to Regulation AC (such person hereinafter a "lead analyst") must be based on quantifiable measures of the quality and accuracy of the lead analyst's research and analysis, including his or her ratings and price targets, if any. In assessing quality, the firm may rely on, among other things, evaluations by the firm's investing customers, evaluations by the firm's sales personnel and rankings in independent surveys. In assessing accuracy, the firm may use the actual performance of a company or its equity securities to rank its own lead analysts' ratings and price targets, if any, and forecasts, if any, against those of other firms, as well as against benchmarks such as market or sector indices.

   d. Other factors that may be taken into consideration in determining lead analyst compensation include: (i) market capitalization of, and the potential interest of the firm's investing clients in research with respect to, the industry covered by the analyst; (ii) Research management's assessment of the analyst's overall performance of job duties, abilities and leadership; (iii) the analyst's seniority and experience; (iv) the analyst's productivity; and (v) the market for the hiring and retention of analysts.

e. The criteria to be used for compensation decisions will be determined by Research management and the firm's senior management (not including Investment Banking) and set forth in writing in advance.

f. Research management will document the basis for each compensation decision made with respect to (i) anyone who, in the last 12 months, has been required to certify a research report (as defined in this Addendum) pursuant to Regulation AC; and (ii) anyone who is a member of Research management (except in the case of senior-most Research management, in which case the basis for each compensation decision will be documented by the firm's senior management).

On an annual basis, the Compensation Committee of the firm's holding/parent company (or comparable independent persons/group without management responsibilities) will review the compensation process for Research personnel. Such review will be reasonably designed to ensure that compensation decisions have been made in a manner that is consistent with these requirements.

6. Evaluations. Evaluations of Research personnel will not be done by, nor will there be input from, Investment Banking personnel.

7. Coverage. Investment Banking will have no input into company-specific coverage decisions (i.e., whether or not to initiate or terminate coverage of a particular company in research reports furnished by the firm), and investment banking revenues or potential revenues will not be taken into account in making company-specific coverage decisions; provided, however, that this requirement does not apply to category-by-category coverage decisions (e.g., a given industry sector, all issuers underwritten by the firm, companies meeting a certain market cap threshold).

8. Termination of Coverage. When a decision is made to terminate coverage of a particular company in the firm's research reports (whether as a result of a company-specific or category-by-category decision), the firm will make available a final research report on the company using the means of dissemination equivalent to those it ordinarily uses; provided, however, that no final report is required for any company as to which the firm's prior coverage has been limited to quantitative or technical research reports. Such report will be comparable to prior reports, unless it is impracticable for the firm to produce a comparable report (e.g., if the analyst covering the company and/or sector has left the firm). In any event, the final research report must disclose: the firm's termination of coverage; and the rationale for the decision to terminate coverage.

9. Prohibition on Soliciting Investment Banking Business. Research is prohibited from participating in efforts to solicit investment banking business. Accordingly, Research may not, among other things, participate in any "pitches" for investment banking business to prospective investment banking clients, or have other communications with companies for the purpose of soliciting investment banking business.

10. Firewalls Between Research and Investment Banking. So as to reduce further the potential for conflicts of interest or the appearance of conflicts of interest, the firm must create and enforce firewalls between Research and Investment Banking reasonably designed to prohibit all communications between the two except as expressly described below:

   a. Investment Banking personnel may seek, through Research management (or an appropriate designee with comparable management or control responsibilities ("Designee")) or in the presence of internal legal or compliance staff, the views of Research personnel about the merits of a proposed transaction, a potential candidate for a transaction, or market or industry trends, conditions or developments. Research personnel may respond to such inquiries on these subjects through Research management or its Designee or in the presence of internal legal or compliance staff. In addition, Research personnel, through Research management or its Designee or in the presence of internal legal or compliance staff, may initiate communications with Investment Banking personnel relating to market or industry trends, conditions or developments, provided that such communications are consistent in nature with the types of communications that an analyst might have with investing customers. Any communications between Research and Investment Banking personnel must not be made for the purpose of having Research personnel identify specific potential investment banking transactions.

   b. In response to a request by a commitment or similar committee or subgroup thereof, Research personnel may communicate their views about a proposed transaction or potential candidate for a transaction to the committee or subgroup thereof in connection with the review of such transaction or candidate by the committee. Investment Banking personnel working on the proposed transaction may participate with the Research personnel in these discussions with such committee or subgroup. However, the Research personnel also must have an opportunity to express their views to the committee or subgroup outside the presence of such Investment Banking personnel.

   c. Research personnel may assist the firm in confirming the adequacy of disclosure in offering or other disclosure documents for a transaction based on the analysts' communications with the company and other vetting conducted outside the presence of Investment Banking personnel, but to the extent communicated to Investment Banking personnel, such communication shall only be made in the presence of underwriters' or other counsel on the transaction or internal legal or compliance staff.

   d. After the firm receives an investment banking mandate, or in connection with a block bid or similar transaction, Research personnel may

i. Communicate their views on the pricing and structuring of the transaction to personnel in the firm's equity capital markets group, which group's principal job responsibility is the pricing and structuring of transactions;

ii. Provide to personnel in the firm's equity capital markets group information obtained from investing customers relevant to the pricing and structuring of the transaction;

iii. Participate with the equity capital markets group, or independently, in efforts to educate the firm's sales force regarding the transaction, including assisting in the preparation of internal-use memoranda (including presentations in electronic format) and communicating with the firm's sales force, provided that Research personnel may not appear jointly with management of the issuer or Investment Banking personnel other than members of the equity capital markets group in such communications with the firm's sales force, and provided that the following conditions are satisfied:

1) Such oral communications by Research personnel with the firm's sales force personnel regarding the transaction in which a recommendation or view, whether or not labeled as such, is expressed by such Research personnel regarding the transaction must have a reasonable basis;

2) Such oral communications to a group of ten or more of the firm's sales force must be "fair and balanced", as such phrase is generally understood under NASD Rule 2210(d)(1) and after taking into consideration the overall context in which such communications are made (hereinafter referred to as the "fair and balanced standard"). In addition, all such oral communications to a group of ten or more of the firm's sales force must be made in the presence of internal legal or compliance personnel;

3) All internal-use memoranda (or portions thereof) regarding such transaction that are identified as being the views of Research personnel (such memoranda or portions thereof hereinafter referred to as "internal Research memoranda") must comply with the fair and balanced standard;

4) Internal Research memoranda that are distributed to a group of ten or more of the firm's sales force must be reviewed in advance by internal legal or compliance personnel;

5) A written log of all oral communications described in (2) above must be maintained; and

6) All written logs and all internal Research memoranda described in (4) above must be retained for the period required by Rule 17a-4(b)(4).

e. Research personnel may attend or participate in a widely-attended conference attended by Investment Banking personnel or in which Investment Banking personnel participate, provided that the Research personnel do not participate in activities otherwise prohibited herein.

f. Research and Investment Banking personnel may attend or participate in widely-attended firm or regional meetings at which matters of general firm interest are discussed. Research management and Investment Banking management may attend meetings or sit on firm management, risk or similar committees at which general business and plans (including those of Investment Banking and Research) and other matters of general firm interest are discussed. Research and Investment Banking personnel may communicate with each other with respect to legal or compliance issues, provided that internal legal or compliance staff is present.

g. Communications between Research and Investment Banking personnel that are not related to investment banking or research activities may take place without restriction.

11. Additional Restrictions on Activities By Research and Investment Banking Personnel.

a. Research personnel are prohibited from participating in company- or Investment Banking-sponsored road shows related to a public offering or other investment banking transaction.

b. Investment Banking personnel are prohibited from directing Research personnel to engage in marketing or selling efforts to investors with respect to an investment banking transaction.

c. After the firm receives an investment banking mandate relating to a public offering of securities, Research personnel may communicate with investors regarding such offering provided that Research personnel may not appear jointly with management of the issuer or Investment Banking personnel in such communications, and provided that the following conditions are satisfied:

i. Such oral communications by Research personnel with investors regarding the offering in which a recommendation or view, whether or not labeled as such, is expressed by such Research personnel regarding the offering must have a reasonable basis;

ii. Such oral communications to a group of ten or more investors regarding such offering must comply with the fair and balanced standard;

iii. All such oral communications to a group of ten or more investors must be made in the presence of internal legal or compliance personnel;

iv. A written log of all oral communications described in (ii.) above must be maintained; and

v. All written logs must be retained for the period required by Rule 17a-4(b)(4).

12. Oversight. An oversight/monitoring committee or committees, which will be comprised of representatives of Research management and may include others (but not personnel from Investment Banking), will be created to:

a. review (beforehand, where practicable) all changes in ratings, if any, and material changes in price targets, if any, contained in the firm's research reports;

b. conduct periodic reviews of research reports to determine whether changes in ratings or price targets, if any, should be considered; and

c. monitor the overall quality and accuracy of the firm's research reports;

provided, however, that Sections I.12.a. and I.12.b. of this Addendum shall not be required with respect to quantitative or technical research reports.

II. Disclosure/Transparency and Other Issues

1. Disclosures. In addition to other disclosures required by rule, the firm must disclose prominently on the first page of any research report and any summary or listing of recommendations or ratings contained in previously-issued research reports, in type no smaller than the type used for the text of the report or summary or listing, that:

a. "[Firm] does and seeks to do business with companies covered in its research reports. As a result, investors should be aware that the firm may have a conflict of interest that could affect the objectivity of this report."

b. "Investors should consider this report as only a single factor in making their investment decision."

2. Transparency of Analysts' Performance. The firm will make publicly available (via its website, in a downloadable format), no later than 90 days after the conclusion of each quarter (beginning with the first full calendar quarter that commences at least 120 days following the issuance of the Order), the following information, if such information is included in any research report (other than any quantitative or technical research report) prepared and furnished by the firm during the prior quarter: subject company, name(s) of analyst(s) responsible for certification of the report pursuant to Regulation AC, date of report, rating, price target, period within which the price target is to be achieved, earnings per share forecast(s) for the current quarter, the next quarter and the current full year, indicating the period(s) for which such forecast(s)

are applicable (e.g., 3Q03, FY04, etc.), and definition/explanation of ratings used by the firm.

3. Applicability. Except as specified in the second and third sentences of this Section II.3., the restrictions and requirements set forth in Section I [Separation of Research and Investment Banking] and Section II [Disclosure/Transparency and Other Issues] of this Addendum will only apply in respect of a research report that is both (i) prepared by the firm, and (ii) that relates to either (A) a U.S. company, or (B) a non-U.S. company for which a U.S. market is the principal equity trading market; provided, however, that such restrictions and requirements do not apply to Research activities relating to a non-U.S. company until the second calendar quarter following the calendar quarter in which the U.S. market became the principal equity trading market for such company. Notwithstanding the foregoing, Section I.7. [Coverage] of this Addendum will also apply to any research report that has been *furnished* by the firm to investors in the U.S., but not prepared by the firm, but only to the extent that the report relates to either (A) a U.S. company, or (B) a non-U.S. company for which a U.S. market is the principal equity trading market. Also notwithstanding the foregoing, Section II.1. [Disclosures] of this Addendum will also apply to any research report that has been *furnished* by the firm to investors in the U.S., but not prepared by the firm, including a report that relates to a non-U.S. company for which a U.S. market is not the principal equity trading market, but only to the extent that the report has been furnished under the firm's name, has been prepared for the exclusive or sole use of the firm or its customers, or has been customized in any material respect for the firm or its customers.

a. For purposes of this Section II.3., the firm will be deemed to have furnished a research report to investors in the U.S. if the firm has made the research report available to investors in the U.S. or has arranged for someone else to make it available to investors in the U.S.

b. For purposes of this Section II.3., a "U.S. company" means any company incorporated in the U.S. or whose headquarters is in the U.S.

c. For purposes of this Section II.3., the calendar quarter in which a non-U.S. company's "principal equity trading market" becomes the U.S. market is a quarter when more than 50% of worldwide trading in the company's common stock and equivalents (such as ordinary shares or common stock or ordinary shares represented by American Depositary Receipts) takes place in the U.S. Trading volume shall be measured by publicly reported share volume.

4. General.

a. The firm may not knowingly do indirectly that which it cannot do directly under this Addendum.

b. The firm will adopt and implement policies and procedures reasonably designed to ensure that its associated persons (including but not limited to the firm's Investment Banking personnel) cannot and do not seek to influence the contents of a research report or the activities of Research personnel for purposes of obtaining or retaining investment banking business. The firm will adopt and implement procedures instructing firm personnel to report immediately to a member of the firm's legal or compliance staff any attempt to influence the contents of a research report or the activities of Research personnel for such a purpose.

5. Timing. Unless otherwise specified, the restrictions and requirements of this Addendum will be effective within 30 days of the issuance of the Order.

6. Superseding Rules and Amendments. In the event that the SEC adopts a rule or approves an SRO rule or interpretation with the stated intent to supersede any of the provisions of this settlement, the SEC or SRO rule or interpretation will govern with respect to that provision of the settlement and such provision will be superseded.

7. Other Obligations and Requirements. Except as otherwise specified, the requirements and prohibitions of this Addendum shall not relieve the firm of any other applicable legal obligation or requirement.

Commissioner Atkins
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8788 / March 14, 2007

SECURITIES EXCHANGE ACT OF 1934
Release No. 55468./ March 14, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12591

In the Matter of Banc of America Securities LLC, Respondent.	ORDER UNDER SECTION 27A(b) OF THE SECURITIES ACT OF 1933 AND SECTION 21E(b) OF THE SECURITIES EXCHANGE ACT OF 1934, GRANTING WAIVERS OF THE DISQUALIFICATION PROVISIONS OF SECTION 27A(b)(1)(A)(ii) OF THE SECURITIES ACT AND SECTION 21E(b)(1)(A)(ii) OF THE EXCHANGE ACT

Banc of America Securities LLC ("BAS"), has submitted a letter on behalf of itself and its affiliates, dated February 8, 2007, requesting a waiver of the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act of 1933 ("Securities Act") and Section 21E(b)(1)(A)(ii) of the Securities Exchange Act of 1934 ("Exchange Act") arising from the settlement of administrative and cease-and-desist proceedings commenced by the Commission. On March 14, 2007, pursuant to BAS's offer of settlement, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Order"). Among other things, the Order finds that BAS violated Sections 15(c) and 15(f) of the Exchange Act, censures the firm, and orders the firm to pay $26 million in disgorgement and penalties.

The safe harbor provisions of Section 27A(c) of the Securities Act and Section 21E(c) of the Exchange Act are not available for any forward looking statement that is "made with respect to the business or operations of the issuer, if the issuer . . . during the 3-year period preceding the date on which the statement was first made . . . has been made the subject of a judicial or administrative decree or order arising out of a governmental action that (I) prohibits future violations of the antifraud provisions of the securities laws; (II) requires that the issuer cease and desist from violating the antifraud provisions of the securities laws; or (III) determines that the issuer violated the antifraud provisions of the securities laws[.]" Section 27A(b)(1)(A)(ii) of the Securities Act; Section 21E(b)(1)(A)(ii) of the Exchange Act. The disqualifications may be

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waived "to the extent otherwise specifically provided by rule, regulation, or order of the Commission[.]" Section 27A(b) of the Securities Act; Section 21E(b) of the Exchange Act.

Based on the representations set forth in BAS's February 8, 2007 request, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the entry of the Order is appropriate and should be granted.

Accordingly, **IT IS ORDERED**, pursuant to Section 27A(b) of the Securities Act and Section 21E(b) of the Exchange Act, that a waiver from the disqualification provisions of Section 27A(b)(1)(A)(ii) of the Securities Act and Section 21E(b)(1)(A)(ii) of the Exchange Act as to BAS and its affiliates resulting from the entry of the Order is hereby granted.

By the Commission.

Nancy M. Morris
Secretary

Commissioner Atkins
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 8787 / March 14, 2007

Administrative Proceeding
File No. 3-12591

In the Matter of Banc of America Securities LLC, Respondent.	ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE DISQUALIFICATION PROVISION OF RULE 602(c)(3)

I.

Banc of America Securities LLC ("BAS" or "Respondent") has submitted a letter, dated February 8, 2007, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from BAS's settlement of an administrative proceeding commenced by the Commission.

II.

On March 14, 2007, pursuant to BAS's Offer of Settlement, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b)(4) and 21C of the Securities Exchange Act of 1934 ("Order") against BAS. In its Order, the Commission found that BAS failed to establish, maintain and enforce written policies and procedures reasonably designed to detect and prevent the misuse of material nonpublic information concerning the firm's equity research, as required by Section 15(f) of the Securities Exchange Act of 1934 ("Exchange Act"), and published materially false and misleading equity research in violation of Section 15(c) of the Exchange Act and Rule 15c1-2(a) thereunder. In the Order, the Commission ordered BAS to cease and desist from committing or causing any violations and any future violations of these provisions, censured BAS pursuant to Section 15(b)(4) of the Exchange Act, ordered BAS to pay a civil penalty in the amount of $16 million and to disgorge $10 million of ill-gotten gains, and order BAS to comply with specific undertakings.

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III.

The Regulation E exemption is unavailable for the securities of small business investment company issuers or business development company issuers if among other things, any investment adviser or underwriter for the securities to be offered is subject to an order of the Commission entered pursuant to section 15(b) of the Exchange Act or Section 203(e) of the Investment Advisers Act of 1940. 17 C.F.R. § 230.602(c)(3).

IV.

Based upon the representations set forth in BAS's request, the Commission has determined that pursuant to Rule 602(e) under the Securities Act of 1933 ("Securities Act"), a showing of good cause has been made that it is not necessary under the circumstances that the exemption be denied as a result of the Order.

Accordingly, IT IS ORDERED, pursuant to Rule 602(e) under the Securities Act, that a waiver from the application of the disqualification provision of Rule 602(c)(3) under the Securities Act resulting from the entry of the Order is hereby granted.

By the Commission.

Nancy M. Morris
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55465 / March 14, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12590

In the Matter of	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934**
Goldman Sachs Execution & Clearing, L.P. f/k/a Spear, Leeds & Kellogg, L.P.,	
Respondent.	

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") against Goldman Sachs Execution & Clearing, L.P. f/k/a Spear, Leeds & Kellogg, L.P. ("Goldman Clearing" 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 Respondent and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 (the "Order"), as set forth below.

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III.

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

Summary

1. From at least March 2000 to May 2002 (the "relevant period"), certain customers of Goldman Clearing who used the firm's direct market access, automated trading system unlawfully sold securities short in advance of follow-on and secondary offerings in their prime broker accounts by, among other means, falsely marking their orders to sell "long." The customers' pattern of illegal sales went undetected by Goldman Clearing, which relied exclusively on the representations made by its customers concerning their positions in securities at the time of sale. Goldman Clearing's exclusive reliance on its customers' representations was unreasonable. The customers' pattern of trading and other information in Goldman Clearing's possession reflected that the customers were selling the offered securities short. Had Goldman Clearing instituted and maintained procedures reasonably designed to detect any significant disparity between its customers' pattern of trading and the manner in which they marked their orders to sell, it could have discovered that its trading and clearance records revealed the pattern of unlawful trades effected by its customers. Goldman Clearing also could have discovered that it was improperly lending the customers borrowed and proprietary securities to make deliveries on their purported long sales and closing their short positions with securities that they purchased in follow-on and secondary offerings. Accordingly, Goldman Clearing did not have a reasonable basis to believe its customers' representations that they were "long" the securities they were selling and, therefore, violated the Commission's short sale rules and was a cause of its customers' violations of the rules, as described below.

Respondent

2. Goldman Clearing is a limited partnership based in Jersey City, New Jersey and has been registered with the Commission as a broker-dealer since 1948. Goldman Clearing was formerly known as Spear, Leeds & Kellogg L.P. ("Spear"). In October 2000, The Goldman Sachs Group, Inc. acquired control of Spear by purchasing SLK LLC, Spear's general partner. On January 14, 2005, the Spear name was changed to Goldman Clearing. Goldman Clearing provides customers with, among other things, direct market access, automated trading and prime broker and stock loan and stock borrow services.

The Selling Customers' Trading Strategy

3. From at least March 2000 to May 2002, certain customers of Goldman Clearing employed a trading strategy that involved selling securities short, including securities listed on the New York Stock Exchange, in advance of follow-on and secondary offerings and covering their short sales with securities that they bought in the offerings (the "Selling Customers").[1] By selling in advance of the offerings, the Selling Customers sought to take advantage of anticipated declines in the market prices of the securities in the days prior to the offerings. Typically, the purchase prices for the offered securities were fixed at, or at a discount to, the closing prices for the stock on the dates before the offerings commenced. The Selling Customers profited when they sold the securities short at prices that were higher than the offering prices set by the market and that they subsequently paid to purchase the covering stock in the offerings. By engaging in this trading strategy, the Selling Customers frequently covered short sales that they made within five days of the pricing of the offerings in contravention of Rule 105 of Regulation M. The Selling Customers also frequently effected their short sales on "minus ticks" (i.e., at prices below the prices at which the securities were last sold) and "zero-minus ticks" (i.e., at the same prices at which the securities were last sold, but lower than the prices of the next preceding sales executed at different prices) in contravention of Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder.

4. The Selling Customers carried out their trading strategy in prime broker accounts that they maintained at Goldman Clearing as follows. Although they were selling the offered securities short, the Selling Customers repeatedly effected their sales as long transactions by submitting their orders for execution through Goldman Clearing's direct market access, automated trading platform, the REDI System© ("REDI"). Using REDI, the Selling Customers prepared their own orders to sell on computer terminals and falsely marked them "long." The orders were routed through REDI directly to the New York Stock Exchange and other markets for execution. After being informed by REDI that their sales had been executed, the Selling Customers frequently covered their sales by purchasing securities in follow-on and secondary offerings in transactions executed away from Goldman Clearing and had the offered securities delivered into their prime broker accounts (the "cover stock"). The cover stock was delivered into the Selling Customers' accounts though the Institutional Delivery System.

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1 During the relevant period, Rule 3b-3 under the Exchange Act defined a short sale as "any sale of a security which the seller does not own or any sale which is consummated by the delivery of a security borrowed by, or for the account of, the seller." In July 2004, the Commission amended the short sale rules by adopting Regulation SHO and Rule 200(a) of the new regulation replaced Rule 3b-3. See Short Sales, Securities Exchange Act Release No. 50103 (Jul. 28, 2004). However, the definition of a short sale generally did not change. Regulation SHO became effective in January 2005.

Goldman Clearing did not Have a Reasonable Basis to Believe its Customers' Representations That They Were "Long" the Securities They Were Selling

5. During the relevant period, Section 10(a) of the Exchange Act and Rule 10a-1(d) thereunder, provided that a broker could mark an order to sell a security registered, or admitted to unlisted trading privileges, on a national securities exchange "long" only if: (a) the security to be delivered after sale was carried in the account in which the sale was to be effected or (b) the broker had been informed that the seller owned the security ordered to be sold and, as soon as possible and without undue inconvenience or expense, would deliver the security owned to the account for which the sale was to be effected. In addition, Section 10(a) of the Exchange Act and Rule 10a-2 thereunder, prohibited brokers from lending, or arranging for the loan of, any security registered on a national securities exchange for delivery to the broker for the purchaser after sale if the broker or dealer knew or had reasonable grounds to believe that the sale was effected pursuant to an order marked "long" unless the broker knew, or had been informed by the seller, that: (a) the security sold had been forwarded to the seller's account, or (b) the seller owned the security sold and that it was then impracticable to deliver the security and that it would be delivered to the seller's account as soon as possible without undue inconvenience or expense. Accordingly, broker-dealers, including Goldman Clearing, had to have a reasonable basis to believe their customers' representations that they were "long" the securities they were selling.[2]

6. From at least March 2000 to May 2002,Goldman Clearing relied exclusively on the representations made by its customers whether they were selling securities "long" or "short" when they did not have the securities in their accounts at the time of sale. In particular, Goldman Clearing relied on agreements that it entered into with each of its customers that provided that a designation of a sell order as "long" was a representation that the customer owned the securities being sold. Consequently, when the Selling Customers marked their orders to sell "long," Goldman Clearing presumed that the Selling Customers owned the securities. It did not take further steps following execution to detect whether the Selling Customers' representations might be false, as discussed below.

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[2] Upon the adoption of Regulation SHO, Rule 10a-1(d) and Rule 10a-2 were removed and replaced by provisions in the new regulation. Rule 10a-1(d) was replaced by Rule 200(g)(1) of Regulation SHO which permits a broker to mark an order to sell "long" only if the security being sold is owned by the seller and "either . . . (i) the security to be delivered is in the physical possession or control of the broker . . . ; or (ii) it is reasonably expected that the security will be in the physical possession or control of the broker . . . no later than the settlement of the transaction." 17 CFR 242.200(g)(1). Rule 203(a) of Regulation SHO, which replaced Rule 10a-2, states in section (1) that "i[f] a broker or dealer knows or has reasonable grounds to believe that the sale of an equity security was or will be effected pursuant to an order marked 'long,' such broker or dealer shall not lend or arrange for the loan of any security for delivery to the purchaser's broker after the sale, or fail to deliver a security on the date delivery is due." 17 CFR 242.203(a)(1). Section (2) of that rule states, however, that a broker or dealer may lend or arrange for the loan of a security to make delivery on a long sale "[i]f the broker or dealer knows, or has been reasonably informed by the seller, that the seller owns the security, and that the seller would deliver the security to the broker or dealer prior to the scheduled settlement of the transaction, but the seller failed to do so." 17 CFR 242.203(a)(2)(ii). Under Rules 200(g)(1) and 203(a), brokers remain obligated to have reasonable grounds to believe their customers' representations that they are "long" the securities that they are selling.

7. During the relevant period, Goldman Clearing's own records contained information about consummated transactions that reflected that the Selling Customers were engaged in a pattern of selling securities short and that they were misrepresenting their "short" sales as "long" sales. Specifically, Goldman Clearing's records contained information that reflected the Selling Customers were repeatedly failing to deliver to Goldman Clearing the securities that they purported to sell long, and that the Selling Customers were purchasing securities in follow-on and secondary offerings away from Goldman Clearing and delivering those securities into their prime broker accounts to cover their sales. In addition, Goldman Clearing's records contained information reflecting it was improperly lending the Selling Customers securities to make deliveries on their purported long sales and closing their short positions with the cover stock that they purchased in the offerings.

8. In its capacity as prime broker, Goldman Clearing received certain confirmations from the brokers from whom the Selling Customers purchased the cover stock indicating that the cover stock were offered securities (the "Confirmations"). The Confirmations indicated that the cover stock were syndicate securities and that the transactions in which the Selling Customers had purchased the cover stock had extended settlement dates typical for transactions involving securities offered in follow-on and secondary offerings. The Confirmations also indicated that the purchases made by the Selling Customers were subject to the closing of the offerings and that the Selling Customers had received prospectuses.

9. Goldman Clearing used the information contained in the Confirmations to post the purchase transactions effected by the Selling Customers to its trading records, including its Clearance Activity and Daily Margin Reports. The Clearance Activity Report reflected the Selling Customers' daily positions in securities. On the days it received the Confirmations, Goldman Clearing's Clearance Activity Report showed that the Selling Customers held short positions in the offered securities because they had sold the securities into the market within the five business days preceding the offerings and did not have the securities in their accounts at the time of sale. Goldman Clearing's Daily Margin Report also reflected the Selling Customers' short positions in the offered securities. Goldman Clearing closed the short positions the Selling Customers' held in the offered securities by posting the cover stock the Confirmations indicated they purchased to its Clearance Activity and Daily Margin Reports.

10. Because the Selling Customers covered their unlawful short sales by purchasing securities in the offerings, Goldman Clearing never had possession of the cover stock on the days that it had to settle such sales transactions (the "settlement dates"). Goldman Clearing only received the cover stock when the offerings settled and the offerings typically settled at least a day after the settlement dates for the sales. Rather than fail the sales made by the Selling Customers, however, Goldman Clearing delivered borrowed and proprietary securities to the brokers for the purchasers to settle the transactions. As a consequence, on the settlement dates, Goldman Clearing's Daily Stock Record, which showed the firms' daily positions in securities, contained information that reflected the short sales made by the Selling Customers. Specifically, the Daily Stock Record showed the Selling Customers held short positions in the offered securities that were offset by long positions in the offered securities in Goldman Clearing's stock borrow and proprietary accounts. Goldman Clearing closed the Selling Customers' short

positions on its Daily Stock Record after it paid the brokers who executed the purchase transactions in full for the cover stock and it received the cover stock from them.

11. Thus, for more than two years, Goldman Clearing's records contained information that reflected the Selling Customers were falsely marking their REDI orders to sell "long." As reflected in Goldman Clearing's records, the Selling Customers never delivered the securities that they purported to sell long to Goldman Clearing. Rather, they frequently covered their sales by purchasing securities in follow-on and repeat offerings after they effected their sales transactions. In addition, Goldman Clearing always settled the Selling Customers' sales with borrowed and proprietary securities and closed their short positions in the offered securities only after it paid for and received the cover stock purchased by the Selling Customers. The Selling Customers' pattern of trading was therefore consistent with selling securities short and not long as they represented on their orders to sell.

12. In light of the foregoing facts, Goldman Clearing's exclusive reliance on the Selling Customers' representations was unreasonable. The Selling Customers' pattern of trading and other information in Goldman Clearing's possession reflected that the Selling Customers were selling the offered securities short. Had Goldman Clearing instituted and maintained procedures reasonably designed to detect any significant disparity between its customers' pattern of trading and the manner in which they marked their orders to sell, it could have discovered that its trading and clearance records contained information reflecting that the Selling Customers were, in fact, falsely marking their REDI orders to sell "long" and selling securities short in violation of Rule 105 of Regulation M and Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder. In addition, Goldman Clearing could have discovered that it was improperly lending the Selling Customers borrowed and proprietary securities to make deliveries on their purported long sales and closing their short positions with offered securities.

Violations

13. As a result of the conduct described above, Goldman Clearing willfully[3] violated Section 10(a) of the Exchange Act and Rule 10a-1(d) thereunder, which, during the relevant period, prohibited a broker or dealer, directly or indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of any facility of any national securities exchange, from marking any order to sell a security registered on, or admitted to unlisted trading privileges on, a national securities exchange "long" unless (1) the security to be delivered after sale was carried in the account for which the sale was to be effected, or (2) such broker or dealer was informed that the seller owned the security ordered to be sold and, as soon as was possible without undue inconvenience or expense, would deliver the security owned to the account for which the sale was to be effected.

14. As a result of the conduct described above, Goldman Clearing willfully violated Section 10(a) of the Exchange Act and Rule 10a-2 thereunder, which, during the relevant period, prohibited a broker or dealer, directly or indirectly, by use of the means and instrumentalities of

[3] "Willfully," as used in the Order, means intentionally committing the act that constitutes the violation. See 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 it is violating one of the Rules or Acts.

interstate commerce, and of the mails, and of any facility of any national securities exchange, from lending, or arranging for the loan of any security registered, or admitted to unlisted trading privileges, on a national securities exchange for delivery to the broker for the purchaser after sale, or from failing to deliver a security on the date delivery was due if such broker or dealer knew or had reasonable grounds to believe that the sale was effected, or would be effected, pursuant to any order marked "long" unless such broker or dealer knew or had been informed by the seller, (1) that the security sold had been forwarded to the account for which the sale was effected, or (2) that the seller owned the security sold, that it was then impracticable to deliver to such account the security owned and that he would deliver such security to such account as soon as it was possible without undue inconvenience or expense.

15. As a result of the conduct described above, Goldman Clearing was a cause of the Selling Customers' violations of Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder, which prohibit any person for his own account, directly or indirectly, by use of the means and instrumentalities of interstate commerce, and of the mails, and of any facility of any national securities exchange, from effecting on a national securities exchange a short sale of any security (1) below the price at which the last sale thereof, regular way, was effected on such exchange, or (2) at such price when such price was below the next preceding different price at which a sale of such security, regular way, was effected on such exchange.

Remedial Efforts by Goldman Clearing

16. In determining to accept the Offer, the Commission considered remedial acts undertaken by Goldman Clearing.

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, pursuant to Sections 15(b)(4) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent Goldman Clearing is hereby censured;

B. Respondent Goldman Clearing cease and desist from committing or causing any violations and any future violations of Section 10(a) of the Exchange Act and Rule 10a-1(a) thereunder, and Rules 200(g) and 203(a) of Regulation SHO under the Exchange Act (formerly Rules 10a-1(d) and 10a-2); and

C. Respondent Goldman Clearing shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of $1 million to the United States Treasury. Such payment shall be: (1) made by United States postal money order, certified check, bank cashier's check or bank money order; (2) made payable to the Securities and Exchange Commission; (3) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312;

and (4) submitted under cover letter that identifies Goldman Clearing as a respondent in these proceedings and the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Teresa J. Verges, Assistant Regional Director, Securities and Exchange Commission, Southeast Regional Office, 801 Brickell Avenue, Suite 1800, Miami, Florida 33131.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

Securities Act of 1933
Release No. 8789/March 14, 2007

Securities Exchange Act of 1934
Release No. 55469/March 14, 2007

ORDER REGARDING REVIEW OF FASB ACCOUNTING SUPPORT FEE FOR 2007 UNDER SECTION 109 OF THE SARBANES-OXLEY ACT OF 2002

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

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

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standard-setting body under the Act, and recognizing the FASB's financial accounting and reporting standards as "generally accepted" under Section 108 of the Act.[1] As a consequence of that recognition, the Commission undertook a review of the FASB's accounting support fee for calendar year 2007. In connection with its review, the Commission also reviewed the proposed budget for the FAF and the FASB for calendar year 2007.

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

After its review, the Commission determined that the 2007 annual accounting support fee for the FASB is consistent with Section 109 of the Act. Accordingly,

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

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

[1] Financial Reporting Release No. 70.

Commissioner Casey Not Participating

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 8790 / March 15, 2007

SECURITIES EXCHANGE ACT OF 1934
Release No. 55476 / March 15, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2578 / March 15, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12592

In the Matter of **FRANKLYN A. CAINE,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933 AND SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act") and Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Franklyn A. Caine ("Caine" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933 and Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.[1]

[1] In a separate civil action filed simultaneously with this proceeding, Caine separately consented to the entry of a judgment by the U.S. District Court for the District of Columbia pursuant to Section 20(d) of the Securities Act and Section 21(d) of the Exchange Act ordering him to pay a civil penalty of \$125,000 and disgorgement of \$550,000 plus pre-judgment interest of \$156,072. *SEC v. Franklyn A. Caine*, Civil Action No. 07-cv-00494 (GK).

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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:[2]

A. RESPONDENT

1. Caine, age 57, served as the Chief Financial Officer ("CFO") of Raytheon Company ("Raytheon") from April 1999 to December 2002.

B. SUMMARY

2. Between 1997 and 2001, Raytheon Company and certain members of its senior management ("Raytheon" or the "company") made false and misleading disclosures and used improper accounting practices that operated as a fraud by masking the declining results and deteriorating business of Raytheon Aircraft Company ("RAC") and inaccurately reporting the company's operating results on both a segmented and consolidated basis. As set forth below, certain of these disclosures and accounting practices were undertaken by or with the knowledge of senior company officers, including Caine.

3. Between 1997 and 2001, Raytheon failed to fully and accurately disclose known risks, trends, uncertainties, and other information concerning the deteriorating state of RAC's commuter aircraft business and the negative impact this decline was having on asset values associated with RAC's line of nineteen-seat, turboprop aircraft (the "commuters" or the "1900s") and, thus, on the company's (including RAC's) results of operations. Raytheon also engaged in several improper accounting practices that delayed and mischaracterized known losses associated with RAC's commuter line during this time period.

4. As Raytheon's CFO, Caine failed to make or ensure the timely, accurate, and full disclosure of these material trends and uncertainties in the company's public filings during 2000 and 2001 and failed to take sufficient steps to ensure that Raytheon properly accounted for the company's on- and off-balance sheet commuter assets during this time period. Caine also did not ensure that the company maintained an adequate system of internal accounting controls related to these assets.

5. Had Raytheon properly accounted for its commuter assets, the company would have reported material reductions in RAC's reported operating income of at least \$34 million, \$22 million, and \$21 million at year-end 1998, 1999, and 2000, respectively, which represented 13 percent of the subsidiary's reported annual operating income in each of these periods.

6. RAC's operating results would have been further reduced by at least \$67 million (41 percent) at year-end 2000 had Caine and others in senior Raytheon and RAC management timely and appropriately recognized losses inherent in a planned "soft landing" of the commuter aircraft line. Internal company documents and other information further indicate that, at this

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

time, these senior executives expected commuter losses of $240 million given the cash sales prices that had been approved in the "soft landing," and a charge of $67 million to $240 million would have reduced Raytheon's 2000 profit before taxes by at least 8 to 27 percent. Caine and others, however, caused Raytheon to improperly take this charge in the third quarter of 2001, when the company wrote down its on-balance sheet commuter assets and increased reserves for its off-balance sheet commuter receivables by a total of $693 million after the terrorist attacks of September 11th. Given the charge that the company should have taken at year-end 2000, Raytheon's third quarter 2001 commuter loss provision was materially overstated by at least 10 to 53 percent.

C. BACKGROUND

7. Raytheon is a Delaware corporation, headquartered in Waltham, Massachusetts. The company is an industry leader in defense, government electronics, space technology, and business and special mission aircraft. Between 1997 and 2001, Raytheon reported between $13 billion and $20 billion in net sales revenue annually and employed between 75,000 to 120,000 individuals. During this time period and continuing through today, Raytheon's securities have been registered with the Commission pursuant to Section 12(b) of the Exchange Act and listed on the New York, Chicago, and Pacific Exchanges.

8. In the early 1990s, Raytheon was a diversified, multi-national conglomerate, which operated in the defense, electronics, engineering and construction, major appliances and aircraft businesses. The company formed RAC in 1994 through the combination of Beech Aircraft and Raytheon Corporate Jets, and the wholly-owned Raytheon subsidiary has been reported as a separate segment in all of the company's public filings since that time.

9. RAC manufactures, markets, and services business jets, turboprops, and piston-powered aircraft for the world's commercial, fractional ownership, and military aircraft markets. Due to the cyclical nature of these markets, RAC often experienced fluctuating results. For example, between 1997 and 2001, RAC generated between $2.3 billion and $3.2 billion in net sales revenue for the company annually, accounting for 13 to 19 percent of Raytheon's consolidated annual sales revenues. In addition, while the revenues generated by the commuter aircraft product line represented approximately 1 percent of Raytheon's consolidated net sales revenue during this time period, the company's financing of those sales left Raytheon with substantial recourse obligations related to over $1 billion in commuter receivables that were off the balance sheet, which represented approximately 9 percent of Raytheon's reported stockholder's equity each year between 1997 and 2001.

10. In 1997, Raytheon completed two multi-billion dollar defense acquisitions in an effort to streamline its operations and solidify its position as one of the nation's largest military contractors. These acquisitions led to a doubling of Raytheon's long-term debt load (increasing it to over $8 billion) and a substantial lowering of Raytheon's credit rating. In an effort to reduce the burden of its debt expense on earnings and cash flows, Raytheon began to divest many of its "non-core" commercial units, using the cash generated by these sales to pay down debt it incurred as a result of its defense acquisitions. RAC was considered for divestiture as part of this plan.

D. RAYTHEON'S IMPROPER ACCOUNTING AND DISCLOSURES FOR ITS COMMUTER BUSINESS

11. Between 1997 and 2001, Raytheon deferred substantial losses related to RAC's line of commuter aircraft. These planes were typically used by small, thinly capitalized airlines to transport passengers along regional or local routes. These carriers were generally seen as significant credit risks, were thus frequently unable to obtain independent financing for their aircraft purchases, and typically lacked sufficient cash on hand to make outright purchases of RAC's commuter aircraft.

12. As a result, RAC rarely sold its new or used 1900s for cash. Instead, RAC's sales were regularly financed by the subsidiary's captive finance company, Raytheon Aircraft Credit Corporation ("RACC"), which often offered below-market interest rates and other favorable terms to customers in order to increase demand for the 1900s. RAC also regularly took used commuter aircraft (model 1900Bs and 1900Cs) in trade for the purchase of newer planes (model 1900Ds), which left RAC with a supply of used 1900s in inventory that required reconditioning and refurbishment in order to be remarketed.

13. RACC sold most of its aircraft receivables, including commuter financing receivables, into a revolving credit facility funded by an outside bank syndicate, which removed the debt associated with these financed sales from the company's balance sheet. Under the terms of the credit facility agreement, Raytheon was obligated to re-purchase certain delinquent and defaulted receivables, and the level of recourse to Raytheon on the commuter receivables generally ranged between 75 to 100 percent depending upon the type of financing. RACC also renegotiated and restructured many of the payment arrangements it had with certain RAC customers in order to keep these customers from becoming overly delinquent or otherwise defaulting on their notes.

14. As Raytheon's CFO, Caine was aware that the company regularly substituted new or restructured commuter notes for delinquent receivables prior to their triggering any defaults under the credit facility. Thus, despite the financial stress accumulating in the portfolio's commuter exposure, Caine was of the view that the portfolio as a whole was always "performing" from an accounting standpoint.

1. The Declining Commuter Market between 1997 and 1998

15. During the late 1990s, RAC began to experience softening demand for its commuter aircraft due to, among other things, shifting consumer preferences, increased government regulation of nineteen-seat aircraft, increased competition in the used aircraft market, and the introduction of regional jets. These and other factors combined to place downward pressure on the sales prices, lease rates, and asset values of these planes. Thus, in 1997, RAC began for the first time to place used 1900s with customers on operating leases and substantially ceased outright sales of used 1900s for cash.

16. In addition, many of the used commuters that RAC received as returns, repossessions, and trade-ins required significant refurbishment before RAC could re-market them. These refurbishment costs were capitalized as part of the aircraft's book value, which led

to "[h]igher book values" that "can and do exceed fair market value." In response, during the mid 1990s, prior to Caine's arrival, RAC adopted a policy of depreciating the used commuter aircraft on an accelerated basis during the life of their leases to "bring down values" to amounts that were more likely to be recovered in later cash sales. By so doing, RAC improperly deferred and re-characterized impairment losses associated with high commuter book values as ordinary depreciation.

17. As Raytheon's CFO, Caine understood that the book value of all used commuters could not be recovered by cash sales into the then-current market. He was also repeatedly informed by Raytheon's outside auditors that "The most significant accounting issue for used commuters is the realizability of assets. Management's plan is to lease the aircraft, depreciate them down to 50% of book value over 10 years and sell them to the freighter market at the end of the lease."

2. The Deferral of Significant Commuter Losses in 1999

18. Throughout 1999, certain senior Raytheon and RAC officers (including Caine) were made aware of potential negative and adverse trends, uncertainties, and risks related to RAC's commuter business.

19. In April 1999, Caine's first month as Raytheon's CFO, an outside consultant presented a report to senior management, which stated that the commuter market was "at a turning point," that other "[c]arriers have begun to flood the market with...used 19-seat airplanes," that "lease rates for used 19-seat aircraft [we]re declining," that the "[d]ownward pressure on lease rates w[ould] grow as the surplus of 19-seat aircraft expands," and that "[a]dditional lease rate pressures could impact the company's asset values and re-marketing efforts."

20. An April 1999 e-mail that previewed this report for Caine informed him that such "surplus" aircraft and "lower lease rates could drive declining asset values and represent a potential material write down" of the commuter assets. Caine subsequently received a copy of the report, and both he and other senior Raytheon officers were briefed on this situation and management's views of it. That same month, during their first meeting, Raytheon's lead auditor discussed issues related to the commuters with Caine.

21. In May 1999, an internal Raytheon study forecasted that RAC's portfolio of commuter receivables would generate an estimated $95 million in losses due to "[t]he lack of portfolio equity, poor customer credit and payment behavior, high loan-to-value ratios, and the modest level of reserves" established for these assets. That same study identified a "worst case scenario" that could generate $200 million in additional losses depending upon the impact of the "upcoming introduction" of regional jets.

22. An e-mail that previewed the conclusions of this internal study further informed Caine that there was an "obvious" need for a "material write-down" of RAC's commuter assets, that these losses were "large and growing," that RAC was engaging in "misleading financial reporting," and that the situation was "as bad as [the author of the study had] seen." Caine

subsequently received a copy of the internal study, and both he and other senior Raytheon officers were briefed on both its conclusions and management's views of them.

23. In June 1999, Raytheon's then-Controller advised Caine that there was an estimated exposure of $300 million to $500 million in marking the RACC portfolio to market.

24. Also in June 1999, Caine and other senior Raytheon officers received a "response" from RAC to the April and May 1999 external and internal studies. This response set forth the view of RAC management that there was greater demand for new commuter aircraft than forecast by the company's outside consultant. With respect to the internal study, RAC's response advised Caine and others that it was "a corporate decision" whether to adopt a proposed "equity model" as an alternative way to establish commuter reserves at RAC, but described the model as "[a] means to build reserves at the expense of current period profits." RAC's response instead proposed a series of "risk mitigation plans" for the commuter portfolio, such as addressing the $95 million commuter exposure identified in the May 1999 internal study through various means (including "third party, no recourse notes" that would provide an estimated $93 million "improvement"). These sales did not materialize, however. Yet, reserves were not adequately increased.

25. In July 1999, Raytheon's investment bankers informed company executives that "[p]ortfolio policies may be masking problems from being recognized," that "actual collateral values may be substantially lower than loan balances," and that, if the company attempted to securitize all of RAC's commuter receivables, the commuter portfolio would be valued "at a material discount to its current book value." Management subsequently decided not to pursue a securitization of these receivables.

26. In August 1999, as part of an initial consideration to divest RAC, Caine and other senior Raytheon executives were informed that there was "approximately $250 Million - $350 Million risk in [the] $2.4 Billion loan/lease portfolio," and the "risk is likely to approach the high end of this range over time" since "about 40% of loan/lease payments are delinquent" and "business cycle downturn may also drive up defaults [and] reduce residual values of used aircraft."

27. In the Fall of 1999, after the initial effort to divest RAC failed, Raytheon management attempted to sell RAC's portfolio of aircraft receivables (including its commuter receivables) to an outside finance company. The finance company, however, informed certain Raytheon executives that it would not purchase any of the commuter receivables due to, among other things, concerns over their high loan-to-value ratios and high concentrations in certain customers. The finance company also provided Raytheon personnel with an independent valuation analysis of the 1900s, which stated that the commuter industry was experiencing a "distinct reduction in sales activity" and a "downturn" in leasing activity over the past year. This report also listed estimated market values for the 1900s that were below their book values.

28. In October 1999, due to unrelated difficulties in its defense businesses and engineering and construction unit, Raytheon announced an unexpected $640 million charge, which caused the price of the company's stock to fall 44 percent in one day. This charge also led to a downgrading of the company's bond and credit ratings, and Raytheon management

continued with the strategy to pay down the company's debt by divesting certain "non-core" commercial units. As part of this strategy, senior Raytheon management undertook a new effort to divest RAC.

29. Contemporaneous documents further indicate that, during January 2000 presentations to Raytheon management and the audit committee, the company's outside auditors informed Caine and others that they had a "continued concern about commuter portfolio exposure," that "higher refurb[ishment] costs on used commuters" accounted for a $15 million decrease in RAC's operating profit that year, that the company "need[ed] to relook at FAS 125 calculations based on higher refurb costs," that the used commuter inventory was projected to be "higher than prior years" in 2000, that, if there is "any slip," the commuter inventory "balance will balloon."

30. In addition, following a number of production and accounting problems that arose at RAC as part of the year-end 1999 close, the subsidiary's CEO stepped down from his executive position, and Raytheon's CEO traveled to the subsidiary to make it clear that RAC personnel had to improve their processes to prevent similar issues from occurring in the future. Upon learning of the year-end closing issues at RAC, Caine immediately revoked the recent promotion and transfer of a senior RAC financial officer and directed him to return to RAC and help solve the problems there.

31. Thereafter, in early 2000, RAC's newly-installed CEO instructed his staff to critically examine the subsidiary's operations, and RAC's Deputy CFO took the lead role in identifying issues to be examined. As part of this review, RAC personnel identified a potential $220 million exposure related to the commuter assets on and off the balance sheet. This estimate was calculated by comparing "[p]rices which could be readily obtainable in today's market" to commuter book values. The market values used in the analysis were supplied by the lead commuter sales officials at RAC and averaged from $500,000 to $1 million below the commuter book values.

32. During this time period, Caine commissioned a review of RAC's commuter program by a separate audit firm and requested that Raytheon's internal audit department also examine RAC's commuter accounting. In addition, as Caine was aware, Raytheon's outside auditors were conducting extended procedures at RAC as part of the year-end audit process given the issues that had previously arisen at the subsidiary, and the potential $220 million commuter exposure was reviewed as part of this process as well. However, based on overly optimistic internal analyses prepared by RAC executives, which indicated that no "event of impairment" had occurred, RAC's commuter assets were not written down nor were RAC's commuter reserves adequately increased at that time.

33. In January 2000, Raytheon had issued an earnings advisory for the fourth quarter of 1999 and the full year 2000 because of aircraft production delays at RAC, a restatement due to RAC's improper bill and hold accounting, higher interest expenses, a higher effective tax rate, and other unfavorable results in its defense and other businesses. Following this announcement, Raytheon's stock price fell approximately 17 percent in one day. By March 2000, it was reported that Raytheon's bond and credit ratings might be further downgraded "[i]f corrective

actions do not lead to material long-term improvements in overall performance and its balance sheet, or if material new operating problems emerge...."

3. Raytheon's Improper Accounting and Disclosures in 1999

34. Raytheon's SEC filings for 1999 did not contain adequate disclosures of the negative and adverse trends, uncertainties, risks, and other information related to RAC's commuter aircraft or the subsidiary's commuter business.

35. Although certain forward-looking statements in Raytheon's third quarter 1999 Form 10-Q, which was signed by Caine as the company's CFO, did disclose that one of the fourteen "important factors that could cause actual results to differ" was "the impact of recourse obligations of Raytheon Aircraft [RAC] due to changes in the collateral value of financed aircraft," these statements did not reference commuter aircraft by name or describe how the collateral value of these aircraft were particularly susceptible to negative changes due to the current and anticipated market conditions for these planes. In addition, these and other statements in Raytheon's third quarter 1999 Form 10-Q did not disclose that there were tens to hundreds of millions of dollars of "risk" associated with the company's portfolio of commuter and general aviation receivables, as Caine and others at the company were aware at the time.

36. While Raytheon's 1999 Form 10-K did refer to "commuter valuation costs" as one of five factors affecting RAC's "decline in operating income as a percent of sales in 1999," this disclosure failed to provide adequate information concerning the known material and adverse risks, uncertainties, and trends posed by the commuters.

37. In addition, the forward-looking statements in Raytheon's 1999 Form 10-K stated that "the effect of market conditions, particularly as it affects the general aviation market, the impact of competing products and pricing, [and] the impact on recourse obligations of RAC due to changes in the collateral value of financed aircraft" were among the many "factors that could cause actual results to differ," but did not mention "commuter" aircraft by name or provide adequate information about the negative trends, uncertainties, and risks concerning the commuters that were known to management at the time. Likewise, another set of forward-looking statements in Raytheon's 1999 Form 10-K stated that "continued market acceptance of, and government regulations affecting, 19-seat turboprop commuter aircraft" could affect RAC's future results of operations, but Raytheon did not disclose the significant information that it had about the declining commuter market and the exposures facing the company.

38. These forward-looking statements were also inconsistent with disclosures in the footnotes to the company's 1999 financial statements, which misleadingly stated that "the Company does not expect to incur any material losses against the net book value of the long-term receivables" because "it is the Company's policy to have the aircraft serve as collateral for the commuter airline receivables;" that "any liability arising from these transactions will not have a material effect on the Company's financial position, liquidity, or results of operations" given Raytheon's experience to date with resale activities and pricing and the Company's plan to continue production into the foreseeable future; and that "[t]hese financial instruments are recorded at estimated fair value. No material gain or loss resulted from the sales of receivables." As certain members of Raytheon management were aware, the fair value of the commuter

aircraft serving as collateral for the corresponding receivables was declining given the deteriorating market conditions for these planes. Yet, the company was not adequately increasing its reserves for these anticipated short falls, causing significant potential future liability under its recourse provisions to the revolving credit facility. At the time, Caine considered the off-balance sheet portfolio of commuter receivables to be performing from an accounting standpoint since the ongoing substitutions of new or restructured notes for any troubled receivables avoided actual defaults under the facility.

39. In addition, contrary to the company's footnote disclosures, during 1999, RAC continued an incorrect practice of using FAS 125 gains on commuter receivables sold into the credit facility to set up equally off-setting commuter loss reserves. As a result, Raytheon's reported financial statements did not accurately reflect the accounting impact of declining commuter values.

40. For example, in the third quarter of 1999, RAC increased its "cushion" for commuter losses by roughly $11 million given the improper FAS 125 gains it recognized on the sale of commuter receivables into the credit facility. RAC, however, subsequently reduced that increase by roughly $7 million in the fourth quarter of 1999 that offset a significant FAS 125 loss caused by a reduction in Raytheon's credit rating. These adjustments represented approximately 17 and 19 percent of the subsidiary's reported operating income/loss in the third and fourth quarters of 1999, respectively.

41. Also, during 1999, RAC still had not properly applied FAS 125 to its off-balance sheet commuter receivables. As a result, RAC's reported annual operating income should have been reduced by at least $21 million (13 percent) at year-end.

4. In 2000, the Commuter Market Continued to Deteriorate

42. In 2000, a variety of internal and external sources continued to inform Raytheon and RAC executives that the market for 1900s was in substantial decline. These sources further indicated that there were actual material commuter losses at RAC and that the potential losses associated with the 1900 line were in the hundreds of millions of dollars.

43. In January 2000, Caine and other senior Raytheon and RAC officers were informed that the company's strategic planning department viewed RAC as having a substantial negative "economic value added," an internal business metric, due in large part to $240 million in negative value and exposure associated with RAC's off-balance sheet commuter and general aviation receivables.

44. In February 2000, the same outside consultant that conducted the April 1999 external study reported to Raytheon executives that there would be "[c]ontinued downward pressure on turboprop lease rates due to falling demand for new units and a growing supply of used capacity" and that "demand for new [commuters] will average 7 to 12 sales annually," well below what RAC was planning to manufacture that year. RAC, however, had exceeded the consultant's sales predictions in the prior year due in part to its continued willingness to accept trade-ins of used commuters for the latest model (1900Ds).

45. In March 2000, auditors with a major public accounting firm that had been retained to perform a review of RAC's "used commuter program exposures" informed Caine and other members of senior Raytheon and RAC management that "the Company's largest exposure in the [commuter] portfolio is with potential returned aircraft" and that "the book values of certain aircraft in the portfolio exceed the current market values." In particular, these auditors identified a $115 million "shortfall" associated with RAC's 1900Cs that were on and off the balance sheet, assuming a strategy of selling the aircraft for cash at their fair market value. The auditors also noted that RAC personnel were "rejecting cash offers on commuter aircraft because of the income statement repercussions . . . [implying that] the carrying amounts of commuter airplanes exceed their fair market values." The auditors further noted that RAC only wrote down used commuter asset values "when the Company enters into a new finance/lease transaction." The auditors also reported that RAC lacked formal and documented policies and practices concerning the accounting for commuter aircraft, commuter loan restructurings, the creation of commuter valuation reserves, and the monitoring of customer accounts and collections.

46. In April 2000, in response to Caine's request, Raytheon's internal audit department prepared a report for Caine and other members of senior Raytheon and RAC management that examined the items identified as part of the year-end closing process, as set forth in Paragraph No. 31 above. Caine received a copy of the report's executive summary and certain attachments, which among other things stated that, although there was "[n]o event of impairment prior to 12/31/99" regarding the commuters, there was an "[u]ndetermined but likely to be significant" exposure related to these assets. The attachments to the executive summary also stated that there was another "undetermined" exposure associated with the subsidiary's commuter bad debt reserve, that the "[n]on-performing segment of [the] portfolio is increasing," and that there was "no formal collections process for non-performing customers" at RAC.

47. Between April and July 2000, in connection with the company's efforts to sell RAC and/or its portfolio of commuter financing receivables, Raytheon's outside investment bankers provided certain members of senior management with a series of valuation analyses for the commuter receivables. A July 2000 analysis indicated that a sale of RACC's portfolio of commuter receivables might generate losses of between $63 million and $622 million, depending on the underlying assumptions, and that the value of discounted cash flows on the portfolio was between $200 million and $273 million lower than the total loan balances, depending upon the underlying interest rate assumptions. Caine received a copy of this report.

48. Underlying the investment banker's analysis was a July 2000 report from the same major public accounting firm that had previously analyzed RAC's "used commuter program exposures." This report highlighted significant problems related to the commuters, including high levels of delinquencies and repossessions and "between $10 million and $200 million of collateral exposure" that was not reflected by RAC's accounting and restructuring methodologies, such as the practice of recognizing losses only upon a new sale or lease of the aircraft instead of upon return or repossession. Caine received versions of this report and was aware of its contents.

49. Also, in the Summer of 2000, a senior RAC executive informed Caine and another senior Raytheon officer of his significant concern about a problem with the commuters in the "half a billion dollar" range based on his view of the number of idle aircraft that were then

in inventory and the substantial number of commuter returns that were forecasted at year-end. Ultimately, this problem was addressed by transferring pension income to RAC to gradually build up commuter reserves.

a. The Undisclosed Surplus Pension Income

50. In the third quarter of 2000, Caine approved the quarterly use of $14 million in surplus pension income at RAC on a going forward basis to increase commuter reserves. This income was generated by an over-funded pension plan that had been retained by Raytheon after the divestiture of another business unit and merged with a RAC pension plan. As a result, RAC recognized $14 million in surplus pension income each quarter on a going forward basis, which was generated by the over-funded pension plan.

51. As Caine and others were aware, this surplus pension income was going to be used to fund "a general commuter reserve" at RAC, which would increase the company's "ability to absorb losses" and "allow us to continue to sell more 1900Cs versus continuing to lease them." In November 2000, a senior corporate financial officer told senior RAC executives to "[a]nticipate that the $14M per quarter coming from the 'over[-]funded pension income' is available indefinitely." Thereafter, RAC personnel projected that they would continue to receive $14 million in pension-related income per quarter through at least 2004, which would enable the subsidiary to build up nearly $260 million in commuter reserves.

52. However, the surplus pension-related income was not separately identified and disclosed in any of the company's SEC filings because management viewed the amounts as immaterial. In fact, $14 million represented 24 to 353 percent of RAC's reported quarterly operating income/loss between the third quarter of 2000 and the second quarter of 2001 (which ranged from a $4 million operating loss to $59 million in reported operating income). This income also eliminated the comparability of the segment's current results with prior periods and represented 17 percent of RAC's reported annual operating income in 2000. In addition, Raytheon's 2000 Form 10-K failed to disclose that, had the surplus pension income from the discontinued operation not been reclassified to RAC's 2000 results, the RAC segment would have experienced a three-year decline in its reported annual operating income from $227 million in 1998, to $163 million in 1999, to $136 million in 2000.

b. The Improper "Pooling" of Commuter Aircraft

53. In the fourth quarter of 2000, at the direction of a senior corporate financial officer and others, RAC personnel instituted an improper "pooling" analysis when testing RAC's on-balance sheet commuter assets for impairment under FAS 121. This approach pooled aircraft on an aggregate basis, not on a plane-by-plane basis as required by GAAP. Although Raytheon's outside auditors were informed of the approach, they did not agree with its use. Pooling further enabled $45.7 million in "cushions" associated with low-book-value aircraft to be used to off-set losses associated with higher-book-value aircraft. These "benefits" were then used to lower the book values of its used 1900Bs and 1900Cs in small amounts at year-end 2000, and the company's public filings contained no disclosure of the aircraft's declining value.

54. In addition, even though the company's "pooling" analysis at year-end 2000 suggested that RAC did not need reserves on the 1900s that were held for sale, Caine and others at the company kept $26.4 million in commuter reserves on RAC's books and continued to use the $14 million in excess pension-related income at the subsidiary each quarter going forward to fund continued increases to a "general commuter reserve," which indicated that the anticipated losses associated with the 1900s were greater than the current level of reserves that had been established at RAC.

c. The "Soft Landing" for the Commuters

55. By late 2000, Caine and other senior Raytheon and RAC officers were aware that "[m]arket forces ha[d] created a non-performing asset problem" with the 1900s. Specifically, contemporaneous internal company documents show that, at December 31, 2000, RAC's inventory of used commuters had increased to over 100 airplanes due to an exceptionally high number of commuter returns and repossessions at year-end, and significant commuter returns were expected in the years ahead.

56. During January 2001, in response to a perceived "market shift" concerning the commuters, RAC prepared a "1900 Business Plan" intended to "steer[] to a 'soft landing' in 4 years" by (i) further reducing the build rate for new 1900Ds to one plane per month (the minimum production rate that the subsidiary could sustain without incurring an operating loss); (ii) moving away from RAC's historic commuter financing and leasing strategies to instead "sell 1900B[s and] 1900Cs for cash" at prices that were "well below" existing book values; and (iii) building up RAC's commuter reserves by at least an additional $240 million through the continued use of surplus pension-related income to facilitate commuter sales.

57. The "reduced cash sale prices" were approved by Caine and others in senior Raytheon management during January 2001, and the 1900 Business Plan projected that the revised "cash sale" values for the commuters would create at least $60 million in anticipated losses in 2001 alone. These losses, however, would be charged against the reserves that were being built up at RAC through the use of surplus pension-related income and, thus, would not be reflected in Raytheon's reported financial statements.

58. Caine and others at the company were aware of the strategy to move to "cash sales," including the effort to "maximiz[e] conversion of 1900Cs for cash" and use "gross margin generated by additional [commuter sales] to fund more sales." In January 2001, Caine further identified that one of his "goals" for the coming year was to sell "$180 million of 1900B and 1900C inventory, the proceeds of which will be used for debt reduction."

59. Consistent with the company's new commuter business plan, by February 2001, RAC's commuter sales force was instructed that "the operating lease program they had relied upon [in] the previous few years to place used commuters was gone.... In its place were new lower cash prices on 1900Cs and 1900Ds plus an emphasis on cargo sales."

d. Raytheon's Inadequate Disclosures in 2000

60. In his introductory remarks during the company's second quarter 2000 earnings call, which was held on July 20, 2000, Caine disclosed that Raytheon was "experiencing some

pressure on pricing in the commuter line" and that "refurb[ishment] costs and remarketing costs on used commuters were also higher this year than they were in the same period a year ago." When subsequently asked about this issue during the earnings call, Caine explained that "one of the risk factors that we are trying to keep our eyes on is the commuter market and that would include pricing in the commuter market, so we're not trying to ring any alarm bells. On the other hand, it...is one of the risk factors for Raytheon Aircraft." Caine, however, did not disclose relevant information that he possessed concerning the commuters during this call, including the plan to begin recording the reassigned pension income within the RAC segment for the purposes of building commuter reserves.

61. During the company's third quarter 2000 earnings call, which was held on October 19, 2000, Caine responded to certain questions concerning RAC's commuter aircraft by disclosing that "we have made some adjustments to our planning for the year with regard to used aircraft and that's part of what has hurt RAC cash flow this year to our plan, but those effects are baked into our outlook." Caine also disclosed that "[w]e admit that we've got a lot of work to do between now and the end of the year in order to place not only commuter but also some GA (general aviation) planes that would come back in to us on a trade-in basis, but we think we've captured that in our forecast." Caine, however, again did not disclose relevant information that he possessed concerning the commuters, including that, in the third quarter of 2000, he had approved the merger of the over-funded pension plan with a plan in the RAC segment in order to use the surplus pension income to establish a "general reserve" to "absorb losses" for the purposes of facilitating commuter sales at prices that were below book value.

62. Similarly, Raytheon's SEC filings for 2000 did not contain adequate disclosures of the negative, adverse, and material trends, uncertainties, risks, and other information described above related to RAC's commuter operations and the subsidiary's commuter line. Raytheon's SEC filings also did not disclose the $14 million in surplus pension income that was available to RAC each quarter on a going forward basis from the over-funded pension plan, or the improper testing of RAC's on-balance sheet commuter assets on a "pooled" basis. In addition, Raytheon's 2000 Form 10-K did not disclose the various elements of the "soft landing" plan for RAC's commuter line, including the decision to emphasize cash sales at prices that were "well below" book values to address a perceived "market shift" in the commuter business.

63. Although Raytheon's Forms 10-Q for the second and third quarter of 2000 did cite "pricing pressure on commuter aircraft" as one of the factors affecting RAC's operating income, these disclosures did not adequately describe the substantial negative information concerning the commuters that was known to management at the time. While Raytheon's third quarter 2000 Form 10-Q also disclosed that "a downturn in demand could have a material adverse effect on the company's financial position or results of operations" and its 2000 Form 10-K stated that the company would "continue to...watch for any indications of a downturn in demand for RAC's aircraft," these disclosures incorrectly suggested that management was not yet aware of any such downturn in the commuter aircraft market or its severity.

64. In addition, while Raytheon's SEC filings for 2000 contained disclosures concerning the effect of overall market conditions in the forward-looking statements, these disclosures did not provide adequate information concerning the deteriorating state of the commuter aircraft market and the negative effect that this decline was having on RAC and

commuter asset values. For example, Raytheon's 2000 Form 10-K included the forward-looking statement that the company's "operating results may vary significantly over time for a variety of reasons, many of which are outside of our control," such as "the impact on recourse obligations at Raytheon Aircraft due to changes in the collateral value of financed aircraft...[and] general economic conditions, particularly the cyclical nature of the general aviation...market[] in which we participate." These disclosures made no mention of "commuter" aircraft by name and did not reflect that company management was aware of significant losses related to RAC's commuter assets and anticipating that these losses would continue to grow in the future.

65. Also, other forward-looking statements in the company's annual report disclosed that some of the "[i]mportant factors that could cause actual results to differ" were "the effect of market conditions, particularly in relation to the general aviation and commuter aircraft markets; [and] the impact on recourse obligations of Raytheon Aircraft due to changes in the collateral values of financed aircraft, particularly commuter aircraft." These statements were contrary to other disclosures in the footnotes to the company's 2000 financial statements, which misleadingly stated that the company had a secure line of commuter financing receivables, that any liability resulting from the sale of commuter receivables into the revolving credit facility "will not have a material effect on the Company's financial position, or results of operations" given Raytheon's "experience to date with resale activities and pricing and the Company's plan to continue production into the foreseeable future," and that "[n]o material gain or loss resulted from the sales of receivables in 2000, 1999, or 1998." These disclosures did not reflect a move to cash sales of commuter aircraft at prices that were well below book value, a significant reduction in the 1900D build rate, actual material commuter losses at RAC, and potential losses associated with the 1900 line in the hundreds of millions of dollars.

66. The footnotes to Raytheon's 2000 financial statements also disclosed that the company sold commuter receivables to a bank syndicate and other financial institutions with recourse against the company "at varying percentages, depending upon the character of the receivables sold." These footnotes further stated that the outstanding balance on those receivables was over $1.7 billion year-end 2000. However, these footnotes did not disclose the high degree of recourse against the company on commuter receivables, which ranged up to 100 percent, and also failed to adequately disclose the significant declines in the commuter market and the recent restructuring of several commuter receivables to keep them from defaulting.

67. Caine reviewed and approved the inaccurate filings and disclosures described in Paragraph Nos. 60 to 66 above.

e. Raytheon's Improper Accounting in 2000

68. As described in Paragraph Nos. 50 to 52 above, the establishment of $56 million in additional commuter reserves through the transfer of surplus pension income to RAC between the third quarter of 2000 and the second quarter of 2001 was inconsistent with GAAP. No adequate contemporaneous documentation supported the amount of these commuter loss provisions, and the amount reserved corresponded only to the amount of the surplus pension income available. Caine and others were also aware of the surplus pension income and how it was used to increase commuter reserves.

69. Although Raytheon's outside auditors did review the use of the surplus pension income to establish additional commuter reserves at RAC, the auditors informed Caine and others in October 2000 that there was a "need to enhance documentation" on these reserves. According to Caine, he was advised that each quarterly reserve increase was supported by the appropriate accounting analysis. However, Caine was never provided with any such analyses supporting the need for equal $14 million additions to the commuter reserve quarter after quarter.

70. In 2000, Raytheon's outside auditors also informed Caine and others that it was "not appropriate" to pool commuter aircraft when testing for impairment under FAS 121 because the planes "d[id] not represent a large pool of homogenous assets." The auditors, therefore, proposed a $12 million audit adjustment, which represented the supposed "benefit" that the company obtained through pooling. With the knowledge of Raytheon's auditors, this adjustment was not booked because the amount was considered to be immaterial to the company's consolidated financial results. Caine and others were aware of this decision. The $12 million audit entry, however, represented approximately 7 percent of RAC's reported operating income for 2000 and, thus, was material to the financial results reported for that segment.

71. In 2000, Raytheon's outside auditors further informed Caine and other senior Raytheon and RAC executives that RAC "ha[d] not appropriately accounted for the gain or loss on notes sold to [the revolving credit facility]" or properly measured other components of the FAS 125 calculation and, thus, offered to sell RAC an improved FAS 125 model. After some initial "resistance" from a senior corporate financial officer and another senior RAC financial officer, the company did ultimately purchase and implement at the subsidiary the FAS 125 model proposed by the auditors before filing the 2000 Form 10-K. However, this model also failed to comply with GAAP. Because much of the data serving as the inputs for this model was incomplete and inaccurate, the new FAS 125 model materially misestimated the amount of RAC's various off-balance sheet assets and liabilities.

72. Also, the new FAS 125 model calculated a $22 million overstatement related to prior period FAS 125 gains. As Caine and others were aware, this proposed audit entry was not made because, among other reasons, it was deemed immaterial to the company's consolidated financial results. Such a charge, however, would have reduced RAC's reported annual operating income for 2000 by 13 percent (from $164 million to $142 million) and, thus, was material to the segment.

73. Together, the $12 million proposed audit adjustment for incorrect FAS 121 accounting and the $22 million proposed audit adjustment for RAC's incorrect FAS 125 accounting would have reduced RAC's reported operating income by 20 percent.

74. Finally, had senior Raytheon and RAC management timely recognized losses inherent in the planned "soft landing" of the commuter aircraft line, the company would have been required to take a charge of at least $67 million at year-end 2000, and contemporaneous internal company documents and other information indicate that Caine and other senior Raytheon and RAC officers were expecting commuter losses of $240 million given the cash sales prices that had been approved in the "soft landing." A charge of $67 million to $240 million at year-end 2000 would have reduced RAC's reported annual operating income by at least 41 to 146 percent and Raytheon's 2000 profit before taxes by at least 8 to 27 percent.

75. Caine reviewed the accounting described in Paragraph Nos. 68 to 74 above, and he knew or should have known that it was inaccurate.

5. In 2001, Caine Continued to Be Aware of the Ongoing Decline in the Commuter Market, and the Commuter Assets Were Written Down after September 11, 2001

76. Throughout 2001, Caine and other senior Raytheon executives continued to be aware of the ongoing decline of the commuter market and how this decline was creating serious operational issues at RAC, including substantial actual and anticipated losses associated with the 1900s on and off the company's balance sheet.

a. The First Quarter of 2001

77. In early 2001, Caine and others at Raytheon attempted to purchase risk insurance for the cash flows associated with the 1900D notes receivable in the company's off-balance sheet commuter portfolio. During these discussions, the insurer informed certain Raytheon and RAC executives that the $1.1 billion book value the 1900Ds, which RAC had financed and were off Raytheon's balance sheet, was approximately 20 percent higher than a third-party's evaluation of their current market value. These executives subsequently briefed Caine on their discussions with the insurer as well as their conclusions and analyses of the situation. Ultimately, Caine and others decided not to pursue an insurance strategy for the commuters since it was cost prohibitive given the amount of coverage provided.

78. By April 2001, Caine and others at Raytheon were aware that RAC had not sold any used commuters for cash under the "soft landing" plan during the first quarter and that recent offers for used 1900Cs were "in the $1.2M range," which was "far below" the initial "cash sale" estimates of $2.2 million approved by management as part of the "soft landing." Caine and others were further aware that "each cash order looks like it will require a great deal of focus and effort to get the ball over the goal line. Simply put, it's harder to sell for cash, but...we knew this 'going in.'" In response to this statement, one senior Raytheon executive explained that $1.5 million was a "more realistic" price for these used aircraft and further emphasized the need to "raise cash" on these sales.

b. The First Quarter 2001 Earnings Call

79. During the first quarter 2001 earnings call, which was held on April 19, 2001, Caine omitted reference to "commuter" aircraft from his introductory remarks, stating instead that "Raytheon Aircraft revenue is down $178 million, $154 million related to new aircraft deliveries and about $43 million related to a decline in used aircraft sales" and that, "[i]n Raytheon Aircraft, we see some weakness in Q-1 from a bookings standpoint.... [O]ur booking in the first quarter of this year were weak, relative to where we have been historically and also weak relative to our plan for the year. The used aircraft market is also of concern to us and we will continue to watch the numbers of planes available on the used aircraft market as we move through the second and third quarters. Our existing backlog, though, at Raytheon Aircraft is strong and appears to be stable. We do have planes in forecast for sale in...Q-2, Q-3, and Q-4, which as of yet are unsold. That is not unusual for us and we are watching carefully to see

what's happening in the market demand for both new and used aircraft and are going to be taking a close look at our planned production rates for the second, third, and fourth quarters as we move through the next 30 days."

80. In addition, in response to an analyst question concerning "the 1900D used aircraft model" and whether management had "seen weakening used aircraft prices there," Caine stated that, "during the first quarter, we...had a stronger level of activity around both new and used 1900Ds that we might have planned for the year.... I don't want you to take that to be too strong a positive signal, but...I would say that the 1900D was not a disappointment in the first quarter." Caine, however, did not disclose that, in January 2001, he and other senior Raytheon executives had approved a reduction of the build rate for new 1900Ds to one aircraft per month (the minimum line rate that RAC could sustain without incurring an operating loss). Caine also did not disclose the January 2001 reduction in used 1900D sale prices by as much as $900,000 below their average book value. Caine further did not disclose the other elements of the "soft landing," including the reduction in sales prices for used 1900Cs to roughly $1 million below their average book value and the continued quarterly use of $14 million in pension-related income at RAC for the purposes of building up commuter reserves to facilitate sales at these reduced prices. At the time, $14 million represented over 14 percent of the company's first quarter 2001 consolidated income from continuing operations of $97 million.

81. In response to another question concerning the previously discussed "weakness in the new and used aircraft market," Caine did state that "we have a number of airplanes in our outlook for Q-2, Q-3, Q-4 which, as of yet, are unsold... [T]he percentage unsold as of today is probably a little higher than the percentage unsold was at this same time a year ago, and so we're watching this carefully, and...we're going to be taking a close look at our production rates over the course of the next 30 days." Caine, however, did not disclose that RAC had not sold any used commuters for cash under the "soft landing" plan during the first quarter of 2001 or that recent cash offers on used commuters were roughly $1 million below the previously approved "soft landing" prices, as he was informed on April 17, 2001 (two days before the first quarter 2001 earnings call).

c. The Second Quarter of 2001

82. In May 2001, Caine received an e-mail, which indicated that a senior corporate financial officer disapproved of the sale of $200 million in commuter receivables to an outside party since it would occur at a $20 million (10 percent) discount. Even though this senior corporate financial officer was informed that RAC's "surplus" pension-related reserves could be used to off set this loss, he explained that "we need to understand what a 10% loss on the $200M RACC portfolio sale does to our collateral value on the rest of the portfolio. Any use of $20M of pension reserves will severely limit our ability to sell on-balance sheet aircraft for cash."

83. In June 2001, a RAC sales forecast informed Caine and others that "[a] clear trend exists that prices will have to continue to be lowered to move inventory.... In order to get more cash sales in Q4, the price will have to be lowered to between $1.1 - $1.5 MM. This could create accounting issues." Caine and others subsequently received an e-mail from a senior executive in RAC's commuter business, which stated that it would be necessary to "discount heavily" and offer 1900Cs at between $1.1 million to $1.5 million in order to make sales for cash. These

officers were further informed that RAC's 2001 sales forecast was "contingent" upon these values.

84. As Caine was aware, these transactions were subsequently blocked by a senior corporate financial officer and others in the financial organization because "these deals could cause a write down of the entire portfolio and, as a result, we need to sell the airplanes at a higher value." As set forth in internal company documents, "[w]e cannot afford to change NRVs [the Net Realizable Values of the aircraft] below $2,500,000" due to the income statement repercussions for the company. "Price integrity issues and limited reserves prevent us from lowering prices to meet a large portion of the market. Market pricing will require additional reserves."

85. In July 2001, at Caine's request, the company's investment bankers provided Raytheon management with an update of earlier analyses of the company's commuter portfolio. This analysis indicated that, at the close of the second quarter, there was at least $113 million to $198 million in losses associated with the on- and off-balance sheet commuters given the difference between their book and assumed collateral values. This analysis also indicated that the value of the discounted cash flows from the on- and off-balance sheet commuters were $431 million to $528 million below their total book values. Caine received a copy of this report.

d. The Second Quarter 2001 Earnings Call

86. During the second quarter 2001 earnings call, which occurred on July 19, 2001, Caine stated that "we also had considerably fewer commuter aircraft shipped this year relative to last year" and the "[n]umber of used aircraft sales was down considerably." Caine also stated that inventory levels at RAC had increased and were, among other things, "a function of our ability to remarket used commuter aircraft...in a tougher environment for used aircraft." Caine further presented a slide that disclosed the historical and forecasted inventory levels of commuter aircraft at RAC from June 2000 through December 2001.

87. In response to an analyst question concerning Raytheon's off-balance sheet obligations, Caine stated that, "[o]n the commuter side...we watch the performance of those assets and the liquidity and credit quality of our customers very closely. We have reserves... against the assets in the portfolio in the aggregate and in some cases we apply specific reserves to specific transactions if we have concerns about an individual credit or an individual asset. We review all of that regularly.... [T]he analysis that we have done with regard to the aging of the receivables and the risks associated with some of the receivables, particularly in commuter, has probably heightened our sensitivity relative to where we might have been a year ago. I would say that aging has gotten to be a little older. We have more receivables that are, say, 90-plus days past due today than we did a year ago or two years ago. That's always a concern. That's not necessarily a problem, but it is certainly a concern and it's one that we manage actively. I would also tell you that our reserve levels in the portfolio are higher today than they were a year ago and we add to those reserves periodically, as required."

88. However, Caine did not disclose that members of senior Raytheon and RAC management had been restructuring the payment arrangements of several major commuter customers to keep them from defaulting on their notes payable and, thus, triggering Raytheon's

recourse obligations to the credit facility. Caine also did not disclose that, by the second quarter of 2001, $56 million in pension-related income had been used at RAC to increase commuter reserves (including $28 million in the first half of 2001, which represented 13 percent of the company's consolidated income from continuing operations for the six months ended July 1, 2001). Furthermore, as set forth in Paragraph No. 68, the way in which these additional commuter reserves were established through the use of pension-related income did not comply with GAAP.

89. In addition, in response to a follow-up question by another analyst, Caine stated that the increases in the commuter reserves at RAC would be reflected in the segment's reported "operating income." However, as Caine was aware, these reserves were being established through the undisclosed use of $14 million in pension-related income each quarter, which also occurred "above the line." As such, Raytheon's financial statements did not accurately reflect the negative impact that these commuter reserves were having on RAC's reported operating income.

90. Furthermore, one week before the July 2001 earnings call, Caine received an analysis from Raytheon's investment bankers, which indicated that there was upwards of $198 million in losses associated with the on- and off-balance sheet commuters at the close of the second quarter given the difference between their book and collateral values and that the value of the discounted cash flows from the on- and off-balance sheet commuter receivables were as much as $528 million below their total book values. And, one day before this call, Caine was informed that (i) the market price for future fleet sales of used 1900Cs was between $1.1 million and $1.5 million per plane and (ii) senior executives in his finance department were blocking these transactions because they "could cause a write down of the entire portfolio and, as a result, we need to sell the airplanes at a higher value." Caine, however, did not disclose this information during the July 2001 earnings call.

e. The August 2001 Commuter Summit

91. In August 2001, Raytheon convened a "commuter summit" at its corporate headquarters to discuss the state of the commuter market and the negative effect this decline was having on RAC's commuter business. At this meeting, an outside consultant informed Caine and others in senior Raytheon and RAC management that "[c]ompetitive market pressures are intense. Critically, they are not anticipated to ease anytime soon.... Turboprop aircraft orders have stagnated at best.... Only a handful of companies still operate 19-seat turboprops.... The prognosis for U.S. 19-seat operators is not very good.... Downward pricing pressure is not anticipated to ease as the number of surplus 20 to 35 seat turboprop aircraft grows, making them more attractive as 19-seat replacements.... With turboprop aircraft demand falling and supply raising, pricing must reflect basic market conditions not internal benchmarks."

92. At this "commuter summit," another outside consultant reported that estimates of fair market value for the commuters were, on average, $2 million below book value for the 1900Cs and $1.3 million below book value for the 1900Ds. At the time, the company had over 130 1900Cs and nearly 320 1900Ds on and off the balance sheet, making for an estimated exposure of approximately $676 million.

f. The First and Second Quarter 2001 Forms 10-Q

93. Despite the substantial information that management possessed concerning the decline in RAC's commuter aircraft business and the erosion of commuter asset values, the company's first quarter 2001 Form 10-Q did not adequately disclose these adverse views of and developments in RAC's commuter operations, including management's decision to move from a leasing to a cash sales strategy for used commuters.

94. For example, although this filing did state that, "[d]uring the first quarter of 2001, RAC experienced softness in orders for new and used commercial aircraft," that Raytheon "remains concerned about the market outlook at RAC," and that "[w]eak demand for RAC's new or used aircraft could have a material adverse effect on RAC's financial position and results of operations," these disclosures discussed only "commercial" aircraft in general, which covered several other product lines in addition to the commuters. Because these and other disclosures covered all of RAC's "new and used" commercial aircraft, the company's filing did not make adequate disclosure of the negative risks and trends related to the commuters that were known to senior management at the time.

95. Raytheon's second quarter 2001 Form 10-Q, which was filed one week after the August 2001 commuter summit, also did not adequately disclose the negative risks and trends associated with the company's commuter aircraft. For example, Raytheon's Form 10-Q disclosed that RAC's second quarter 2001 "[o]perating income was down primarily due to the lower sales volume and margin pressure on T-6A, Beechjet, and used aircraft due to the current market environment. During 2001, RAC experienced softness in orders for new and used commercial aircraft. The Company remains concerned about the market outlook at RAC. During the second quarter of 2001, RAC responded to a softening market by announcing workforce reductions and adjustments in production rates." These disclosures made no specific mention of "commuter" aircraft and failed to adequately disclose the negative risks and trends concerning the commuters that were known to senior management at the time.

96. The only disclosure specifically referencing "commuters" in the Management Discussion and Analysis section of Raytheon's second quarter 2001 filing concerned "[t]he aging on RAC's commuter customer financing receivables [which] has deteriorated over the past year. Non-performance on these loans and leases, in the aggregate, could have a material adverse effect on the Company's liquidity." At this time, senior Raytheon officers had been informed that there were hundreds of millions of dollars of actual and potential losses associated with these receivables based on the analyses that the company's investment bankers had performed and the other information the company had received. Thus, Raytheon's Form 10-Q failed to adequately disclose the significant declines in the commuter market, recent restructuring of several commuter customers to keep them from defaulting on their notes payable, and the substantial financial repercussions that would follow given the company's recourse obligations to the bank facility.

97. Also, both of Raytheon's first and second quarter 2001 filings contained inadequate disclosures about the potential effect of market conditions in their forward-looking statements. In particular, both Forms 10-Q stated that of the many "[i]mportant factors that could cause actual results to differ" were "the effect of market conditions, particularly in relation

to the general aviation and commuter aircraft markets; [and] the impact of recourse obligations of Raytheon Aircraft due to changes in the collateral values of financed aircraft, particularly commuter aircraft." These disclosures, however, failed to provide investors with sufficient information concerning the negative trends and risks associated with the commuters that were known by management at the time. The inclusion of these disclosures in the company's forward-looking statements gave the inaccurate impression that Raytheon was not presently facing any risks associated with its on- and off-balance sheet commuter assets during these time periods.

g. Raytheon's Equity Offering

98. In April and May 2001, Raytheon filed a Form S-3 and prospectus supplements in connection with its $3 billion shelf registration and takedown of equity securities. These filings contained materially misleading statements and omissions concerning the commuters because:

(a) Raytheon's Form S-3 incorporated prior filings by reference and thus repeated the false and misleading statements from those periodic reports. In addition, the Form S-3 did not disclose the material and adverse trends and uncertainties that were known to management at the time concerning the commuters. The Form S-3 also incorporated by reference "any future filings made by us...until we sell all of the securities." As alleged below, these future filings were also misleading.

(b) In addition, the forward-looking statements of the Form S-3 contained disclosures about "regional aircraft" and "price pressures within the market" but did not specifically reference commuters by name. Similarly, these forward-looking statements disclosed that "a decline in demand in the market for our aircraft, would have an adverse effect, which may be material, on our financial results," but did not describe the declining commuter market or RAC's deteriorating commuter business. Likewise, other forward-looking statements disclosed that "[t]he value of our securities may fluctuate as a result of considerations that are difficult to forecast, such as...the impact on recourse obligations at Raytheon Aircraft Company due to changes in the collateral value of financed aircraft...and general economic conditions, particularly the cyclical nature of the general aviation and other commercial markets in which we participate." These forward-looking statements, however, did not specifically mention the known risks posed by the deteriorating state of the commuter market, RAC's growing inventory of used commuter aircraft, or the over-valued commuter financing receivables that were off the company's balance sheet.

99. Caine reviewed and approved the inaccurate filings and disclosures described in Paragraph Nos. 93 to 98 above.

h. Raytheon's Improper Accounting and Disclosures in the Third Quarter of 2001 and at Year-End

100. Although Raytheon's on- and off-balance sheet commuter assets were over-valued by hundreds of millions of dollars as of August 31, 2001, it was not until after the terrorist attacks on September 11th that management began the process of a write down. However, much of the information used to estimate fair value for the commuters was from three or four weeks

earlier in August of 2001, and none of the publicly available data used in the write-down analysis was post-September 11th. Caine and another senior corporate financial officer also considered offers that RAC had received from commuter customers during the most recent year, even though these officers had previously refused to sell planes for these prices in July 2001 since "these deals could cause a write down of the entire portfolio…." Also, a post-September 11th "top down, market study" upon which a senior Raytheon officer and Caine relied to support the final charge estimated that there was $400 million to $500 million in pre-existing exposure on the commuters as of July 2001. This amount represented roughly 60 to 70 percent of the $693 million charge that was ultimately taken by the company. As the Vice President of Investor Relations informed senior management near completion of the write down, a survey of buy- and sell-side analysts prior to the upcoming earnings call indicated that "defense companies get a free pass this quarter" given recent events. These analysts were further "expecting a $400-500 million charge" on the commuters, and they would be "irritated" with the company "if we do not take this opportunity to adjust these values."

101. Thus, in the third quarter of 2001, Raytheon stated that it had taken a $693 million loss provision related to RAC's commuter aircraft as "a result of continued weakness in the commuter aircraft market and the impact of the events of September 11, 2001." This misleading statement was repeated in substance in the company's 2001 Form 10-K. Given the charge that the company should have taken at year-end 2000 to properly account for RAC's on- and off-balance sheet commuter assets and the $240 million in commuter reserves that company management planned to build to cover anticipated losses, the $693 million commuter loss provision that Raytheon took in the third quarter of 2001 was materially overstated by at least 10 to 53 percent.

102. Raytheon's SEC filings also did not disclose that the third quarter 2001 commuter loss provision was largely determined by implementing for the first time a market-based measure of portfolio loss under FAS 140, the successor to FAS 125. Contrary to Raytheon's prior public disclosures, the company's recourse liability obligations on the commuter receivables sold into the credit facility had previously been calculated through a pooled, probable loss analysis.

103. Caine reviewed and approved the inaccurate filings and disclosures described in Paragraph Nos. 101 to 102 above. Caine further reviewed the accounting described in Paragraph Nos. 101 to 102 above, and he knew or should have known that it was inaccurate.

E. THE IMPACT OF THE IMPROPER ACCOUNTING AND DISCLOSURE PRACTICES

104. As a result of the improper disclosure and accounting practices described above, Raytheon filed at least nine quarterly reports, three annual reports, and two registration statements that contained materially false and misleading disclosures and financial statements.

F. LEGAL ANALYSIS

105. Section 17(a)(2) of the Securities Act prohibits a person from obtaining money or property by means of any untrue statement of a material fact or any misleading omission of material fact in the offer or sale of securities. *See* 15 U.S.C. § 77q(a)(2). Section 17(a)(3) of the

Securities Act prohibits a person from engaging in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser in the offer or sale of securities. *See* 15 U.S.C. § 77q(a)(3). Information is material where there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision. *See Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988). Establishing a violation of Sections 17(a)(2) and (3) does not require a showing of scienter. *See Aaron v. SEC*, 446 U.S. 680, 701-02 (1980).

106. Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13 require issuers with securities registered under Section 12 to file annual, quarterly, and other reports with the Commission. The obligation to file such reports embodies the requirement that they be true and correct. *See, e.g., SEC v. Savoy Indus., Inc.*, 587 F.2d 1149, 1165 (D.C. Cir. 1978), *cert. denied*, 440 U.S. 913 (1979). Rule 12b-20 further requires the inclusion of any additional material information that is necessary to make required statements, in light of the circumstances under which they were made, not misleading. Information regarding the financial condition of a company is presumptively material. *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985). No showing of scienter is necessary to establish a violation of Section 13(a) or Rules 12b-20, 13a-1, and 13a-13. *See, e.g., Savoy*, 587 F.2d at 1167. Additionally, Item 303 of Regulation S-K requires registrants to disclose "any known trends or uncertainties that have had or that the registrant reasonably expects will have a material ... unfavorable impact on net sales or revenues or income from continuing operations." 17 C.F.R. § 229.303(a)(3)(ii). The failure to comply with Regulation S-K constitutes a violation of Section 13(a) of the Exchange Act.

107. Caine violated Sections 17(a)(2) and (3) of the Securities Act and caused certain of Raytheon's violations of Section 13(a) of the Exchange Act as well as Rules 12b-20, 13a-1, and 13a-13 thereunder, through conduct in 2000 and 2001. As described above, as Raytheon's CFO, Caine (i) failed to make or ensure full, accurate, and adequate disclosure of the known trends and uncertainties associated with the company's commuter line in Raytheon's public filings for 2000 and 2001, such as the deteriorating state of RAC's commuter business and the various means that the company was using to address this problem; (ii) failed to ensure that Raytheon properly accounted for the resulting commuter losses that were known and anticipated by management during 2000 and 2001, which led to material misstatements of the company's reported results on both a segment and a consolidated basis; and (iii) through such conduct, caused Raytheon's filing of at least six quarterly reports, two annual reports on Forms 10-Q and 10-K, and two sets of registration statements and prospectus supplements for May 2001 and October 2001 offerings that contained inadequate disclosures and inaccurate financial statements.

108. Section 13(b)(2)(A) of the Exchange Act requires Section 12 registrants to make and keep books, records and accounts that accurately and fairly reflect the transactions and dispositions of their assets. Section 13(b)(2)(B) of the Exchange Act requires such registrants to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are recorded as necessary to permit preparation of financial statements in conformity with GAAP and to maintain the accountability of assets. Rule 13b2-1 prohibits the falsification of any book, record, or account subject to Section 13(b)(2)(A). No showing of scienter is necessary to establish violations of these provisions. *See SEC v. McNulty*, No. 94 CIV. 7114 (MBM), 1996 WL 422259, at *7 (S.D.N.Y. July 29, 1996).

109. Caine caused certain of Raytheon's violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rule 13b2-1 thereunder. As described above, during 2000 and 2001, he failed to ensure that the company's commuter assets and liabilities were properly recorded in the company's books and records. He also failed to ensure that Raytheon designed and maintained an adequate system of internal controls to ensure that the company properly measured its commuter assets and liabilities.

110. Based on the foregoing, the Commission finds that Caine violated Sections 17(a)(2) and (3) of the Securities Act, and caused certain of Raytheon's violations of Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act as well as Rules 12b-20, 13a-1, 13a-13 and 13b2-1 thereunder.

IV.

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

Accordingly, it is hereby ORDERED that Respondent Caine cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and (3) of the Securities Act and Rule 13b2-1 under the Exchange Act and from causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) of the Exchange Act, and Rules 12b-20, 13a-1, and 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor
Assistant Secretary

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Commissioner Atkins
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55483A / March 15, 2007

INVESTMENT ADVISERS ACT OF 1940
Release No. 2597A / March 15, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12593

In the Matter of **IMPERIUM ADVISORS, LLC,** **Respondent.**	**CORRECTED ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(e) 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 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(e) of the Investment Advisers Act of 1940 ("Advisers Act"), against Imperium Advisors, LLC (the "Respondent" or "Imperium Advisors").

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

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herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 and Section 203(e) of the Investment Advisers Act of 1940 ("Order"), as set forth below.

III.

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

Summary

On three occasions from August 2004 through November 2004, the Respondent willfully violated Rule 105 of Regulation M by selling securities short within five business days before the pricing of public offerings and then covering the short positions with securities purchased in the offerings. The Respondent's clients' profits on these transactions totaled $75,192.

Respondent

1. **Imperium Advisors, LLC** is a limited liability company organized under Delaware law and is the investment adviser to Imperium Master Fund, LP (the "Master Fund"), a Cayman Islands hedge fund, and the Master Fund's three feeder funds, Imperium Market Neutral Fund, LP, Imperium Market Neutral Fund (QP), LP, and Imperium Market Neutral Offshore Fund, Ltd. Imperium Advisors was a registered investment adviser, but it withdrew its registration in early 2006 because it is ceasing operation. During the relevant time period, Imperium Advisors had full investment discretion for the Master Fund, which, in turn, holds all or substantially all of the feeder funds' assets in a single prime brokerage account.

Background

2. Rule 105 of Regulation M, "Short Selling in Connection with a Public Offering," ("Rule 105") prohibits covering a short sale with securities obtained in a public offering if the short sale occurred within the shorter of the period beginning five business days before the pricing and ending with the pricing of the offering or the period beginning with the initial filing of the registration statement or notification on Form 1-A and ending with pricing (the "restricted period").

In pertinent part, Rule 105 provides:

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

> In connection with an offering of securities for cash pursuant to a registration statement ... filed under the Securities Act, it shall be unlawful for any person to cover a short sale with offered securities purchased from an underwriter or broker or dealer participating in the offering, if such short sale occurred during the shorter of: (1) The period beginning five business days before the pricing of the offered securities and ending with such pricing; or (2) The period beginning with the initial filing of such registration statement ... and ending with the pricing.

17 C.F.R. § 242.105(a)(1). Rule 105 is prophylactic and prohibits the conduct irrespective of the short seller's intent in effecting the short sale.

3. During the relevant period, Imperium Advisors engaged in short selling and covering transactions prohibited under Rule 105 in connection with purchases of securities in public offerings made by Pioneer Drilling Company ("Pioneer"), Premcor, Inc. ("Premcor"), and The Houston Exploration Company ("Houston Exploration").

4. After the close of the market on August 5, 2004, Pioneer and certain selling shareholders priced a follow-on offering of 9,582,018 shares of common stock at $6.90 per share. The offering was offered to the public through an underwriter on a firm commitment basis. Accordingly, the Rule 105 restricted period was July 30, 2004 through August 5, 2004.

5. Imperium Advisors sold short a total of 114,100 Pioneer shares on three consecutive days during the Rule 105 restricted period and covered this restricted-period short position using Pioneer shares received in the follow-on offering. The Master Fund's profit on the restricted-period short sales was $41,328.

6. After the close of market on September 14, 2004, selling shareholders of Premcor priced a follow-on offering of 10,000,000 shares of common stock. The selling shareholders offered the shares to the public through an underwriter on a firm commitment basis. Accordingly, the Rule 105 restricted period was September 8, 2004 through September 14, 2004.

7. Imperium Advisors sold short a total of 30,000 Premcor shares on two days during the Rule 105 restricted period and covered this restricted-period short position using Premcor shares received in the follow-on offering. The Master Fund's profit on the restricted-period short sales was $33,864.

8. After the close of the market on November 18, 2004, a selling shareholder of Houston Exploration priced a follow-on offering of 6,580,392 shares of common stock at $56.25 per share. The selling shareholder offered the shares to the public through an underwriter on a firm commitment basis. Accordingly, the Rule 105 restricted period for Houston Exploration shares was November 12, 2004 through November 18, 2004.

9. Imperium Advisors sold short 3,000 Houston Exploration shares during the Rule 105 restricted period. Imperium Advisors purchased 275,000 shares of Houston Exploration in the

follow-on offering and covered the restricted-period short sale using Houston Exploration shares received in the follow-on offering at a loss to the Master Fund.

10. As a result of the conduct described above, the Respondent willfully[2] violated Rule 105 of Regulation M, which makes it "unlawful for any person to cover a short sale with offered securities purchased from an underwriter or broker or dealer participant in the offering, if such short sale occurred during the ... period beginning five business days before the pricing of the offered securities and ending with the pricing."

Imperium Advisors' Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Imperium Advisors and cooperation afforded the Commission's staff.

IV.

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

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

A. Respondent is censured.

B. Respondent cease and desist from committing or causing any violations and any future violations of Regulation M, Rule 105.

C. IT IS FURTHER ORDERED that Respondent shall, within thirty (30) days of the entry of this Order, pay disgorgement in the amount of $75,192 and prejudgment interest in the amount of $7,176 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, Stop 0-3, VA 22312; and (D) submitted under cover letter that identifies Imperium Advisors, LLC as Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Helene Glotzer, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Northeast Regional Office, 3 World Financial Center, New York, NY 10281.

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2 "Willfully" as used in this Order means intentionally committing the act which constitutes the violation, Cf. Wonsover v. S.E.C., 205 F.3d 408, 414 (D.C. Cir. 2000); Tager v. S.E.C., 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.

D. IT IS FURTHER ORDERED that Respondent shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of $37,596 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Imperium Advisors, LLC as Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Helene Glotzer, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, Northeast Regional Office, 3 World Financial Center, New York, NY 10281.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 40
Docket ID OCC-2007-0003
RIN 1557-AC80

FEDERAL RESERVE SYSTEM
12 CFR Part 216
Docket No. R-1280

FEDERAL DEPOSIT INSURANCE CORPORATION
12 CFR Part 332
RIN 3064-AD16

DEPARTMENT OF THE TREASURY
Office of Thrift Supervision
12 CFR Part 573
Docket ID OTS-2007-0005
RIN 1550-AC12

NATIONAL CREDIT UNION ADMINISTRATION
12 CFR Part 716
RIN 3133-AC84

FEDERAL TRADE COMMISSION
16 CFR Part 313
RIN 3084-AA94 Project No. 034815

COMMODITY FUTURES TRADING COMMISSION
17 CFR Part 160
RIN 3038-AC04

SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 248
[Release Nos. 34-55497, IA-2598, IC-27755; File No. S7-09-07]
RIN 3235-AJO6

Interagency Proposal for Model Privacy Form under the Gramm-Leach-Bliley Act

AGENCIES: Office of the Comptroller of the Currency, Treasury (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Office of Thrift Supervision, Treasury (OTS); National Credit Union Administration (NCUA); Federal Trade

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Commission (FTC); Commodity Futures Trading Commission (CFTC); and Securities and Exchange Commission (SEC).

ACTION: Proposed rule.

SUMMARY: The OCC, Board, FDIC, OTS, NCUA, FTC, CFTC, and SEC (the Agencies) are proposing amendments to their rules that implement the privacy provisions of the Gramm-Leach-Bliley Act (GLB Act), Title V, Subtitle A. These rules require financial institutions to provide initial and annual privacy notices to their customers. As required under Section 728 of the Financial Services Regulatory Relief Act of 2006 (Regulatory Relief Act or Act), the Agencies are proposing a safe harbor model privacy form that financial institutions may use to provide disclosures under the privacy rules. Institutions that use notices based on the Sample Clauses currently contained in most of the privacy rules would lose the benefit of a safe harbor for compliance with respect to those notices if they are provided more than one year following the date of publication of a final rule. Similarly, institutions that use notices based on the Sample Clauses in the SEC's privacy rule could no longer rely on the guidance provided with respect to those notices if they are provided more than one year following the date of publication of a final rule.

DATES: Comments must be submitted on or before **[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

For information regarding the effective dates of the provisions proposed in this document, see the discussion under "Proposed Effective Dates" in the SUPPLEMENTARY INFORMATION section.

ADDRESSES: Because the Agencies will jointly review all of the comments submitted, interested parties may send comments to any of the Agencies and need not send comments (or copies) to all of the Agencies. Commenters are encouraged to use the title "Model Privacy Form" to facilitate the organization and distribution of comments among the Agencies. Interested parties are invited to submit written comments to:

Office of the Comptroller of the Currency: You may submit comments by any of the following methods:

- **Federal eRulemaking Portal – "Regulations.gov":** Go to http://www.regulations.gov, select "Comptroller of the Currency" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "OCC-2007-0003" to submit or view public comments and to view supporting and related materials for this notice of proposed rulemaking. The "User Tips" link at the top of the Regulations.gov home page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- **Mail:** Office of the Comptroller of the Currency, 250 E Street, SW, Mail Stop 1-5, Washington, DC 20219.
- **Hand Delivery/Courier:** 250 E Street, SW, Attn: Public Information Room, Mail Stop 1-5, Washington, DC 20219.

Instructions: You must include "OCC" as the agency name and "Docket Number OCC-2007-0003" in your comment. In general, OCC will enter all comments received into the docket and publish them on Regulations.gov without change, including any business or personal information that you provide such as name and address information, e-mail addresses, or phone numbers. Comments, including attachments and other supporting materials, received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

You may review comments and other related materials by any of the following methods:

- **Viewing Comments Electronically:** Go to http://www.regulations.gov, select "Comptroller of the Currency" from the agency drop-down menu, then click "Submit." In the "Docket ID" column, select "OCC-2007-0003" to view public comments for this notice of proposed rulemaking.
- **Viewing Comments Personally:** You may personally inspect and photocopy comments at the OCC's Public Information Room, 250 E Street, SW, Washington, DC. You can make an appointment to inspect comments by calling (202) 874-5043.
- **Docket:** You may also view or request available background documents and project summaries using the methods described above.

Board of Governors of the Federal Reserve System: You may submit comments, identified by Docket No. R-1280, by any of the following methods:

- Agency Web Site: http://www.federalreserve.gov. Follow the instructions for submitting comments at http://www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm.
- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- E-mail: regs.comments@federalreserve.gov. Include docket number in the subject line of the message.
- FAX: 202/452-3819 or 202/452-3102.
- Mail: Jennifer J. Johnson, Secretary, Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

All public comments are available from the Board's Web site at www.federalreserve.gov/generalinfo/foia/ProposedRegs.cfm as submitted, unless modified for technical reasons. Accordingly, your comments will not be edited to remove any identifying or contact information. Public comments may also be viewed electronically or in paper in Room MP-500 of the Board's Martin Building (20th and C Streets, N.W.) between 9:00 a.m. and 5:00 p.m. on weekdays.

FDIC: You may submit comments by any of the following methods:

Agency Web Site: http://www.fdic.gov/regulations/laws/federal. Follow instructions for submitting comments on the Agency Web Site.

E-mail: Comments@FDIC.gov. Include "Model Privacy Form" in the subject line of the message.

Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m. (EST).

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

Public Inspection: All comments received will be posted without change to http://www.fdic.gov/regulations/laws/federal including any personal information provided. Comments may be inspected and photocopied in the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226, between 9 a.m. and 5 p.m. (EST) on business days. Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275-3342 or (703) 562-2200.

Office of Thrift Supervision: You may submit comments, identified by OTS-2007-0005, by any of the following methods:

- **Federal eRulemaking Portal:** Go to http://www.regulations.gov, select "Office of Thrift Supervision" from the agency drop-down menu, then click submit. Select Docket ID "OTS-2007-0005" to submit or view public comments and to view supporting and related materials for this notice of proposed rulemaking. The "User Tips" link at the top of the page provides information on using Regulations.gov, including instructions for submitting or viewing public comments, viewing other supporting and related materials, and viewing the docket after the close of the comment period.
- **Mail:** Regulation Comments, Chief Counsel's Office, Office of Thrift Supervision, 1700 G Street, NW, Washington, DC 20552, Attention: OTS-2007-0005.
- **Hand Delivery/Courier:** Guard's Desk, East Lobby Entrance, 1700 G Street, NW, from 9:00 a.m. to 4:00 p.m. on business days, Attention: Regulation Comments, Chief Counsel's Office, Attention: OTS-2007-0005.

Instructions: All submissions received must include the agency name and docket number for this rulemaking. All comments received will be entered into the docket and posted on Regulations.gov without change, including any personal information provided. Comments, including attachments and other supporting materials received are part of the public record and subject to public disclosure. Do not enclose any information in your comment or supporting materials that you consider confidential or inappropriate for public disclosure.

Viewing Comments Electronically: Go to http://www.regulations.gov, select "Office of Thrift Supervision" from the agency drop-down menu, then click "Submit." Select Docket ID "OTS-2007-0005" to view public comments for this notice of proposed rulemaking.

Viewing Comments On-Site: You may inspect comments at the Public Reading Room, 1700 G Street, NW, by appointment. To make an appointment for access, call (202) 906-5922, send an e-mail to public.info@ots.treas.gov, or send a facsimile transmission to (202) 906-6518. (Prior notice identifying the materials you will be requesting will assist us in serving you.) We schedule appointments on business days between 10:00 a.m. and 4:00 p.m. In most cases, appointments will be available the next business day following the date we receive a request.

National Credit Union Administration: Comments should be directed to Mary Rupp, Secretary of the Board. You may submit comments by any of the following methods (**Please send comments by one method only**):

- Federal eRulemaking Portal: http://www.regulations.gov. Follow the instructions for submitting comments.
- NCUA Web Site: http://www.ncua.gov/news/proposed_regs/proposed_regs.html. Follow the instructions for submitting comments.
- E-mail: Address to regcomments@ncua.gov. Include "[Your name] Comments on Proposed Rule Part 716 (Model Form for Privacy Notice)" in the e-mail subject line.
- Fax: (703) 518-6319. Use the subject line described above for e-mail.
- Mail: Address to Mary Rupp, Secretary of the Board, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.
- Hand Delivery/Courier: Same as mail address.

Federal Trade Commission: All persons are invited to submit written comments. Comments should refer to "Model Privacy Form, FTC File No. P034815" to facilitate the organization of comments. Comments filed in paper form should include this reference both in the text and on the envelope, and should be mailed or delivered to: Federal Trade Commission/Office of the Secretary, Room 135 (Annex C), 600 Pennsylvania Avenue, NW, Washington, DC 20580. Because paper mail in the Washington area and at the Commission is subject to delay, please consider submitting your comments in electronic form, as prescribed below. If the comment contains any material for which confidential treatment is requested, it must be filed in paper (rather than electronic) form, and the first page of the document must be clearly labeled "Confidential."[1] The FTC is requesting that any comment filed in paper form be sent by courier or overnight service, if possible.

Comments filed in electronic form should be submitted by using the following weblink: https://secure.commentworks.com/ftc-modelform (and following the instructions on the Web-based form). To ensure that the Commission considers an electronic comment, you must file it on the Web-based form at the weblink https://secure.commentworks.com/ftc-modelform. If this notice appears at www.regulations.gov, you may also file an electronic comment through that Web site. The Commission will consider all comments that www.regulations.gov forwards to it.[2] The FTC Act and other laws the Commission administers permit the collection of public comments to consider and use in this proceeding as appropriate. All timely and responsive public comments

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1 Commission Rule 4.2(d), 16 CFR 4.2(d). The comment must also be accompanied by an explicit request for confidential treatment, including the factual and legal basis for the request, and must identify the specific portions of the comment to be withheld from the public record. The request will be granted or denied by the Commission's General Counsel, consistent with applicable law and the public interest. See Commission Rule 4.9(c), 16 CFR 4.9(c).

2 An electronic comment can be filed by (1) clicking on http://www.regulations.gov; (2) selecting "Federal Trade Commission" at "Search for Open Regulations;" (3) locating the summary of this notice; (4) clicking on "Submit a Comment on this Regulation;" and (5) completing the form. For a given electronic comment, any information placed in the following fields – "Title," "First Name," "Last Name," "Organization Name," "State," "Comment," and "Attachment" – will be publicly available on the FTC Web site. The fields marked with an asterisk on the form are required in order for the FTC to fully consider a particular comment. Commenters may choose not to fill in one or more of these fields, but if they do so, their comments may not be considered.

with all required fields completed, whether filed in paper or electronic form, will be considered by the Commission, and will be available to the public on the FTC Web site, to the extent practicable, at www.ftc.gov. As a matter of discretion, the Commission makes every effort to remove home contact information for individuals it receives from the public comments before placing those comments on the FTC Web site. More information, including routine uses permitted by the Privacy Act, may be found in the FTC's privacy policy, at http://www.ftc.gov/ftc/privacy.htm.

Commodity Futures Trading Commission: Comments should be directed to Eileen Donovan, Acting Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581. Comments may be sent by facsimile transmission to (202) 418-5528 or by e-mail to secretary@cftc.gov.

Securities and Exchange Commission: 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 S7-09-07 and "Model Privacy Form" 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 S7-09-07 and "Model Privacy Form." 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:

OCC: Amy Friend, Assistant Chief Counsel, (202) 874-5200; Heidi Thomas, Special Counsel, Jonathan Mitchell, Attorney, Legislative and Regulatory Activities Division, (202) 874-5090; David H. Nebhut, Director, Policy Analysis, (202) 874-5387; or Paul Utterback, NBE Compliance Specialist, (202) 874-4428, Office of the Comptroller of the Currency, 250 E Street SW, Washington, DC 20219.

Board: Adrianne Threatt, Counsel, Legal Division, (202) 452-3554; Jeanne Hogarth, Consumer Policies Program Manager, or Krista Ayoub, Senior Attorney, or Ky Tran-Trong, Counsel, Division of Consumer and Community Affairs, (202) 452-3667; or Michelle E. Shore, Federal Reserve Board Clearance Officer, (202) 452-3829 (for Paperwork Reduction Act questions only), Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

FDIC: David P. Lafleur, Senior Policy Analyst, Compliance Section, Division of Supervision and Consumer Protection, (202) 898-6569; or Ruth R. Amberg, Senior Counsel, (202) 898-3736, or Kimberly A. Stock, Attorney, (202) 898-3815, Legal Division; Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 20429.

OTS: Ekita Mitchell, Consumer Regulations Analyst, Examinations, Supervision, and Consumer Protection, (202) 906-6451; or Richard Bennett, Counsel, Regulations and Legislation Division, (202) 906-7409, 1700 G Street, NW, Washington, DC 20552.

NCUA: Regina Metz, Staff Attorney, (703) 518-6561, or Ross Kendall, Staff Attorney, Office of General Counsel, (703) 518-6562, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

FTC: Loretta Garrison, Senior Attorney, Division of Privacy and Identity Protection, Bureau of Consumer Protection, (202) 326-3043, Federal Trade Commission, 600 Pennsylvania Avenue, NW, Stop NJ-3158, Washington, DC 20580.

CFTC: Laura Richards, Senior Assistant General Counsel, (202) 418-5126, or Gail B. Scott, Attorney, Office of General Counsel, (202) 418-5139, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

SEC: Catherine McGuire, Chief Counsel, or Brice Prince, Special Counsel, Office of the Chief Counsel, Division of Market Regulation, (202) 551-5550; or Penelope Saltzman, Branch Chief, or Vincent Meehan, Senior Counsel, Office of Regulatory Policy, Division of Investment Management, (202) 551-6792, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION:

The Agencies are proposing amendments to each of their rules (which are consistent and comparable) that implement the privacy provisions of the GLB Act: 12 CFR part 40 (OCC); 12 CFR part 216 (Board); 12 CFR part 332 (FDIC); 12 CFR part 573 (OTS); 12 CFR part 716

(NCUA); 16 CFR part 313 (FTC); 17 CFR part 160 (CFTC); and 17 CFR part 248 (SEC) (collectively, the "privacy rule").[3]

I. BACKGROUND

The Regulatory Relief Act was enacted on October 13, 2006.[4] Section 728 of the Act directs the Agencies to "jointly develop a model form which may be used, at the option of the financial institution, for the provision of disclosures under [section 503 of the GLB Act]."[5] The Regulatory Relief Act stipulates that the model form shall be a safe harbor for financial institutions that elect to use it. Section 728 further directs that the model form shall:

(A) be comprehensible to consumers, with a clear format and design;

(B) provide for clear and conspicuous disclosures;

(C) enable consumers easily to identify the sharing practices of a financial institution and to compare privacy practices among financial institutions; and

(D) be succinct, and use an easily readable type font.

The Agencies are required to propose a model form for public comment by April 11, 2007.

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3 Because each Agency's privacy rule has the same section numbers, relevant sections will be cited, for example, as "section __.6" unless otherwise noted.

4 P.L. 109-351 (Oct. 13, 2006), 120 Stat. 1966.

5 Id., adding 15 U.S.C. 6803(e). Section 728 of the Regulatory Relief Act directs the agencies named in Section 504(a)(1) of the GLB Act, 15 U.S.C. 6804(a)(1), to develop a model form. The CFTC, which did not become subject to Title V of the GLB Act until 2000, is not named in that section. The Commodity Exchange Act ("CEA") was amended in 2000 by the Commodity Futures Modernization Act of 2000 to make the CFTC a "federal functional regulator" subject to the GLB Act Title V. See Section 5g of the CEA, 7 U.S.C. 7b-2. The CFTC interprets Section 728 of the Regulatory Relief Act as applying to it through Section 5g.

A. The Gramm-Leach-Bliley Act Privacy Notices

Subtitle A of title V of the GLB Act, captioned Disclosure of Nonpublic Personal Information,[6] requires each financial institution to provide a notice of its privacy policies and practices to its customers who are consumers.[7] In general, the privacy notices must describe a financial institution's policies and practices with respect to disclosing nonpublic personal information about a consumer to both affiliated and nonaffiliated third parties.[8] The notices also must provide a consumer a reasonable opportunity to direct the institution generally not to share nonpublic personal information[9] about the consumer (that is, to "opt out") with nonaffiliated third parties other than as permitted by the statute (for example, sharing for everyday business purposes, such as processing transactions and maintaining customers' accounts, and in response to properly executed governmental requests).[10] The privacy notice must provide, where applicable under the Fair Credit Reporting Act (FCRA), a notice and an opportunity for a consumer to opt out of certain information sharing among affiliates.[11]

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6 Codified at 15 U.S.C. 6801-6809.

7 15 U.S.C. 6803(a). A "customer" means a consumer who has a "customer relationship with a financial institution." Privacy rule, section ___.3(h), SEC section 248.3(j), CFTC section 160.3(k). A "consumer" is "an individual who obtains, from a financial institution, financial products or services which are to be used primarily for personal, family, or household purposes, and also means the legal representative of such an individual." 15 U.S.C. 6809(9); privacy rule, section __.3(e), SEC section 248.3(g)(1), CFTC section 160.3(h)(1).

8 15 U.S.C. 6803(a)-(c).

9 15 U.S.C. 6809(4). "Nonpublic personal information" is generally defined as personally identifiable financial information provided by a consumer to a financial institution, resulting from any transaction or any service performed for the consumer, or otherwise obtained by the financial institution. See privacy rule, sections __.3(n) and (o), SEC sections 248.3(t) and (u), CFTC sections 160.3(t) and (u).

10 15 U.S.C. 6802; privacy rule, sections __.14 and __.15.

11 15 U.S.C. 1681a(d)(2)(A)(iii) (FCRA); 15 U.S.C. 6803(c)(4) (GLB Act).

The privacy rule requires a financial institution to provide a privacy notice to its customers no later than when a customer relationship is formed and annually for as long as the relationship continues. The notice must accurately reflect the institution's information collection and disclosure practices and must include specific information. Section __.6 of the privacy rule requires the privacy notice to include the following:

(1) the categories of nonpublic personal information that the institution collects;

(2) with respect to both current and former customers, the categories of nonpublic personal information that it discloses and the categories of affiliates and nonaffiliated third parties to whom it discloses such information other than as permitted by the exceptions in sections __.14 and __.15;

(3) where the institution relies on the exception in section __.13 to share nonpublic personal information (pertaining to joint marketing), the categories of information disclosed, and the categories of third parties with which the institution has contracted;

(4) where applicable, an explanation of the consumer's right under section __.10(a) to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties and the methods by which the consumer may opt out;

(5) disclosures made under section 603(d)(2)(A)(iii) of the FCRA (pertaining to the ability to opt out of certain sharing with affiliates) and the applicable opt-out notice;

(6) the institution's policies and practices with respect to protecting the confidentiality and security of nonpublic personal information; and

(7) where applicable, a statement that the institution discloses nonpublic personal information to nonaffiliated third parties pursuant to the section __.14 and __.15 exceptions.

The privacy rule does not prescribe any specific format or standardized wording for these notices. Instead, institutions may design their own notices based on their individual practices provided they comply with the law and meet the "clear and conspicuous" standard in the statute and the privacy rule.[12] The Appendix to the privacy rule contains model language (Sample Clauses) that institutions may use in privacy notices to satisfy the privacy rule.

Financial institutions first were required to distribute privacy notices to their customers by July 1, 2001.[13] Many privacy notices in the initial effort were long and complex. In addition, because the privacy rule allows institutions flexibility in designing their privacy notices, notices have been formatted in various ways and as a result have been difficult to compare, even among financial institutions with identical privacy policies.

In response to broad-based concerns expressed by representatives of financial institutions, consumers, privacy advocates, and members of Congress, the Agencies conducted a workshop in December 2001 to provide a forum to consider how financial institutions could provide more useful privacy notices to consumers.[14] The workshop featured panel presentations by financial institutions, consumer advocates, and communications experts, and highlighted key communication principles to improve the notices. A number of institutions, particularly those with complex information-sharing practices, described the challenges they faced in explaining their practices and the choices available to consumers in a simple fashion while meeting all of the legal requirements

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12 15 U.S.C. 6802, 6803; privacy rule, section __.3(b), SEC 248.3(c).

13 The CFTC was added by Section 5g of the Commodity Exchange Act, 7 U.S.C. 7b-2 (as amended by the Commodity Futures Modernization Act of 2000), on December 21, 2000, and privacy notices were required to be delivered to consumers by March 31, 2002.

14 Get Noticed: Writing Effective Financial Privacy Notices, Interagency Public Workshop (Dec. 4, 2001), workshop transcripts and other supporting documents are available at http://www.ftc.gov/bcp/workshops/glb/index.html.

for notice. Some institutions described results of consumer testing and their efforts to make privacy notices clearer and more useful to consumers.

On December 30, 2003, the Agencies published an Advance Notice of Proposed Rulemaking to Consider Alternative Forms of Privacy Notices under the Gramm-Leach-Bliley Act[15] (ANPR) to solicit comment on a wide range of issues related to improving privacy notices. The Agencies sought, for example, comment on issues associated with the format, elements, and language used in privacy notices that would make the notices more accessible, readable, and useful, and whether to develop a model privacy notice that would be short and simple. The Agencies also solicited examples of forms, model clauses, and other information, such as applicable research that has been conducted in this area. The ANPR stated that the Agencies expected that consumer testing would be a key component in the development of any specific proposals.

During January and February 2004, the Agencies met with a number of interested groups and individuals to discuss the issues raised in the ANPR.[16] The Agencies received forty-four comments in response to the ANPR.[17] While commenters expressed a variety of views on the questions posed in the ANPR, many commenters agreed that the Agencies should conduct consumer testing before proposing any alternative privacy notice.

B. The Interagency Notice Project

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15 See Interagency Proposal to Consider Alternative Forms of Privacy Notices Under the Gramm-Leach-Bliley Act, 68 FR 75164 (Dec. 30, 2003), available at http://www.ftc.gov/os/2003/12/031223anprfinalglbnotices.pdf.

16 Summaries of the outside meetings are available at http://www.ftc.gov/privacy/privacyinitiatives/financial_rule_inrp.html

17 Public comments to the ANPR are available at http://www.ftc.gov/privacy/privacyinitiatives/financial_rule_inrp.html.

In the summer of 2004, six Agencies[18] agreed to launch a project to fund consumer research (Notice Project). Their goals were to identify barriers to consumer understanding of current privacy notices and to develop an alternative privacy notice, or elements of a notice, that consumers could more easily use and understand compared to current notices. When the Agencies initiated this project, they contemplated conducting the consumer research in two sequential phases. The first phase was designed as qualitative testing, that is, form development research. This research involved a series of in-depth individual consumer interviews to develop an alternative privacy notice that would be easier for consumers to use and understand. The second phase was designed as quantitative testing, to test the effectiveness of the alternative privacy notice developed in phase one among a larger number of consumers. The first phase has been completed and resulted in the model notice we are proposing for comment today. The Agencies expect to conduct the second phase of testing after receipt of comments in response to this proposal.[19]

In September 2004, the six Agencies selected Kleimann Communication Group, Inc. (Kleimann) as their contractor for the phase one form development research. The research objectives of the Notice Project included designing a privacy notice that consumers could understand and use, that facilitated comparison of sharing practices and policies across privacy notices, and that addressed all relevant legal requirements of the GLB Act and FCRA. At the outset of the research, the Agencies considered a range of possible options for the notice, including a short notice, a layered approach (highlighting key information upfront), as well as a longer fully-compliant notice. The Agencies limited the project to paper-based notices, reasoning that a

[18] The six Agencies are the Board, FDIC, FTC, NCUA, OCC, and SEC. Information related to the Notice Project can be found at http://www.ftc.gov/privacy/privacyinitiatives/financial_rule_inrp.html

[19] OTS has joined the Notice Project for the phase two research.

successful paper notice could be readily adapted to another medium such as the Internet. The Agencies used a readable font[20] and, in order not to confound the research findings on comprehension by introducing too many variables into the test notice, expressly did not use color, logos, or other graphical designs in the test notices. Instead, the Agencies focused on formulating and testing content that consumers could understand and use in order to develop a short, simplified privacy notice that met the research objectives.

The form development phase culminated in an extensive research report released by the Agencies in March 2006. Prepared by Kleimann, "Evolution of a Prototype Financial Privacy Notice," details the process by which the Agencies and Kleimann developed an alternative privacy notice.[21] As explained more fully in the Kleimann Report, over a one-year period, Kleimann conducted two focus groups followed by a series of 46 in-depth, individual interviews, conducted sequentially at seven sites around the country. The interviews tested consumers on their ability to comprehend, use, and compare notices based on variations in vocabulary, ordering of content, and format. The structure, content, ordering of the text information, and title of the proposed model form all reflect the research findings in the qualitative consumer testing.

The Agencies now are proposing the model privacy notice produced in the form development phase with some minor revisions (the proposed model form) for comment in accordance with the Regulatory Relief Act. The Agencies contemplate that the safe harbor for the proposed model form will be effective upon publication of the final rule in order to permit

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20 The text of the prototype notice is in 10 point BK Avenir Book font.

21 See Kleimann Communication Group, Inc., Evolution of a Prototype Financial Privacy Notice: A Report on the Form Development Project (Feb. 28, 2006) (Kleimann Report). For a copy of the full report, go to http://www.ftc.gov/privacy/privacyinitiatives/ftcfinalreport060228.pdf. For the executive summary, go to http://www.ftc.gov/privacy/privacyinitiatives/FTCFinalReportExecutiveSummary.pdf.

institutions that elect to use the form to do so immediately. The Agencies recognize that institutions may post their privacy notices on their Internet sites, as well as deliver paper or email versions to their customers. The Agencies contemplate that institutions that post a pdf version of the proposed model privacy form may obtain a safe harbor, but are requesting comment on whether to develop a Web-based design for financial institutions to use on their Internet sites, including comment on particular design and/or technical considerations.

The Agencies believe that the proposed model form meets all the requirements of the Act and is easier to understand than most privacy notices currently being disseminated. The following section describes the proposed model form and highlights some key research findings. For more detailed information on the research methodology and the form development process, commenters are encouraged to review the full Kleimann Report. The Agencies also are proposing instructions on how institutions may obtain a safe harbor by using the proposed model form, including an explanation of aspects of the form that may and may not be varied.[22] Institutions would not be able to vary content or format, other than as described in this proposal, to take advantage of the safe harbor. Moreover, institutions would not be able to include any other information in the proposed model form nor incorporate this model form into any other document.

II. THE PROPOSED MODEL FORM

A. <u>The Structure</u>

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22 While the model form would provide a safe harbor, institutions could continue to use other types of notices that vary from the model form so long as these notices comply with the privacy rule. For example, an institution could continue to use a simplified notice as described in section __.6(c)(5) (NCUA 716.6(e)(5)) of the privacy rule if it does not have affiliates and does not intend to share nonpublic personal information with nonaffiliated third parties outside of the exceptions provided in sections __.14 and __.15.

The proposed model form has either two or three pages, depending on whether the financial institution provides an opt-out. While the research showed that page one alone was adequate for comprehension and usability, page one together with page two address the legal requirements of applicable Federal financial privacy laws and increase consumer comprehension. Each of the pages of the model form is printed separately and only on one side of an 8.5 by 11 inch piece of paper because, during testing, consumers expressed a preference for the model which allowed them to view the information on pages one and two side-by-side.[23] The proposed model form in Appendix A is designed to be customized by each financial institution that elects to use it by inserting, for example, the institution's name, contact information, and information about affiliates, nonaffiliates, or joint marketing partners, if any, with which it shares personal information. In addition, the disclosure table requires that each institution complete the responses in each of the boxes provided in a manner that accurately reflects its information sharing policies and practices.

Below is one example of a completed model form for a fictional financial institution, Neptune, whose privacy policy provides for broad sharing in a manner that triggers consumer opt-out rights. For comparison, a second example is also provided for another fictional institution, Mars, whose privacy policy limits sharing and does not trigger consumer opt-out rights. Each of these institutions uses and shares personal information in different ways; thus, their responses in the disclosure table vary, as do the descriptions of their affiliates, nonaffiliates, or joint marketing

23 The proposed model form has the opt-out options and instructions on a separate page. Staff of certain of the Agencies issued Frequently Asked Questions in December 2001 (Privacy FAQs), stating that a consumer should be able to detach a mail-in opt-out form from a privacy notice without removing text from the privacy policy. Otherwise, the institution may violate section __.9(e) of the privacy rule, which requires that a privacy policy must be provided in such a way that a customer can retain the text of the notices or obtain them later. See F.4 of the Privacy FAQs, available at http://www.ftc.gov/privacy/glbact/glb-faq.htm.

partners in the definition section.[24] Importantly, since Mars does not share in a way that triggers an opt-out, the opt-out form (page 3 of the proposed model form) is not required and so is not included in the Mars notice. Thus, not every institution subject to the privacy rule will have to provide page three of the model form; only those institutions whose privacy practices require delivery of an opt-out notice or those institutions that choose to provide opt-outs beyond those required by law.

24 The Agencies understand that many consumers are not familiar with institutions' information sharing practices. During the Notice Project's initial research, some consumers expressed concern about financial institutions changing their practices and policies without adequately informing consumers about such changes. A few consumers suggested that, at a minimum, the notices should be dated to reflect the most recent revision so consumers would know when the notice was last changed and could more easily identify the most recent policy statement. Changes to an institution's policy may be reflected in a revised notice under section __.8 of the privacy rule or in an annual notice. Some institutions highlight changes to their privacy notices in some distinctive way, so that consumers can readily identify the change. As discussed later in Section V, the Agencies invite comment on whether financial institutions should be required to alert consumers to changes in an institution's privacy practices as part of the proposed model form.

Example 1.

Neptune model privacy form.

FACTS	WHAT DOES NEPTUNE DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ■ Social Security number and income ■ account balances and payment history ■ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons Neptune chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does Neptune share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus	Yes	No
For our marketing purposes— to offer our products and services to you	Yes	No
For joint marketing with other financial companies	Yes	No
For our affiliates' everyday business purposes— information about your transactions and experiences	Yes	No
For our affiliates' everyday business purposes— information about your creditworthiness	Yes	Yes *(Check your choices, p. 3)*
For our affiliates to market to you	Yes	Yes *(Check your choices, p. 3)*
For nonaffiliates to market to you	Yes	Yes *(Check your choices, p. 3)*

Contact Us	Call 1-800-XXX-XXXX or go to www.neptune.com/privacy

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FACTS WHAT DOES NEPTUNE DO WITH YOUR PERSONAL INFORMATION?

Sharing practices	
How often does Neptune notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does Neptune protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does Neptune collect my personal information?	We collect your personal information, for example, when you ■ open an account or deposit money ■ pay your bills or apply for a loan ■ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ■ affiliates' everyday business purposes—information about your creditworthiness ■ affiliates to market to you ■ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ■ processing transactions, mailing, and auditing services ■ providing information to credit bureaus ■ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ■ *Our affiliates include companies with a Neptune name; financial companies, such as Orion Insurance; and nonfinancial companies, such as Saturn Marketing Agency.*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ■ *Nonaffiliates we share with can include mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations*
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ■ *Our joint marketing partners include credit card companies.*

FACTS

WHAT DOES NEPTUNE DO WITH YOUR PERSONAL INFORMATION?

If you want to limit our sharing	
Contact us	**By telephone:** 1-800-XXX-XXXX— our menu will prompt you through your choices **On the web:** www.neptune.com/privacy **By mail:** mark your choices below, fill in and send form to: Neptune Privacy Department PO Box 00000 City, State 00000 **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices	
Your choices will apply to everyone on your account.	**Check any/all you want to limit:** *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.

Your name		Mail to: Neptune Privacy Department PO Box 00000 City, State 00000
Your address		
Account number		

Example 2.

Mars model privacy form.

FACTS	WHAT DOES MARS DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ▪ Social Security number and income ▪ account balances and payment history ▪ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons Mars chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does Mars share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus	Yes	No
For our marketing purposes— to offer our products and services to you	Yes	No
For joint marketing with other financial companies	No	We don't share
For our affiliates' everyday business purposes— information about your transactions and experiences	No	We don't share
For our affiliates' everyday business purposes— information about your creditworthiness	No	We don't share
For our affiliates to market to you	No	We don't share
For nonaffiliates to market to you	No	We don't share

Contact Us	Call 1-800-XXX-XXXX or go to www.marsfi.com/privacy

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FACTS WHAT DOES MARS DO WITH YOUR PERSONAL INFORMATION?

Sharing practices	
How often does Mars notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does Mars protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does Mars collect my personal information?	We collect your personal information, for example, when you ▪ open an account or deposit money ▪ pay your bills or apply for a loan ▪ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ▪ affiliates' everyday business purposes—information about your creditworthiness ▪ affiliates to market to you ▪ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ▪ processing transactions, mailing, and auditing services ▪ providing information to credit bureaus ▪ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ▪ *Mars has no affiliates.*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ▪ *Mars does not share with nonaffiliates so they can market to you.*
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ▪ *Mars doesn't jointly market.*

Example 3.

Illustration of type size for the various elements of the model form.[25]

Font size: 17 point

Font size: 11 point

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ▪ Social Security number and income ▪ account balances and payment history ▪ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Font size: 14 point

Font size: 10 point

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Font size: 10.5 point

Contact Us	Call [toll-free telephone] or go to [web address]

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25 See infra note 37 and accompanying text. This illustration displays the font sizes of the various elements in the model form.

B. Page One – Background Information and the Disclosure Table

Page one of the proposed model form has four parts: (1) the title; (2) an introductory section called the "key frame," which provides context to help the consumer better understand the required disclosures; (3) a table that describes the types of sharing Federal law allows, which of those types of sharing the institution actually does, and whether the consumer can opt out of any type of the institution's sharing; and (4) the institution's contact information.

The research showed that the title, "FACTS What Does **[name of financial institution]** Do With Your Personal Information," is more likely to catch consumers' attention so they will read the notice. The title can be used by all institutions regardless of their information sharing practices.

The "key frame," with its three short headings – Why, What, and How – is included because the research showed that, unless consumers have some basic facts about information sharing, they are less likely to understand why they are receiving a privacy notice and what to do with one. The "Why" box tells consumers that Federal law requires that the financial institution send the notice. The "What" box explains the types of personal information financial institutions collect and share.[26] The "How" box explains that some information sharing is necessary for all institutions in order to provide the products and services that consumers request. It also briefly explains what information consumers will find in the disclosure table below. The research found that these particular headings and the bulleted explanations enhanced consumers' understanding of

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[26] The Agencies recognize that some financial institutions may not collect each type of information described in the "What" box. As reflected in the introductory clause, which states that the "information [collected] can include …," the standardized terms are designed to reflect the range of information typically collected by financial institutions required to provide privacy notices under the GLB Act and FCRA, rather than the specific information collected by each particular institution, and therefore, are not to be modified to reflect an institution's particular practices. The SEC's model privacy form reflects modified terms in the "What" box that are intended to include the range of information typically collected by brokers, dealers, investment advisers registered with the Commission, and investment companies.

the purpose of the notice, enabled them to make an informed decision about the use of their personal information, and aided their overall comprehension.

The disclosure table at the bottom of page one provides information about the financial institution's sharing practices. The research found that this table is the "heart" of the proposed model form, "enabl[ing] consumers to understand the details of their financial institution's sharing practices in the context of how other financial institutions can share. It is critical for comprehension and comparability."[27] The table is featured on page one because it is one of the most important elements of the model form.

Key research findings were that providing this information in a table form greatly increased consumers' ability to readily identify and understand an institution's sharing practices and what, if any, choices they had to limit any of that sharing, and easily compare these practices and choices among institutions. The Agencies asked Kleimann to develop and test a "prose" version describing information sharing practices since such a format would be more comparable to notices currently used by financial institutions. However, the research found that the table design of the proposed model form outperformed the prose design on a variety of measures, including comprehension, comparability, and usability.[28]

The disclosure table includes a description of the possible types of sharing and uses of personal information and the associated opt-out choices that must be disclosed. The opt-out disclosures are required under: (1) section 502(b) of the GLB Act (regarding certain sharing with nonaffiliated third parties); (2) section 603(d)(2)(A) of the FCRA (regarding sharing of creditworthiness and credit report information among affiliates); and (3) section 624 of the FCRA,

[27] See Kleimann Report, supra note 21, at v and 7.

[28] See id. at 185, 215, 256.

as added by section 214 of the Fair and Accurate Credit Transactions Act of 2003 (Fact Act), 15 U.S.C. 1681s-3 (use of that information for marketing).[29] The table provides important context about what information sharing a financial institution actually does relative to what it could do. The research showed that the table, with its standardized content, facilitates easy comparison of information sharing practices among different institutions. The structure of the disclosure table and the reasons for sharing are designed to be consistent for all financial institutions.[30] The institution-specific information lies in the answers to the questions within each of the boxes. Accordingly, even if a financial institution does not share for one of the reasons listed in the table (for example, it has no affiliates and therefore does not share with affiliates), the institution could not exclude that reason from the table, but would answer "No" under "Does **[name of financial institution]** share?"

The language used in the disclosure table is based on Kleimann's research. The simplified phrases describing information sharing practices were continually refined through the consumer

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29 Pub. L. 108-159, 117 Stat. 1952. Section 624 provides that information that may be shared among affiliates – including transaction and experience information and certain creditworthiness information – cannot be used for marketing purposes unless the consumer has received a notice of such use and an opportunity to opt out, and the consumer does not opt out. The Agencies have included language pertaining to this affiliate marketing provision and the related opt-out on the notice developed in the consumer research in response to comments to the ANPR. While the Agencies have not yet issued a final regulation implementing this provision of the FACT Act, they are coordinating this rulemaking with the affiliate marketing rulemaking to ensure that language addressing the section 624 opt-out as incorporated in this model form (when finalized) would be deemed to comply with the affiliate marketing rule. Institutions would not be required to include reference to this provision until a final rule for section 624 is issued and becomes effective, and only in the event that institutions choose to consolidate the 624 notice and opt-out with the GLB Act privacy notice.

30 The reasons for sharing are grouped into three main categories. The first three reasons describe what financial institutions do with their consumers' personal information. The next three reasons describe what a financial institution's affiliates do with that information. The last reason describes what nonaffiliated companies may do with the personal information, other than acting as a service provider to or acting jointly with the financial institution (that is, outside the exceptions provided in sections __.13, __. 14, and __.15). This generally means marketing by the nonaffiliated company.

testing process to allow consumers to better understand the information sharing and use possibilities. The laws governing the disclosure of consumers' personal information are not easily translated into short, comprehensible phrases that are also legally precise. Thus, the table in some cases uses more easily understandable short-hand terms to describe sharing practices required to be in the notice. For example, the table uses the term "everyday business purposes" to describe the sharing contemplated by the exceptions in sections ___.14 and ___.15 of the privacy rule, which does not trigger opt-out rights. The research found that consumers understood that "everyday business purposes" means that companies must share in some basic ways in order to provide the financial products or services that consumers request. The table also speaks in terms of the institution's own "marketing purposes" to capture the idea that nearly all, if not all, financial institutions share information in connection with marketing their own products and services to their customers (for example, with a service provider such as a bulk mailer or data processor) in a manner that does not trigger an opt-out right. With respect to the reasons for information sharing among affiliated companies that track the FCRA provisions[31] (the sharing of "transaction and experience information" and the sharing of "other information"), the disclosure table uses "Information about your creditworthiness" as a short-hand term for the statutory term "other information."

The institution's contact information appears at the bottom of page one in response to consumers' preferences expressed during testing.

C. <u>Page Two – Supplemental Information</u>

The second page provides additional explanatory information that, in combination with page one, ensures that the notice includes all elements described in the GLB Act as implemented by

[31] <u>See</u> section 603(d)(2)(A) of the FCRA.

the privacy rule. There is supplemental information in the form of Frequently Asked Questions (FAQs)[32] at the top and definitions below.[33] The research showed that although consumers generally understood the concepts of certain technical words, they found that the four definitions on page two provided helpful additional information that further clarified the nature and type of information sharing by a financial institution. Some of the definitions include institution-specific information required by the GLB Act. For example, an institution that has affiliates must identify the categories of its affiliates after the definition. Likewise, an institution that has no affiliates can explain after the definition that it does not have affiliates.

Examples of institution-specific information are shown for the last three definitions in the italicized print in both the Neptune and Mars forms. Thus, Neptune has affiliates with which it shares certain information and, under the definition of "affiliates," Neptune includes information in italics that describes the categories of its affiliates. Since Mars has no affiliates, the Mars form states "*Mars has no affiliates*."

D. Page Three – The Opt-Out Form

The third page provides an opt-out form, for use by those financial institutions that share in a manner that triggers consumer opt-out rights under the GLB Act or FCRA (see the proposed model privacy form in Appendix A and the Neptune form). Institutions using the proposed model

[32] Note that financial institutions should insert their names as indicated in the first three questions in this section.

[33] The FAQ box regarding sources of information does not permit a financial institution to customize the sources of information it collects. As with the standardized terms describing information the institution collects on page one, see supra note 26, the disclosure is intended to include the range of information sources typically used by institutions subject to the GLB Act and FCRA rather than the information sources used by each particular institution. The SEC's model form reflects additional terms in this box that are intended to include the range of sources of information typically used by brokers, dealers, investment advisers registered with the Commission, and investment companies.

form must include page three in their notices only if they (1) share or use information in a manner that triggers an opt-out, or (2) choose to provide opt-outs beyond what is required by law.

The opt-out page lists three common methods for opting out – by telephone, on the Web, and by mail – and summarizes the opt-out choices available to the consumer in a clear and easy-to-read format that the research found consumers appreciated. Financial institutions that provide opt-out forms are not required to provide all the opt-out choices and methods described in the Neptune opt-out form. The Agencies expect that institutions may need to tailor the opt-out page to reflect accurately the institution's particular practices.[34] The model form, for example, includes information for the customer's account number as a means of identifying both the customer and account to which the opt-out should apply. Institutions requiring consumers with multiple account numbers to list each account number to which the opt-out should apply should modify that portion of the form. Institutions requiring information other than an account number should modify that portion of the form. Institutions that allow more than 30 days from issuing the notice may insert that time period in place of the number "30". The proposed rule accordingly provides instructions explaining permissible variations to page three of the Neptune notice.

E. <u>Additional Opt-Outs in the Model Form</u>

The third column in the disclosure table in the proposed model form is intended to provide flexibility for financial institutions to include additional opt-out choices that are not required by Federal law. For example, a financial institution may give its customers the opportunity to limit

[34] <u>See</u> note 29. For institutions that choose to consolidate the 624 notice into the model form and offer this opt-out, the italicized language accompanying the affiliate sharing opt-out choice on page three of the proposed model form is required only if an institution wants to limit the time of the opt-out period, with 5 years the minimum opt-out period required by the statute. Where an institution elects to limit the time period for which the opt-out is effective, it should look to the Agencies' affiliate marketing rule for guidance on the manner and form in which to provide any additional notice that would effectively permit a consumer to renew or extend the opt-out period.

sharing for joint marketing. In that case, the financial institution would answer the question "Can you limit this sharing?" in the far right column with "Yes (Check your choices, p. 3)" and would describe the additional opt-out choice on its opt-out form, for example by stating, "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution wanted to offer its customers the opportunity to opt out of its own marketing, it could provide for that option by answering "Yes" in the appropriate box of the disclosure table and by describing the opt-out choice on the opt-out form, for example by stating "Do not share [or use] my personal information to market to me." To obtain the safe harbor for use of the proposed model form, an institution that uses the disclosure table to show any additional opt-out choice must include the opt-out form on page three to provide consumers with a method for opting out. The Agencies specifically invite comment on other opt-outs that financial institutions may provide, and on whether the Agencies should provide model language based on the opt-out provisions provided in the proposed model form.

F. Appearance of the Model Form

In addition to the requirements that the proposed model form be comprehensible, clear and conspicuous, and allow for easy comparison of privacy practices among financial institutions, the law requires that the model form use an easily readable type font. The prototype notice developed in the Agencies' phase one research and shown here as the proposed model form, reflects consideration of a number of typographical factors in the design.[35] Type size, type style, leading, x-height, serif versus sans serif,[36] upper and lower case type, along with the page layout — all play

35 The prototype notice developed in the consumer research is 10 on 12 BK Avenir Book. The "10 on 12" means that the font size is 10 points, and the leading (that is, the additional space between the lines of type) is 2 points of spacing.

36 Serif typeface has small strokes at the ends of the lines that form each letter. Sans serif typeface does not have those small strokes.

an important role in designing a typeface that is highly readable. Consumers who saw the prototype notice during the research process commented on how easy the type was to see and read.[37]

All of these factors together affect the readability of a document. Therefore, in considering these various factors for the design of an easily readable type font, the Agencies are proposing 10-point font as the minimum type size and sufficient spacing between the lines of type (leading). The Agencies are further providing general guidance on type styles.

Type size: The readability of type size is highly dependent on the selection of the type style. Some styles in 10-point font are more readable than others in 12-point font and appear larger because of their design. Accordingly, the Agencies are proposing 10-point type size as the minimum size for use on the model form.

Leading: Leading is the spacing between lines of type, measured in points. If the line spacing is too narrow, the type is hard to read. In such a case, the ascenders (such as the upward line in the letter "h") and descenders (such as the downward line in a "g") may touch, blending the lines of type and making it much harder to distinguish the letters on the page. Research on the legibility of typography indicates that people read faster when text is set with 1 to 4 points of

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[37] Example 3 in this proposal illustrates the different font sizes used in the prototype notice for the title, headings, and key text. Thus, the word "FACTS" in the title is in 17-point type; the remainder of the title is in 11-point; the Why, Why, How, and Contact Us headings are in 14 point; the headings in the disclosure table, the reasons in the left column of the disclosure table, and the questions in the left column of the FAQs are in 10.5-point; and the text in the body of the form is in 10-point. This information shows the relative sizes of the various elements of the prototype and is intended only as a guide (and not a requirement) to those institutions that elect to use the proposed model form so that they can design the key elements, such as the headings and title, larger than the 10-point font size in the text.

leading.[38] The Agencies are proposing a requirement that the leading used allow for sufficient spacing between the lines, but are not mandating a specific amount. Nevertheless, the Agencies are providing these general recommendations for use with the model form: 10- or 11-point type should have between 1 and 3 points of leading. Twelve-point type should have between 2 and 4 points of leading.[39]

Type style and "x"-height: Experts differ on the question of the most desirable type style. The model form uses both sans serif and "monoweight" type, and upper and lower case lettering in the body of the form. While much of the printed material in the United States and western Europe uses serif styles, Web designers are increasingly using sans serif type, as they have found that serif type is harder to read in this new medium. These changes in Web design are also beginning to affect font styles in printed materials. Accordingly, some typography designers are now using sans serif typefaces, as well as type with a uniform thickness throughout the letter (monoweight typeface), finding such typefaces easier to read than those with variable thickness. While a variety of type styles would be suitable for the model notice, the Agencies caution that institutions that use idiosyncratic fonts or highly stylized typefaces will not meet the model form safe harbor standard.

Larger x-height[40] makes a font appear larger and thus more readable, and fonts with larger x-heights are better for smaller text. Research shows that our eyes "scan the top of the letters' x-

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38 Karen A. Schriver, Dynamics In Document Design, 274 (1997).

39 Id. at 262; see also James Hartley, Designing Instructional Text (1994); and Barbara Chaparro et al., Reading Online Text: A Comparison of Four White Space Layouts, 6(2) (2004).

40 The "x-height" is the height of the lower-case "x" in relation to full height letters, such as a capital G. X-height is critical to type legibility.

heights during the normal reading process, so that is where the primary identification of each letter takes place."[41] Generally, a font with an x-height ratio of around .66 is easier to read.[42]

The Agencies are not mandating a particular type style or x-height in order for a financial institution to obtain a safe harbor. Nevertheless, based on the research, the Agencies are providing these general guidelines for type style in the model form: For typefaces with a smaller x-height, 11- or 12-point font should be used; for typefaces with a larger x-height, a 10-point font would be sufficient.[43] Fonts that satisfy the type style and x-height guidelines for the proposed model form include sans serif fonts such as Tahoma, Century Gothic, Myriad, Avant Garde, Bk Avenir Book, ITS Franklin Gothic, Arial, and Gill Sans, and serif fonts such as the Chaparral Pro Family, Minion Pro, Garamond, Monotype Bodoni, and Monotype Century.[44]

For ease of reference, the following table summarizes the recommendations discussed here for institutions that choose to use the model form and obtain the safe harbor.

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41 Erik Spiekermann & E.M. Ginger, Stop Stealing Sheep & Find Out How Type Works, 93 (1993).

42 See, e.g., Hewlett-Packard Corporation, Panose Classification Metrics Guide (2006), available at http://www.monotypeimaging.com/productsservices/pan2.aspx.

43 See Schriver, supra note 38 at 264; see also pp. 258-59.

44 A number of these font styles, including Arial, Tahoma, Century Gothic, Garamond, and Bodoni, are preloaded on commonly used operating systems with most new personal computers. The other font styles are commercially available as well.

If	Then Use	And Use	And Use Font with
Font is 10-point	1–3 points leading	Monoweight typeface	Large x-height sans serif (around .66 ratio)
Font is 11-point	1–3 points leading	Monoweight typeface	Smaller x-height is acceptable; either serif or sans serif (less than .66 ratio is acceptable)
Font is 12-point	2–4 points leading	Monoweight or variable typeface	Smaller x-height is acceptable; either serif or sans serif (less than .66 ratio is acceptable)

G. Printing, Logos, and Color

The Agencies recognize that financial institutions have a strong interest in ensuring that documents they provide to the public have a distinctive look that may be readily recognized by consumers. Thus, a financial institution that uses the proposed model form may include its corporate logo on any of the pages, so long as the logo design does not interfere with the readability of the model form or space constraints of each page.

The model form used in the consumer testing was printed on 8.5 by 11 inch non-glossy paper, using varying shades of black ink to achieve the black and gray tones in the published prototype. The Agencies propose printing each page of the model form on one side of an 8.5 by 11 inch piece of paper so that each page of the model form can be viewed simultaneously. The Agencies seek comment on other formats that may achieve the readability and ease of use preferred by consumers.

The Agencies propose that institutions using the model form use white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color is permitted to achieve visual interest to the model form, so long as the color contrast is distinctive and the color does not detract from the form's readability. The Agencies seek comment on whether, how, and to what extent institutions that elect to use the model form will use logos and/or color.

III. THE SAMPLE CLAUSES

The proposed model form is a standardized notice that would replace the Sample Clauses currently found in Appendix A of the privacy rule. It could be used by a financial institution at its option to comply with requirements for a clear and conspicuous privacy notice that meets the content requirements in sections __.6 and __.7 of the privacy rule.[45] Research to date indicates that the language in the Sample Clauses is confusing, and accordingly, the Agencies propose to eliminate the Sample Clauses from the privacy rule.

However, to ease the compliance burden for those institutions that currently have privacy notices based on the Sample Clauses, the Agencies are proposing a transition period of one year after which financial institutions would no longer obtain a safe harbor by using the sample clauses. Privacy notices using the Sample Clauses that are delivered to consumers (either in paper form or by electronic delivery such as email) or, alternatively, are posted electronically to meet the annual notice requirement of section __.9(c), would have a safe harbor for one year. Privacy notices using the Sample Clauses that are delivered or posted electronically after the one-year transition period would no longer obtain the safe harbor. Since institutions are required to send notices annually to their customers, annual notices that are delivered to consumers (either in paper form or by electronic delivery such as email) within the transition period would continue to get the safe harbor

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45 The Agencies are also proposing conforming amendments to sections __.2, __.6, and __.7 of the privacy rule and to the Appendix.

until the next annual privacy notice is due one year later.[46] The Sample Clauses would be rescinded one year after the transition period ends.

The Agencies note that the SEC's privacy rule does not provide a safe harbor for financial institutions that use the Sample Clauses. Rather, the Sample Clauses provide guidance concerning the SEC privacy rule's application in ordinary circumstances.[47] Consistent with this proposal, the SEC proposes that one year after the end of the transition period, the Sample Clauses would be rescinded and no longer provide guidance regarding the rule's application to financial institutions subject to the SEC's privacy rule.

IV. PROPOSED EFFECTIVE DATES

The provisions of the final rule will be effective [DATE OF PUBLICATION OF THE FINAL RULE], with the following exceptions:

Sec. __.6, paragraph (g) will be effective [DATE OF PUBLICATION OF THE FINAL RULE] until [DATE 2 YEARS AFTER PUBLICATION OF THE FINAL RULE].

Newly redesignated Appendix B will be effective [DATE OF PUBLICATION OF THE FINAL RULE] until [DATE 2 YEARS AFTER PUBLICATION OF THE FINAL RULE].

V. REQUEST FOR COMMENTS

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46 For example, if an institution provides a notice using the Sample Clauses on day 361 after the effective date of the rule, it would continue to have the safe harbor for one year until its next annual notice is due. If an institution provides a notice using the Sample Clauses on day 369 after the effective date of the rule, it would not obtain the safe harbor. Privacy notices using the Sample Clauses posted on an institution's Web site to meet the annual notice requirements of section __.9(c) would no longer get the safe harbor beginning one year after the final rule becomes effective.

47 See SEC privacy rule, section 248.2(a). The facts and circumstances of each individual situation determine whether use of the Sample Clauses constitutes compliance with the SEC's privacy rule.

The Agencies seek comment on all aspects of the proposed model form. The Agencies also invite commenters to submit any additional consumer research that may inform the statutory requirements. <u>Commenters proposing alternative model notices or elements of a notice should submit any available supporting consumer research and documentation demonstrating that these alternatives meet the statutory requirements</u>. The Agencies expect to do additional testing before finalizing a model form. We solicit comment on particular approaches to consumer testing for the Agencies to consider.

The Agencies particularly seek comment on the following issues:

A. <u>Content of the Model Form</u>

1. Whether a commenter believes particular aspects of the form are not clear and conspicuous or comprehensible; and, if so, identify those aspects and explain in detail the basis for that conclusion.

2. Whether financial institutions can accurately disclose their information sharing practices by using the standardized provisions and vocabulary in the proposed model form, including whether the proposed disclosure table provides a financial institution with sufficient flexibility to disclose its sharing practices, or any additional opt-outs it offers, including a detailed explanation of why or why not.

3. The extent to which modifications to the opt-out form are necessary for a financial institution to describe its information practices accurately, facilitate consumer use of the opt-out form, or offer additional opt-outs, including an explanation of the modifications that could be made to page one and/or page three in

accordance with legal requirements and the intent to keep the table on the first page of the form.

4. The extent to which financial institutions intend to incorporate the FCRA section 624 disclosure and opt-out for affiliate marketing in the model form, with an explanation of why or why not, and the time period they may offer to consumers for the opt-out period.

5. Whether financial institutions should be required to alert consumers to changes in an institution's privacy practices as part of the model form.

B. Format of the Model Form

1. Whether each page of the proposed model form should be required to be on a separate piece of paper or whether another format could also allow consumers to readily see all the information in the model form at the same time.

2. Whether the guidance on easily readable type font in the instructions is helpful and/or sufficient for institutions that use the proposed model form.

3. What size paper would be appropriate for the model form while conforming to the guidance for easily readable type font and layout.

4. Whether financial institutions want to use color and/or logos on the proposed model form, and the manner and extent to which they would use them without conflicting with readability of the form and space requirements.

C. Additional Information

1. The extent to which financial institutions subject to the GLB Act are likely to use the proposed model form, including a detailed explanation of why the commenter does or does not expect financial institutions to use the form.

2. Particular approaches to additional consumer testing of the model form that the Agencies should consider.

3. The proposal to replace the Sample Clauses with the proposed model form, including – (1) the transition period after which use of these clauses no longer qualifies for a safe harbor, or, for institutions subject to the SEC's privacy rule, guidance concerning the rule's application and (2) whether the Agencies should retain Sample Clauses A-1, A-3, and A-7, or develop model clauses to replace those sample clauses, for use as a safe harbor only by those institutions that provide the simplified notice described in section __.6(c)(5) (NCUA 716.6(e)(5)) of the privacy rule.

4. Whether the Agencies should develop a Web-based design for those financial institutions that would like to use an electronic version of the proposed model form, and if so, whether institutions have suggestions for particular design and/or technical considerations.

5. Whether the Agencies should develop and make available on their Web sites a readily accessible and downloadable model form with "fillable" fields for institutions that wish to use the model form to create their own privacy notices; if so, whether institutions would use this downloadable model form; and whether it would be useful, particularly for smaller institutions that want to obtain the safe harbor.

6. Whether an SEC-regulated entity and an affiliated institution regulated by another Agency that intend to provide a joint privacy notice should be able to choose to rely on either the SEC model privacy form or the model privacy form proposed by the other Agency.[48]

7. The Agencies are aware that many institutions, but not all, currently request the customer to provide his or her account number or Social Security number (or other personal information, separately or in conjunction with such information) in order to opt out, whether by toll-free telephone, by electronic means such as e-mail, or by regular mail. Do institutions need that information in order to process opt-out requests, or would the customer's name and address alone, or the customer's name, address, and a truncated account number for a single account, be sufficient to process opt-out requests, including for customers with multiple accounts at the same institution? Should the Agencies consider omitting a line for such information on the opt-out page for the model privacy form in order to better protect customers and make it easier to opt out? Alternatively, should the opt-out page on the model form contain a line for a truncated account number or other identifying information?

The SEC specifically requests the following additional comment from its regulated entities:

1. Whether the standardized provisions and vocabulary in the proposed model form for SEC-regulated financial institutions are sufficient to allow these

[48] As noted above, see supra notes 26, 33, the SEC model privacy form provides slightly modified terms on pages one and two of the model form, which include the range of information typically collected by brokers, dealers, investment advisers registered with the SEC, and investment companies.

financial institutions accurately to disclose their information sharing practices, and specifically on the terms used in: (a) the description of the types of personal information that may be collected (in the key frame on page one), and (b) the examples of sources of information collection (in the FAQ on sharing practices on page two). The SEC requests that commenters who believe the proposed terms are not sufficient suggest alternative or additional terms that would be more accurate and explain why those terms would more accurately reflect typical information collection and sharing practices for brokers, dealers, investment advisers registered with the SEC, and investment companies.

2. Whether institutions should be able to omit certain terms that may not apply to their information collection practices or their sources of information.

VI. REGULATORY FLEXIBILITY ACT

The Regulatory Flexibility Act ("RFA"), 5 U.S.C. 601-612, requires an agency to provide an Initial Regulatory Flexibility Analysis ("IRFA") with a proposed rule and a Final Regulatory Flexibility Analysis ("FRFA") with the final rule, if any, unless the agency certifies that the rule would not have a significant economic impact on a substantial number of small entities. See 5 U.S.C. 603-605. Because the use of the model form issued in this proposal is optional, the Agencies do not expect that the rule will have a significant economic impact on a substantial number of small entities. However, because the statute creates a new safe harbor for institutions by replacing the Sample Clauses in the current rule, with a model form, we have determined that it is appropriate to publish the following IRFA in order to inquire into the impact of the proposed rule on small entities.

A. Reasons for the Proposed Action

The Agencies are issuing this proposed rule for comment because the Regulatory Relief Act specifically requires them, no later than April 11, 2007, to publish for comment a model form that financial institutions may use as a safe harbor to satisfy their notice requirements under the Agencies' existing privacy rule.

B. Objectives of, and Legal Basis for, the Proposed Action

The goal of the proposed amendments is to satisfy the requirements of section 728 of the Regulatory Relief Act, which requires that the Agencies propose a model form that is comprehensible, clear and conspicuous, and succinct. The final model form that the Agencies adopt after reviewing comments would, if properly used, serve as a safe harbor for satisfying the privacy rule's requirements regarding content of privacy notices. The Act also requires that the proposed model form enable consumers easily to identify a financial institution's sharing practices and compare it with others.

As indicated in Section I of this release, the amendments to Appendix A of the Agencies' privacy rule are proposed pursuant to the authority set forth in § 503 (as amended by section 728 of the Regulatory Relief Act) and § 504 of the GLB Act.[49]

C. Small Entities Subject to the Proposed Rule Amendments

The proposed amendments to Appendix A and conforming amendments to sections __.2, __.6, and __.7 of the Agencies' privacy rules could potentially affect financial institutions,

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49 The SEC also is proposing the amendments under section 504 of the GLB Act [15 U.S.C. 6804], section 23 of the Securities Exchange Act of 1934 [15 U.S.C. 78w], section 38(a) of the Investment Company Act of 1940 [15 U.S.C. 80a-37(a)], and section 211 of the Investment Advisers Act of 1940 [15 U.S.C. 80b-11].

The CFTC also is proposing the amendments under Section 504 of the GLB Act [15 U.S.C. 6804], and Sections 5g and 8a(5) of the Commodity Exchange Act [7 U.S.C. 7b-2, 12a(5)].

including financial institutions that are small businesses or small organizations, that choose to rely on the proposed model privacy form as a safe harbor.

1. *OCC.* The OCC estimates that 1,050 insured national banks, uninsured national banks and trust companies, and foreign branches and agencies are small entities for purpose of the Regulatory Flexibility Act.

2. *Board.* The Board estimates that 473 state member banks are small entities for purposes of the Regulatory Flexibility Act.

3. *FDIC.* The FDIC estimates that 3,302 state nonmember banks are small entities for purposes of the Regulatory Flexibility Act.

4. *OTS.* The OTS estimates that 429 small savings associations are small entities for purposes of the Regulatory Flexibility Act.

5. *NCUA.* The Regulatory Flexibility Act requires NCUA to prepare an analysis to describe any significant economic impact a regulation may have on a substantial number of small credit unions (primarily those under $10 million in assets). The NCUA estimates that 3,805 credit unions are small entities for purposes of the Regulatory Flexibility Act.

6. *FTC.* Determining a precise estimate of the number of small entities that are financial institutions within the meaning of the proposed rule is not readily feasible. The GLB Act does not identify for purposes of the Commission's jurisdiction any specific category of financial institution. In the absence of such information, there is no way to estimate precisely the number of affected entities that share nonpublic personal information with nonaffiliated third parties or that establish customer relationships with consumers and therefore assume greater disclosure obligations.

7. *CFTC.* The CFTC is unable to determine a precise estimate of its registrants that are small entities, or that would be using the model form.

8. *SEC.* The SEC estimates that 911 broker-dealers, 210 investment companies registered with the Commission, and 710 investment advisers registered with the Commission are small entities for purposes of the Regulatory Flexibility Act.[50]

Because use of the model privacy form would be entirely voluntary, the Agencies have no way to estimate how many small financial institutions would use it.[51] The Agencies expect, however, that small financial institutions, particularly those that do not have permanent staff available to address compliance matters associated with the privacy rule, would be relatively more likely to rely on the model privacy form than larger institutions. We believe that most financial institutions currently have legal counsel review their privacy notices for compliance with the GLB Act, the FCRA, and the privacy rule. We believe that a financial institution that uses the model form for its privacy notice would need little, if any, review by legal counsel because the proposed regulation does not permit institutions to vary the form to obtain the benefit of a safe harbor, except as necessary to identify their sharing and opt-out policies.

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50 For purposes of the Regulatory Flexibility Act, under the Securities Exchange Act of 1934 a small entity is a broker or dealer that (i) had total capital of less than $500,000 on the date in its prior fiscal year as of which its audited financial statements were prepared or, if not required to file audited financial statements, on the last business day of its prior fiscal year, and (ii) is not affiliated with any person that is not a small entity and is not affiliated with any person that is not a small entity. 17 CFR 240.0-1. Under the Investment Company Act of 1940, a "small entity" is an investment company that, 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. 17 CFR 270.0-10. Under the Investment Advisers Act of 1940, a small entity is an investment adviser that "(i) manages less than $25 million in assets, (ii) has total assets of less than $5 million on the last day of its most recent fiscal year, and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that manages $25 million or more in assets, or any person that had total assets of $5 million or more on the last day of the most recent fiscal year." 17 CFR 275.0-7.

51 The Agencies have requested comment on the likelihood that financial institutions would use the model privacy form. See supra section V.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The proposed rule does not itself impose any additional recordkeeping, reporting, disclosure, or compliance requirements. Financial institutions, including small entities, have been required to provide notice to consumers about the institution's privacy policies and practices since July 1, 2001 (or March 31, 2002 in the case of the CFTC). The proposed amendments would not affect these requirements and financial institutions would be under no obligation to modify their current privacy notices as a result of the proposed amendments. Instead, the amendments propose a specific model privacy form that a financial institution may use to comply with notice requirements under the GLB Act, the FCRA (as amended by the FACT Act), and the privacy rule. Nonetheless, if the proposed amendments are adopted, some of the financial institutions that rely on the Sample Clauses in the current privacy rules' appendixes may wish to transition to the proposed model form and may incur some small, incremental costs in making this transition.[52] The Agencies expect, however, that the availability of a standardized model form would offset these costs because the form's standardized formatting and language would make it easier for institutions to prepare and revise their privacy policies.

E. Duplicative, Overlapping, or Conflicting Federal Rules

We believe there are no federal rules that duplicate, overlap, or conflict with the proposed amendments. In fact, the Agencies have designed the model form so that a financial institution may use it to satisfy disclosure requirements for both the GLB Act and the FCRA (as amended by the FACT Act).

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52 We believe that institutions review their privacy policies annually, and the costs associated with this annual review, including professional costs, for compliance are likely to be the same as the costs to complete the proposed model form.

F. Significant Alternatives

The RFA directs the Agencies to consider significant alternatives that would accomplish the stated objectives, while minimizing any significant adverse impact on small entities. In connection with the proposed amendments, we considered the following alternatives:

1. *Different reporting or compliance standards.* As noted above, the Regulatory Relief Act requires the Agencies to publish "a" model form that, among other things, will facilitate comparison of the information sharing practices of different financial institutions. In light of these statutory requirements, the Agencies are proposing only one model form, which includes alternative language in some places that allows a financial institution to accurately describe its particular information sharing practices. The specific model form that the Agencies are proposing was developed as part of a careful and thorough consumer testing process designed to produce a clear, comprehensible, and comparable notice. The proposed model form emerged as the most effective of several notice formats considered as part of this testing. Although the Agencies know of no other model privacy notice that has been developed in this manner, we are specifically inviting comments about alternative model notices or elements of notices, along with supporting research and documentation. The Agencies will carefully consider any such submissions before adopting a final model form.

2. *Clarification, consolidation, or simplification of reporting and compliance requirements.* The Agencies believe that the proposed model form would simplify the reporting requirements for all entities, including small entities, that choose to use the model form. We anticipate that financial institutions that choose to use the proposed model form would spend less time preparing notices than if they had to draft one on their own. Because the model form was developed as part of a consumer testing process, it is difficult for the Agencies to further clarify, consolidate, or simplify the model notice without compromising the research findings.

3. *Performance rather than design standards.* Section 728 of the Regulatory Relief Act specifically requires that the Agencies propose a model form. The model form is an alternative means of providing a privacy notice that institutions may choose to use. The privacy rule does not mandate the format of privacy notices; thus neither the rule nor the proposed amendment would impose a design standard.

4. *Exempting small entities.* We believe that an exemption for small entities would not be appropriate or desirable. The Agencies note that the model form is available for use at the discretion of all financial institutions, including small institutions. Moreover, two key objectives of the proposed model form are that (1) consumers can understand an institution's information sharing practices and (2) they may more easily compare financial institutions' sharing practices and policies across privacy notices. An exemption for small entities would directly conflict with both of these key objectives, particularly enabling comparison across notices.

G. Solicitation of Comments

We encourage the submission of comments with respect to any aspect of this IRFA. In particular, we request comments regarding: (i) the number of small entities that would be affected by the proposed amendments; (ii) the existence or nature of the potential impact of the proposed amendments on small entities discussed in the analysis; (iii) how to quantify the impact of the proposed amendments; and (iv) the consideration of alternatives. Commenters are asked to describe the nature of any impact and provide empirical data supporting the extent of the impact. As noted above in Section V, the Agencies specifically request comment on whether a downloadable version of the proposed model form would be useful for financial institutions, and particularly small entities that would like to take advantage of the safe harbor. All comments on this IRFA will be considered in the preparation of the Final Regulatory Flexibility Analysis, if the proposed amendments are adopted.

VII. PAPERWORK REDUCTION ACT

The final rules governing the privacy of consumer financial information contain disclosures that are considered collections of information under the Paperwork Reduction Act (PRA, 44 U.S.C. 3501 et seq.). Before the Agencies issued their privacy rules, they obtained approval from OMB for the collections. OMB control numbers for the collections appear below. These proposed rules do not introduce any new collections of information into the Agencies' privacy rules, nor do they amend the rules in a way that substantively modifies the collections of information that OMB has approved. Therefore, no PRA submissions to OMB are required.

OCC: Control number 1557-0216.

Board: Control number 7100-0294.

FDIC: Control number 3064–0136.

OTS: Control number 1550-0103.

NCUA: Control number 3133-0163 (NCUA in separate submissions to OMB is currently in the process of requesting reinstatement, with revisions due to the decrease in the number of respondent credit unions, to this number.)

FTC: Control number 3084-0121.

SEC: Control number 3235-0537.

CFTC: Control number 3038-0055.

OCC AND OTS EXECUTIVE ORDER 12866 DETERMINATION

The OCC and OTS each has determined that its portion of the proposed rulemaking is not a significant regulatory action under Executive Order 12866.

OCC AND OTS EXECUTIVE ORDER 13132 DETERMINATION

The OCC and OTS each has determined that its portion of the proposed rulemaking does not have any federalism implications, as required by Executive Order 13132.

NCUA EXECUTIVE ORDER 13132 DETERMINATION

Executive Order 13132 encourages independent regulatory agencies to consider the impact of their actions on State and local interests. In adherence to fundamental federalism principles, the NCUA, an independent regulatory agency as defined in 44 U.S.C. 3502(5) voluntarily complies with the Executive Order. The proposed rule would not have substantial direct effects on the States, on the connection between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. The NCUA has determined that this proposed rule does not constitute a policy that has federalism implications for purposes of the Executive Order.

OCC AND OTS UNFUNDED MANDATES REFORM ACT OF 1995 DETERMINATION

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (Unfunded Mandates Act) requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more in any one year. If a budgetary impact statement is required, section 205 of the Unfunded Mandates Act also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. However, the Unfunded Mandates Act provisions do not apply to regulations that incorporate requirements specifically set forth in law. Because this notice of proposed rulemaking is issued pursuant to section 728 of the Regulatory Relief Act, the OTS and OCC are not required to conduct an Unfunded Mandates Analysis for this rulemaking. Nevertheless, the OCC and OTS each has determined that this proposed rule will not result in expenditures by State, local, and tribal governments, or by the private sector, of $100 million or more. Accordingly, neither the OCC nor the OTS has prepared a budgetary impact statement or specifically addressed the regulatory alternatives considered.

SEC COST BENEFIT ANALYSIS

The SEC is sensitive to the costs and benefits imposed by its rules. As discussed above, the amendments the Agencies are proposing today would replace the sample clauses included in Regulation S-P's Appendix A (17 CFR 248, Appendix A) with a model privacy form that financial institutions could choose to provide to consumers. The proposed amendments are designed to implement section 728 of the Regulatory Relief Act. This Act directs the Agencies to "jointly develop a model form which may be used, at the option of the financial institution, for the provision of disclosures under [section 503 of the GLB Act]." Use of the model form would be voluntary so a financial institution could itself determine the benefits and costs in deciding whether using the model form would be suitable for its business and customers. Moreover, a financial institution that elected to use the model privacy form would benefit from the safe harbor it provides for disclosures required under the GLB Act. There would be no incremental costs of the information requirements for the proposed model privacy form because the disclosures are already required under Regulation S-P. However, financial institutions could incur some personnel costs in implementing the proposed model form. We expect these would be minimal because the language and format in the form are standardized and particularly if the form could be downloaded from a

Web site.[53] Financial institutions can only customize very limited sections of the model privacy form. Insofar as the Sample Clauses in current Regulation S-P may have some value to some financial institutions, their phase-out under the proposed amendments to the rule could create some costs to those institutions. If financial institutions, including SEC-regulated institutions, make widespread use of the model privacy form, we anticipate that consumers will benefit from notices that are more comprehensible and easier to compare and use.

A. Benefits

We anticipate that brokers, dealers, investment advisers registered with the SEC, and investment companies would benefit from the proposed model privacy form's standardized formatting and language. The notice requirements of Regulation S-P have been effective since July 1, 2001, and would not be altered by the proposed amendments, but new brokers, dealers, investment companies, and registered investment advisers would be able to use the model privacy form without investing the time and resources previously necessary to develop their own notices. We believe that institutions currently review their Regulation S-P privacy policies annually. To the extent that these institutions are required to change their policies to reflect changes in their privacy practices, they may find it easier to use the proposed model privacy form as a revised or annual privacy notice rather than to revise their existing notices. In addition, the SEC expects that revisions to an institution's privacy policies would be easier to record in the model form's standardized format. The SEC also anticipates that a financial institution that chooses to use the model notice would need little, if any, ongoing review by legal counsel because an institution cannot vary the form except as necessary to identify certain specific sharing and opt-out policies.

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53 We have asked for comment in Section V on whether a downloadable version of the model form would be useful.

Appendix A of Regulation S-P currently contains sample clauses that the SEC has said provide guidance in ordinary circumstances. The SEC has said, however, that the "facts and circumstances of each individual situation" will determine whether "use of a sample clause" constitutes compliance.[54] In contrast, if the proposed amendments are adopted, SEC-regulated institutions would benefit from the certainty that proper use of the model notice entitles them to a safe harbor for disclosures required under the GLB Act and FCRA.

Finally, as discussed more fully in section I.B above, the proposed model form was developed in an extensive consumer research testing process that evaluated consumers' ability to comprehend, use, and compare privacy notices. The SEC anticipates therefore that if financial institutions choose to use the proposed model form, consumers' comprehension and their ability to use and compare privacy policies would be enhanced. Institutions also might benefit from consumers' enhanced ability to understand and use the notices to the extent that consumers have more trust and confidence in an institution's privacy policies because the consumers understand those policies.

B. Costs

While the proposed amendments would not affect Regulation S-P's substantive requirements, and financial institutions would be under no obligation to modify their current privacy notices, we believe that financial institutions that elect to use the model privacy form could incur some small, incremental costs in making the transition from their current notices to the proposed model form. These costs could include staff time to review the model form and its instructions and complete the proposed form. As noted above, we anticipate there would be minimal computer costs associated with using the form, particularly if the form could be

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[54] See 17 CFR 248.2(a).

downloaded from a Web site. We also believe that a financial institution that would use the model privacy form would need little, if any, review by legal counsel because almost all the disclosures in the form are mandated. Institution-specific information consists of contact information, "yes" or "no" answers and brief descriptions, as necessary, of the types of entities with which they share information. Moreover, we believe that financial institutions currently review their privacy polices annually, and we anticipate that the costs associated with this annual review would likely be the same as the costs of completing the model form. Although there may be some costs to firms that currently rely on the sample clauses for guidance in preparing their privacy notices, we expect those costs to be minimal. As noted above, we believe that financial institutions take approximately the same time to prepare a notice using the proposed form as they currently take to review annual notices. Moreover, the Agencies are proposing to give financial institutions one year in which they can continue to rely on the Sample Clauses as guidance, which should allow time to minimize the costs of transition for institutions that would transition to the model privacy form. The SEC requests commenters to provide data on these and any other costs of transition or implementation, and to specify the type of financial institution (broker, dealer, investment adviser registered with the Commission, or investment company) that would incur the estimated costs.

As discussed above, we cannot estimate the number of institutions that would take advantage of the safe harbor. Accordingly, we cannot estimate the overall costs to broker-dealers, investment advisers registered with the Commission, and investment companies that may use the proposed model form.

C. Request for Comments

The SEC requests comment on the potential costs and benefits of the proposed amendments to Appendix A of Regulation S-P. The SEC specifically requests comment on the costs of each item discussed above that institutions could incur in using the model form and whether any of those costs would differ if the form were downloadable from a Web site. Commenters should specify the type of institution associated with estimates of cost and benefits. The SEC encourages commenters to identify, discuss, analyze, and supply relevant data regarding any additional costs and benefits. For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996,[55] the SEC also requests information regarding the potential impact of the proposals on the U.S. economy on an annual basis.

SEC CONSIDERATION OF BURDEN ON COMPETITION

Securities Exchange Act Section 23(a)(2) requires the SEC, in adopting rules under that Act, to consider the impact that any such rule would have on competition.[56] Section 23(a)(2) also prohibits the SEC from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Securities Exchange Act.

As discussed above, the proposed amendments to Regulation S-P, including the proposed model form, are designed to comply with section 728 of the Regulatory Relief Act, mandating that the Agencies propose a model form that is comprehensible, clear and conspicuous, and succinct. If adopted, SEC-regulated institutions would be able to use the model form in order to comply with the notice requirements under the GLB Act, the FCRA, and Regulation S-P.

The SEC does not expect the proposed amendments to have a significant impact on competition, and believes that any effect on competition would be favorable. Use of the proposed model form would be voluntary, permitting a financial institution to determine whether using the model form would enhance its competitive position. All brokers and dealers, investment companies, and registered investment advisers would be able to use the model form and take

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55 Pub. L. 104-121, Title II, 110 Stat. 857 (1996).

56 See 15 U.S.C. 78w(a)(2).

advantage of the safe harbor. Other financial institutions would be able to use the form and take advantage of the safe harbor under comparable rules proposed by the other Agencies. Under the Regulatory Relief Act, the Agencies have worked in consultation in order to ensure the consistency and comparability of the proposed amendments. Therefore, all financial institutions would have the same opportunity to use the model form and rely on the safe harbor.

Further, if financial institutions choose to use the proposed model form, the proposed amendments could promote competition by enabling consumers more easily to understand and compare competing institutions' privacy policies. The SEC also anticipates that the proposed model form's standardized formatting would reduce the relative burden of compliance on smaller financial institutions, allowing them to compete more effectively with larger institutions that are more likely to have a dedicated compliance staff. As such, the SEC expects any small impact on competition caused by the proposed amendments would be beneficial. We request comment on whether the proposal, if adopted, would have an impact or burden on competition. Commenters are requested to provide empirical data and other factual support for their views if possible.

NCUA: THE TREASURY AND GENERAL GOVERNMENT APPROPRIATIONS ACT, 1999-ASSESSMENT OF FEDERAL REGULATIONS AND POLICIES ON FAMILIES

The NCUA has determined that this proposed rule would not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, 1999, Pub. L. 105-277, 112 Stat. 2681 (1998).

CFTC COST-BENEFIT ANALYSIS

Section 15 of the Commodity Exchange Act requires the CFTC to consider the costs and benefits of its action before issuing a new regulation under the Act. The CFTC understands that, by its terms, section 15 does not require the CFTC to quantify the costs and benefits of a new regulation or to determine whether the benefits of the proposed regulation outweigh its costs. Nor does it require that each proposed rule be analyzed piecemeal or in isolation when that rule is a component of a larger package of rules or rule revisions. Rather, section 15 simply requires the CFTC to "consider the costs and benefits" of its action.

Section 15 further specifies that costs and benefits shall be evaluated in light of five broad areas of market and public concern: Protection of market participants and the public; efficiency, competitiveness, and financial integrity of futures markets; price discovery; sound risk management practices; and other public interest considerations. Accordingly, the CFTC could in its discretion give greater weight to any one of the five enumerated areas of concern and could in its discretion determine that, notwithstanding its costs, a particular rule was necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The CFTC has considered the costs and benefits of the proposed model form as a totality. The form provides a voluntary alternative means of complying with existing requirements of the privacy provisions of the GLB Act and section 5g of the CEA, and thus imposes no mandatory new costs. The CFTC solicits comment on the transitional costs that may be incurred by institutions electing to use the model form, including costs in addition to those already imposed. The CFTC believes that the model form should benefit futures industry consumer customers in better understanding a financial institution's privacy policies, and may facilitate customers in comparing the privacy policies of financial institutions. The Commission invites public comment on its application of the cost-benefit provision. Commenters also are invited to submit any data that they may have quantifying the costs and benefits of the proposed rules with their comment letters.

LIST OF SUBJECTS

12 CFR Part 40

Banks, banking, Consumer protection, National banks, Privacy, Reporting and recordkeeping requirements.

12 CFR Part 216

Banks, banking, Consumer protection, Foreign banking, Holding companies, Privacy, Reporting and recordkeeping requirements.

12 CFR Part 332

Banks, banking, Consumer protection, Foreign banking, Privacy, Reporting and recordkeeping requirements.

12 CFR Part 573

Consumer protection, Privacy, Reporting and recordkeeping requirements, Savings associations.

12 CFR Part 716

Consumer protection, Credit unions, Privacy, Reporting and recordkeeping requirements.

16 CFR Part 313

Consumer protection, Credit, Privacy, Reporting and recordkeeping requirements, Trade practices.

17 CFR Part 160

Brokers, Consumer protection, Privacy, Reporting and recordkeeping requirements.

17 CFR Part 248

Brokers, Consumer protection, Investment companies, Privacy, Reporting and recordkeeping requirements, Securities.

Office of the Comptroller of the Currency

12 CFR Chapter I

Authority and Issuance

For the reasons set forth in the joint preamble, part 40 of chapter I of title 12 of the Code of Federal Regulations is proposed to be revised as follows:

PART 40-PRIVACY OF CONSUMER FINANCIAL INFORMATION

1. The authority citation for part 40 continues to read as follows:

Authority: 12 U.S.C. 93a; 15 U.S.C. 6801 et seq.

2. Revise § 40.2 to read as follows:

§ 40.2 Model privacy form and examples.

(a) Model privacy form. Use of the model privacy form in Appendix A of this part, consistent with the instructions in Appendix A, constitutes compliance with the notice content requirements of §§ 40.6 and 40.7 of this part, although use of the model privacy form is not required.

(b) Examples. The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

3. In § 40.6, revise paragraph (f) and add paragraph (g) to read as follows:

§ 40.6 Information to be included in privacy notices.

* * * * *

(f) Model privacy form. Pursuant to §40.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

(g) Sample clauses. Sample clauses illustrating some of the notice content required by this section are included in Appendix B of this part. Use of a sample clause in a privacy notice provided on or before [DATE ONE YEAR FOLLOWING THE DATE OF PUBLICATION OF THE FINAL RULE], to the extent applicable, constitutes compliance with this part.

4. In § 40.7, add paragraph (i) to read as follows:

§ 40.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model privacy form. Pursuant to §40.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

Appendix A [Redesignated as Appendix B]

5. Redesignate Appendix A as Appendix B.

6. Add new Appendix A to read as follows:

APPENDIX A TO PART 40-MODEL PRIVACY FORM

APPENDIX A. Model Privacy Form.

A. The model privacy form.

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ▪ Social Security number and income ▪ account balances and payment history ▪ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Contact Us	Call **[toll-free telephone]** or go to **[web address]**

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FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

Sharing practices	
How often does [name of financial institution] notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does [name of financial institution] protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does [name of financial institution] collect my personal information?	We collect your personal information, for example, when you ▪ open an account or deposit money ▪ pay your bills or apply for a loan ▪ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ▪ affiliates' everyday business purposes—information about your creditworthiness ▪ affiliates to market to you ▪ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ▪ processing transactions, mailing, and auditing services ▪ providing information to credit bureaus ▪ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ▪ ***[affiliate information]***
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ▪ ***[nonaffiliate information]***
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ▪ ***[joint marketing]***

FACTS WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

If you want to limit our sharing	
Contact us	By telephone: [toll-free telephone] — our menu will prompt you through your choices On the web: [web address] By mail: mark your choices below, fill in and send form to: [mailing address] **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices	
Your choices will apply to everyone on your account.	**Check any/all you want to limit:** *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.

Your name		Mail to: [mailing address]
Your address		
Account number		

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B. General Instructions

1. How the model privacy form is used.

The model form may be used, at the option of a financial institution, including a group of financial holding company affiliates that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in sections 40.6 and 40.7 of this part.

(Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act [15 U.S.C. 1681 – 1681x] (FCRA), such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

2. The contents of the model privacy form.

The model form consists of two or three pages, depending on whether a financial institution shares in a manner that requires it to provide a third page with opt-out information.

(a) *Page One*. The first page consists of the following components:

(1) The title.

(2) The key frame (Why?, What?, How?).

(3) The disclosure table ("Reasons we can share your personal information").

(4) Contact information.

(b) *Page Two*. The second page consists of the following components:

(1) The title.

(2) The Frequently Asked Questions on sharing practices.

(3) The definitions.

(c) *Page Three*. The third page consists of a financial institution's opt-out form.

3. The format of the model privacy form.

The model form is a standardized form, including page layout, page content, format, style, pagination, and shading. No other information may be included in the model form, and the model form may be modified only as described below.

(a) *Easily readable type font.* Financial institutions that use the model form must use an easily readable type font. Easily readable type font includes a minimum of 10-point font and sufficient spacing between the lines of type.

(b) *Logo.* A financial institution may include a corporate logo on any page of the notice, so long as it does not interfere with the readability of the model form or the space constraints of each page.

(c) *Page size and orientation.* Each page of the model form must be printed on one side of an 8.5 by 11 inch paper in portrait orientation.

(d) *Color.* The model form may be printed on white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color may be used to achieve visual interest, so long as the color contrast is distinctive and the color does not detract from the readability of the model form.

C. Information Required in the Model Privacy Form

The model form is a standardized form, and institutions seeking to obtain the safe harbor through use of the model form may modify the form only as described below:

1. **Name of the institution or group of affiliated institutions providing the notice.** Include the name of the financial institution or group of affiliated institutions providing the notice on the form wherever [**name of financial institution**] appears. Contact information, such as the institution's toll-free telephone number, Web address, or mailing address, or other contact information, should be inserted as appropriate, wherever [**toll-free telephone**] or [**web address**] or [**mailing address**] appear.

2. **Page one.**

(a) *General instructions for the disclosure table.* There are reasons for sharing or using personal information listed in the left column of the disclosure table. Each of these reasons correlates to certain legal provisions described below. In the middle column, each institution must provide a "Yes" or "No" response in each box that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. Each institution also must complete each box in the right column as to whether a consumer can limit such sharing. If an institution answers "No" to sharing for a particular reason in the middle column, it must answer "We don't share" in the corresponding right column. If an institution answers "Yes" to sharing for a particular reason in the middle column, it must, in the right column, answer either "No" if it does not offer an opt-out or "Yes (Check your choices, p.3)" if it does offer an opt-out. Except for the sixth row ("For our affiliates to market to you"), an institution must list all reasons for sharing, and complete the middle and right columns of the disclosure table.

(b) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* Because all financial institutions share information for everyday business purposes, as contemplated by sections 40.14 and 40.15 of this part, the financial institution must answer "Yes" to the sharing of such information and "No" to the availability of an opt-out.

(2) *For our marketing purposes.* The financial institution must answer "Yes" or "No" in the middle column. An institution that does not

share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction. This provision includes service providers contemplated by section 40.13 of this part.

(3) *For joint marketing with other financial companies.* As contemplated by section 40.13 of this part, the financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This provision applies to sharing of certain information with an institution's affiliates, as contemplated by sections 603(d)(2)(A)(i) and (ii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason may or may not elect to provide an opt-out and must provide

the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(5) *For our affiliates' everyday business purposes – information about creditworthiness*. This provision applies to the sharing of certain information with an institution's affiliates, as contemplated by section 603(d)(2)(A)(iii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason must provide an opt-out and must provide the appropriate answer in the right column as described in paragraph C.2.(a) of this Instruction.

(6) *For our affiliates to market to you*. This provision applies to information shared among affiliates that is used by those affiliates for marketing, as contemplated by section 624 of the FCRA. Following the effective date of the rules implementing section 624, institutions that elect to incorporate this provision into the model form to satisfy their obligations under this part must include this reason for sharing as set forth in the model form in order to obtain the benefit of the safe harbor. Institutions whose affiliates receive such information and use it for marketing must answer "Yes" in the middle column, and "Yes (Check your choices, p.3)" in the right column corresponding to the availability of an opt-out. Institutions whose affiliates receive such information and do not use it for marketing may elect to include this

provision in the model form and answer "No" in the middle column and "We don't share" in the right column; however, institutions whose affiliates receive such information and do not use it for marketing are not required to use this provision. Institutions that do not have affiliates and elect to include this provision in their notice will answer "No" in the middle column and "We don't share" in the right column.

(7) *For nonaffiliates to market to you.* This provision applies to sharing under sections 40.7 and 40.10(a) of this part. Financial institutions that do not share for this reason must answer "No" in the middle column and "We don't share" in the right column. Financial institutions that do share for this reason must answer "Yes" in the middle column and "Yes (check your choices, p. 3)" corresponding to the availability of an opt-out.

(8) *Additional opt-outs.* A financial institution may customize the model form to offer opt-outs beyond those required under Federal law, so long as the additional information falls within the space constraints of the model form. If the institution chooses to offer its customers an opt-out for its own marketing or for joint marketing, for example, it can provide for that option by stating: "Yes (Check your choices, p.3)" as to the availability of the opt-out.

3. Page two.

(a) *General instructions for the Definitions.*

The financial institution must customize the space below the last three definitions in this section (affiliates, nonafffiliates, and joint marketing). This specific information must be in italicized lettering to set off the information from the standardized definitions.

(b) *Affiliates*. As required by section 40.6(a)(3) of this part, the financial institution must identify the categories of its affiliates or state "[***name of financial institution***] *has no affiliates*" in italicized lettering where [***affiliate information***] appears. A financial institution that shares with affiliates must use, as applicable, the following format: *"Our affiliates include companies with a* ***[name of financial institution]*** *name; financial companies such as* ***[list companies]****; and nonfinancial companies, such as* ***[list companies]****."*

(c) *Nonaffiliates*. If the financial institution shares with nonaffiliated third parties outside the exceptions in sections 40.14 and 40.15 of this part, the institution must identify the types of nonaffiliated third parties with which it shares or state "[***name of financial institution***] *does not share with nonaffiliates so they can market to you.*" in italicized lettering where [***nonaffiliate information***] appears. A financial institution that shares with nonaffiliated third parties as described here must use, as applicable, the following format: *"Nonaffiliates we share with can include* ***[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]****."*

(d) *Joint Marketing*. As required by section 40.13 of this part, the financial institution must identify the types of financial institutions with which it engages in joint marketing or state *"****[name of financial institution]*** *doesn't*

jointly market." in italicized lettering where [***joint marketing***] appears. A financial institution that shares with joint marketing partners must use, as applicable, the following format: *"Our joint marketing partners include **[list categories of companies such as credit card companies]**."*

4. **Page three.**

Opt-out form. Financial institutions must use page three only if they: (1) share or use information in a manner that triggers an opt-out; or (2) choose to provide an opt-out (as disclosed in the table on page 1) in addition to what is required by law. The model opt-out form must be provided on a separate page of the model form.

(a) *Contact us*. The section describes three common methods by which a consumer exercises an opt-out – by telephone, on the Web, and by mail. Financial institutions may customize this section to provide for the particular opt-out methods and options the institution provides. For example, if an institution offers opting out by telephone and the Web but not by mail, it would provide only telephone and Web information as shown in the model form in the "Contact Us" box. Only institutions that allow more than 30 days after providing the notice before sharing information may change the number of days in the lower right hand section of the box.

(b) *Check your choices*. Institutions must display the applicable opt-out options in the "Check your choices" box shown on this page. If an institution chooses not to offer an opt-out by mail, it must delete the boxes for name, address, account number, and mailing directions in the lower right-hand corner of the model form. Financial institutions that only offer one or two of the opt-out options listed on the model form must list only those options

from the model form that apply to their practices and correspond accurately to the disclosures on page one. Thus, if an institution does not share in a manner that requires an opt-out for sharing with nonaffiliates, it must not include that opt-out option on page three of the model form. Institutions requiring information from consumers on the opt-out form other than an account number should modify that designation in the "Check your choices" box. Institutions that require customers with multiple accounts to identify each account to which the opt-out should apply should modify that portion of the model form.

(c) *Section 624 opt-out.* If the financial institution's affiliates use information for marketing pursuant to section 624 of the FCRA, and the institution elects to consolidate that opt-out notice in the model form, it must include that disclosure and opt-out election as shown in the model form. Institutions that elect to limit the time for the affiliate marketing opt-out, consistent with the requirements of section 624, must adhere to the requirements of that section and the Agencies' implementing rule with respect to any subsequent notice and opt-out. Institutions that elect to limit the opt-out period must include a statement in italics, as shown on the model form, that states the period of time for which the opt-out applies.

(d) *Additional opt-outs.* A financial institution that uses the disclosure table to indicate any opt-out choices available to consumers beyond those required by Federal law must include those opt-outs on page three of the model form. For example, if the financial institution discloses in the table that it offers an opt-out for joint marketing, the institution must revise the opt-out form on

page three to reflect the availability of an opt-out, such as by adding a check-off box with the words "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution chooses to offer its customers an opt-out for its marketing, it can provide for that option in the disclosure table and on the opt-out form by adding a check-off box with the words "Do not share [or use] my personal information to market to me."

7. Amend newly redesignated Appendix B by adding a new sentence immediately after the heading:

APPENDIX B TO PART 40-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided until the date that is on or before one year following the date of final publication of this rule. * * *

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Federal Reserve System

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the joint preamble, the Board proposes to amend part 216 of chapter II of title 12 of the Code of Federal Regulations as follows:

PART 216—PRIVACY OF CONSUMER FINANCIAL INFORMATION (REGULATION P)

1. The authority citation for part 216 continues to read as follows:

Authority: 15 U.S.C. 6801 et seq.

2. Revise § 216.2 to read as follows:

§ 216.2 Model privacy form and examples.

(a) Model privacy form. Use of the model privacy form in Appendix A of this part, consistent with the instructions in Appendix A, constitutes compliance with the notice content requirements of §§ 216.6 and 216.7 of this part, although use of the model privacy form is not required.

(b) Examples. The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

3. In § 216.6, revise paragraph (f) and add paragraph (g) to read as follows:

§ 216.6 Information to be included in privacy notices.

* * * * *

(f) Model privacy form. Pursuant to §216.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

(g) Sample clauses. Sample clauses illustrating some of the notice content required by this section are included in Appendix B of this part. Use of a sample clause in a privacy notice provided on or before [DATE ONE YEAR FOLLOWING THE DATE OF PUBLICATION OF THE FINAL RULE], to the extent applicable, constitutes compliance with this part.

4. In § 216.7, add paragraph (i) to read as follows:

§ 216.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model privacy form. Pursuant to §216.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

Appendix A [Redesignated as Appendix B]

5. Redesignate Appendix A as Appendix B.

6. Add new Appendix A to read as follows:

APPENDIX A TO PART 216-MODEL PRIVACY FORM

APPENDIX A. Model Privacy Form.

A. The model privacy form.

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ▪ Social Security number and income ▪ account balances and payment history ▪ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Contact Us	Call [toll-free telephone] or go to [web address]

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

Sharing practices	
How often does [name of financial institution] notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does [name of financial institution] protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does [name of financial institution] collect my personal information?	We collect your personal information, for example, when you ▪ open an account or deposit money ▪ pay your bills or apply for a loan ▪ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ▪ affiliates' everyday business purposes—information about your creditworthiness ▪ affiliates to market to you ▪ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ▪ processing transactions, mailing, and auditing services ▪ providing information to credit bureaus ▪ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ▪ *[affiliate information]*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ▪ *[nonaffiliate information]*
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ▪ *[joint marketing]*

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

If you want to limit our sharing	
Contact us	By telephone: [toll-free telephone] — our menu will prompt you through your choices On the web: [web address] By mail: mark your choices below, fill in and send form to: [mailing address] **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices			
Your choices will apply to everyone on your account.	**Check any/all you want to limit:** *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Your name		Mail to: [mailing address]
	Your address		
	Account number		

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B. General Instructions

1. How the model privacy form is used.

The model form may be used, at the option of a financial institution, including a group of financial holding company affiliates that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in sections 216.6 and 216.7 of this part.

(Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act [15 U.S.C. 1681 – 1681x] (FCRA), such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

2. The contents of the model privacy form.

The model form consists of two or three pages, depending on whether a financial institution shares in a manner that requires it to provide a third page with opt-out information.

(a) *Page One*. The first page consists of the following components:

(1) The title.

(2) The key frame (Why?, What?, How?).

(3) The disclosure table ("Reasons we can share your personal information").

(4) Contact information.

(b) *Page Two*. The second page consists of the following components:

(1) The title.

(2) The Frequently Asked Questions on sharing practices.

(3) The definitions.

(c) *Page Three*. The third page consists of a financial institution's opt-out form.

3. The format of the model privacy form.

The model form is a standardized form, including page layout, page content, format, style, pagination, and shading. No other information may be included in the model form, and the model form may be modified only as described below.

(a) *Easily readable type font.* Financial institutions that use the model form must use an easily readable type font. Easily readable type font includes a minimum of 10-point font and sufficient spacing between the lines of type.

(b) *Logo.* A financial institution may include a corporate logo on any page of the notice, so long as it does not interfere with the readability of the model form or the space constraints of each page.

(c) *Page size and orientation.* Each page of the model form must be printed on one side of an 8.5 by 11 inch paper in portrait orientation.

(d) *Color.* The model form may be printed on white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color may be used to achieve visual interest, so long as the color contrast is distinctive and the color does not detract from the readability of the model form.

C. Information Required in the Model Privacy Form

The model form is a standardized form, and institutions seeking to obtain the safe harbor through use of the model form may modify the form only as described below:

1. Name of the institution or group of affiliated institutions providing the notice. Include the name of the financial institution or group of affiliated institutions providing the notice on the form wherever **[name of financial institution]** appears. Contact information, such as the institution's toll-free telephone number, Web address, or mailing address, or other contact information, should be inserted as appropriate, wherever **[toll-free telephone]** or **[web address]** or **[mailing address]** appear.

2. **Page one.**

(a) *General instructions for the disclosure table.* There are reasons for sharing or using personal information listed in the left column of the disclosure table. Each of these reasons correlates to certain legal provisions described below. In the middle column, each institution must provide a "Yes" or "No" response in each box that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. Each institution also must complete each box in the right column as to whether a consumer can limit such sharing. If an institution answers "No" to sharing for a particular reason in the middle column, it must answer "We don't share" in the corresponding right column. If an institution answers "Yes" to sharing for a particular reason in the middle column, it must, in the right column, answer either "No" if it does not offer an opt-out or "Yes (Check your choices, p.3)" if it does offer an opt-out. Except for the sixth row ("For our affiliates to market to you"), an institution must list all reasons for sharing, and complete the middle and right columns of the disclosure table.

(b) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* Because all financial institutions share information for everyday business purposes, as contemplated by sections 216.14 and 216.15 of this part, the financial institution must answer "Yes" to the sharing of such information and "No" to the availability of an opt-out.

(2) *For our marketing purposes.* The financial institution must answer "Yes" or "No" in the middle column. An institution that does not

share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction. This provision includes service providers contemplated by section 216.13 of this part.

(3) *For joint marketing with other financial companies.* As contemplated by section 216.13 of this part, the financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This provision applies to sharing of certain information with an institution's affiliates, as contemplated by sections 603(d)(2)(A)(i) and (ii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason may or may not elect to provide an opt-out and must provide

the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This provision applies to the sharing of certain information with an institution's affiliates, as contemplated by section 603(d)(2)(A)(iii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason must provide an opt-out and must provide the appropriate answer in the right column as described in paragraph C.2.(a) of this Instruction.

(6) *For our affiliates to market to you.* This provision applies to information shared among affiliates that is used by those affiliates for marketing, as contemplated by section 624 of the FCRA. Following the effective date of the rules implementing section 624, institutions that elect to incorporate this provision into the model form to satisfy their obligations under this part must include this reason for sharing as set forth in the model form in order to obtain the benefit of the safe harbor. Institutions whose affiliates receive such information and use it for marketing must answer "Yes" in the middle column, and "Yes (Check your choices, p.3)" in the right column corresponding to the availability of an opt-out. Institutions whose affiliates receive such information and do not use it for marketing may elect to include this

provision in the model form and answer "No" in the middle column and "We don't share" in the right column; however, institutions whose affiliates receive such information and do not use it for marketing are not required to use this provision. Institutions that do not have affiliates and elect to include this provision in their notice will answer "No" in the middle column and "We don't share" in the right column.

(7) *For nonaffiliates to market to you.* This provision applies to sharing under sections 216.7 and 216.10(a) of this part. Financial institutions that do not share for this reason must answer "No" in the middle column and "We don't share" in the right column. Financial institutions that do share for this reason must answer "Yes" in the middle column and "Yes (check your choices, p. 3)" corresponding to the availability of an opt-out.

(8) *Additional opt-outs.* A financial institution may customize the model form to offer opt-outs beyond those required under Federal law, so long as the additional information falls within the space constraints of the model form. If the institution chooses to offer its customers an opt-out for its own marketing or for joint marketing, for example, it can provide for that option by stating: "Yes (Check your choices, p.3)" as to the availability of the opt-out.

3. **Page two.**

(a) *General instructions for the Definitions.*

The financial institution must customize the space below the last three definitions in this section (affiliates, nonafffiliates, and joint marketing). This specific information must be in italicized lettering to set off the information from the standardized definitions.

(b) *Affiliates*. As required by section 216.6(a)(3) of this part, the financial institution must identify the categories of its affiliates or state "[***name of financial institution***] *has no affiliates*" in italicized lettering where [***affiliate information***] appears. A financial institution that shares with affiliates must use, as applicable, the following format: *"Our affiliates include companies with a **[name of financial institution]** name; financial companies such as **[list companies]**; and nonfinancial companies, such as **[list companies]**."*

(c) *Nonaffiliates*. If the financial institution shares with nonaffiliated third parties outside the exceptions in sections 216.14 and 216.15 of this part, the institution must identify the types of nonaffiliated third parties with which it shares or state "[***name of financial institution***] *does not share with nonaffiliates so they can market to you.*" in italicized lettering where [***nonaffiliate information***] appears. A financial institution that shares with nonaffiliated third parties as described here must use, as applicable, the following format: *"Nonaffiliates we share with can include **[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]**."*

(d) *Joint Marketing*. As required by section 216.13 of this part, the financial institution must identify the types of financial institutions with which it engages in joint marketing or state *"**[name of financial institution]** doesn't*

jointly market." in italicized lettering where [***joint marketing***] appears. A financial institution that shares with joint marketing partners must use, as applicable, the following format: *"Our joint marketing partners include **[list categories of companies such as credit card companies]**."*

4. Page three.

Opt-out form. Financial institutions must use page three only if they: (1) share or use information in a manner that triggers an opt-out; or (2) choose to provide an opt-out (as disclosed in the table on page 1) in addition to what is required by law. The model opt-out form must be provided on a separate page of the model form.

(a) *Contact us*. The section describes three common methods by which a consumer exercises an opt-out – by telephone, on the Web, and by mail. Financial institutions may customize this section to provide for the particular opt-out methods and options the institution provides. For example, if an institution offers opting out by telephone and the Web but not by mail, it would provide only telephone and Web information as shown in the model form in the "Contact Us" box. Only institutions that allow more than 30 days after providing the notice before sharing information may change the number of days in the lower right hand section of the box.

(b) *Check your choices*. Institutions must display the applicable opt-out options in the "Check your choices" box shown on this page. If an institution chooses not to offer an opt-out by mail, it must delete the boxes for name, address, account number, and mailing directions in the lower right-hand corner of the model form. Financial institutions that only offer one or two of the opt-out options listed on the model form must list only those options

from the model form that apply to their practices and correspond accurately to the disclosures on page one. Thus, if an institution does not share in a manner that requires an opt-out for sharing with nonaffiliates, it must not include that opt-out option on page three of the model form. Institutions requiring information from consumers on the opt-out form other than an account number should modify that designation in the "Check your choices" box. Institutions that require customers with multiple accounts to identify each account to which the opt-out should apply should modify that portion of the model form.

(c) *Section 624 opt-out*. If the financial institution's affiliates use information for marketing pursuant to section 624 of the FCRA, and the institution elects to consolidate that opt-out notice in the model form, it must include that disclosure and opt-out election as shown in the model form. Institutions that elect to limit the time for the affiliate marketing opt-out, consistent with the requirements of section 624, must adhere to the requirements of that section and the Agencies' implementing rule with respect to any subsequent notice and opt-out. Institutions that elect to limit the opt-out period must include a statement in italics, as shown on the model form, that states the period of time for which the opt-out applies.

(d) *Additional opt-outs*. A financial institution that uses the disclosure table to indicate any opt-out choices available to consumers beyond those required by Federal law must include those opt-outs on page three of the model form. For example, if the financial institution discloses in the table that it offers an opt-out for joint marketing, the institution must revise the opt-out form on

page three to reflect the availability of an opt-out, such as by adding a check-off box with the words "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution chooses to offer its customers an opt-out for its marketing, it can provide for that option in the disclosure table and on the opt-out form by adding a check-off box with the words "Do not share [or use] my personal information to market to me."

7. Amend newly redesignated Appendix B by adding a new sentence immediately after the heading:

APPENDIX B TO PART 216-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided until the date that is on or before one year following the date of final publication of this rule. * * *

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Federal Deposit Insurance Corporation

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the joint preamble, the Federal Deposit Insurance Corporation proposes to amend part 332 of chapter III of title 12 of the Code of Federal Regulations as follows:

PART 332—PRIVACY OF CONSUMER FINANCIAL INFORMATION

1. The authority citation for part 332 continues to read as follows:

Authority: 12 U.S.C. 1819 (Seventh and Tenth); 15 U.S.C. 6801 et seq.

2. Revise § 332.2 to read as follows:

§ 332.2 Model privacy form and examples.

(a) Model privacy form. Use of the model privacy form in Appendix A of this part, consistent with the instructions in Appendix A, constitutes compliance with the notice content requirements of §§ 332.6 and 332.7 of this part, although use of the model privacy form is not required.

(b) Examples. The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

3. In § 332.6, revise paragraph (f) and add paragraph (g) to read as follows:

§ 332.6 Information to be included in privacy notices.

* * * * *

(f) Model privacy form. Pursuant to §332.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

(g) Sample clauses. Sample clauses illustrating some of the notice content required by this section are included in Appendix B of this part. Use of a sample clause in a privacy notice provided on or before [DATE ONE YEAR FOLLOWING THE DATE OF PUBLICATION OF THE FINAL RULE], to the extent applicable, constitutes compliance with this part.

4. In § 332.7 add paragraph (i) to read as follows:

§ 332.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model privacy form. Pursuant to §332.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

Appendix A [Redesignated as Appendix B]

5. Redesignate Appendix A as Appendix B.

6. Add new Appendix A to read as follows:

APPENDIX A TO PART 332-MODEL PRIVACY FORM

APPENDIX A. Model Privacy Form.

A. The model privacy form.

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ■ Social Security number and income ■ account balances and payment history ■ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Contact Us	Call [toll-free telephone] or go to [web address]

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FACTS	**WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?**

Sharing practices	
How often does [name of financial institution] notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does [name of financial institution] protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does [name of financial institution] collect my personal information?	We collect your personal information, for example, when you ▪ open an account or deposit money ▪ pay your bills or apply for a loan ▪ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ▪ affiliates' everyday business purposes—information about your creditworthiness ▪ affiliates to market to you ▪ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ▪ processing transactions, mailing, and auditing services ▪ providing information to credit bureaus ▪ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ▪ ***[affiliate information]***
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ▪ ***[nonaffiliate information]***
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ▪ ***[joint marketing]***

FACTS WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

If you want to limit our sharing	
Contact us	By telephone: [toll-free telephone] — our menu will prompt you through your choices On the web: [web address] By mail: mark your choices below, fill in and send form to: [mailing address] **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices			
Your choices will apply to everyone on your account.	Check any/all you want to limit: *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Your name		Mail to: [mailing address]
	Your address		
	Account number		

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B. General Instructions

1. How the model privacy form is used.

The model form may be used, at the option of a financial institution, including a group of financial holding company affiliates that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in sections 332.6 and 332.7 of this part.

(Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act [15 U.S.C. 1681 – 1681x] (FCRA), such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

2. The contents of the model privacy form.

The model form consists of two or three pages, depending on whether a financial institution shares in a manner that requires it to provide a third page with opt-out information.

(a) *Page One.* The first page consists of the following components:

(1) The title.

(2) The key frame (Why?, What?, How?).

(3) The disclosure table ("Reasons we can share your personal information").

(4) Contact information.

(b) *Page Two.* The second page consists of the following components:

(1) The title.

(2) The Frequently Asked Questions on sharing practices.

(3) The definitions.

(c) *Page Three.* The third page consists of a financial institution's opt-out form.

3. The format of the model privacy form.

The model form is a standardized form, including page layout, page content, format, style, pagination, and shading. No other information may be included in the model form, and the model form may be modified only as described below.

(a) *Easily readable type font*. Financial institutions that use the model form must use an easily readable type font. Easily readable type font includes a minimum of 10-point font and sufficient spacing between the lines of type.

(b) *Logo*. A financial institution may include a corporate logo on any page of the notice, so long as it does not interfere with the readability of the model form or the space constraints of each page.

(c) *Page size and orientation.* Each page of the model form must be printed on one side of an 8.5 by 11 inch paper in portrait orientation.

(d) *Color*. The model form may be printed on white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color may be used to achieve visual interest, so long as the color contrast is distinctive and the color does not detract from the readability of the model form.

C. Information Required in the Model Privacy Form

The model form is a standardized form, and institutions seeking to obtain the safe harbor through use of the model form may modify the form only as described below:

1. Name of the institution or group of affiliated institutions providing the notice. Include the name of the financial institution or group of affiliated institutions providing the notice on the form wherever **[name of financial institution]** appears. Contact information, such as the institution's toll-free telephone number, Web address, or mailing address, or other contact information, should be inserted as appropriate, wherever **[toll-free telephone]** or **[web address]** or **[mailing address]** appear.

2. **Page one.**

(a) *General instructions for the disclosure table.* There are reasons for sharing or using personal information listed in the left column of the disclosure table. Each of these reasons correlates to certain legal provisions described below. In the middle column, each institution must provide a "Yes" or "No" response in each box that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. Each institution also must complete each box in the right column as to whether a consumer can limit such sharing. If an institution answers "No" to sharing for a particular reason in the middle column, it must answer "We don't share" in the corresponding right column. If an institution answers "Yes" to sharing for a particular reason in the middle column, it must, in the right column, answer either "No" if it does not offer an opt-out or "Yes (Check your choices, p.3)" if it does offer an opt-out. Except for the sixth row ("For our affiliates to market to you"), an institution must list all reasons for sharing, and complete the middle and right columns of the disclosure table.

(b) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* Because all financial institutions share information for everyday business purposes, as contemplated by sections 332.14 and 332.15 of this part, the financial institution must answer "Yes" to the sharing of such information and "No" to the availability of an opt-out.

(2) *For our marketing purposes.* The financial institution must answer "Yes" or "No" in the middle column. An institution that does not

share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction. This provision includes service providers contemplated by section 332.13 of this part.

(3) *For joint marketing with other financial companies.* As contemplated by section 332.13 of this part, the financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This provision applies to sharing of certain information with an institution's affiliates, as contemplated by sections 603(d)(2)(A)(i) and (ii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason may or may not elect to provide an opt-out and must provide

the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This provision applies to the sharing of certain information with an institution's affiliates, as contemplated by section 603(d)(2)(A)(iii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason must provide an opt-out and must provide the appropriate answer in the right column as described in paragraph C.2.(a) of this Instruction.

(6) *For our affiliates to market to you.* This provision applies to information shared among affiliates that is used by those affiliates for marketing, as contemplated by section 624 of the FCRA. Following the effective date of the rules implementing section 624, institutions that elect to incorporate this provision into the model form to satisfy their obligations under this part must include this reason for sharing as set forth in the model form in order to obtain the benefit of the safe harbor. Institutions whose affiliates receive such information and use it for marketing must answer "Yes" in the middle column, and "Yes (Check your choices, p.3)" in the right column corresponding to the availability of an opt-out. Institutions whose affiliates receive such information and do not use it for marketing may elect to include this

provision in the model form and answer “No” in the middle column and “We don’t share” in the right column; however, institutions whose affiliates receive such information and do not use it for marketing are not required to use this provision. Institutions that do not have affiliates and elect to include this provision in their notice will answer “No” in the middle column and “We don’t share” in the right column.

(7) *For nonaffiliates to market to you.* This provision applies to sharing under sections 332.7 and 332.10(a) of this part. Financial institutions that do not share for this reason must answer “No” in the middle column and “We don’t share” in the right column. Financial institutions that do share for this reason must answer “Yes” in the middle column and “Yes (check your choices, p. 3)” corresponding to the availability of an opt-out.

(8) *Additional opt-outs.* A financial institution may customize the model form to offer opt-outs beyond those required under Federal law, so long as the additional information falls within the space constraints of the model form. If the institution chooses to offer its customers an opt-out for its own marketing or for joint marketing, for example, it can provide for that option by stating: “Yes (Check your choices, p.3)” as to the availability of the opt-out.

3. Page two.

(a) *General instructions for the Definitions.*

The financial institution must customize the space below the last three definitions in this section (affiliates, nonafffiliates, and joint marketing). This specific information must be in italicized lettering to set off the information from the standardized definitions.

(b) *Affiliates*. As required by section 332.6(a)(3) of this part, the financial institution must identify the categories of its affiliates or state "[***name of financial institution***] *has no affiliates*" in italicized lettering where [***affiliate information***] appears. A financial institution that shares with affiliates must use, as applicable, the following format: *"Our affiliates include companies with a [**name of financial institution**] name; financial companies such as [**list companies**]; and nonfinancial companies, such as [**list companies**]."*

(c) *Nonaffiliates*. If the financial institution shares with nonaffiliated third parties outside the exceptions in sections 332.14 and 332.15 of this part, the institution must identify the types of nonaffiliated third parties with which it shares or state "[***name of financial institution***] *does not share with nonaffiliates so they can market to you.*" in italicized lettering where [***nonaffiliate information***] appears. A financial institution that shares with nonaffiliated third parties as described here must use, as applicable, the following format: *"Nonaffiliates we share with can include [**list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations**]."*

(d) *Joint Marketing*. As required by section 332.13 of this part, the financial institution must identify the types of financial institutions with which it engages in joint marketing or state *"[**name of financial institution**] doesn't*

jointly market." in italicized lettering where [***joint marketing***] appears. A financial institution that shares with joint marketing partners must use, as applicable, the following format: *"Our joint marketing partners include* ***[list categories of companies such as credit card companies]****."*

4. **Page three.**

Opt-out form. Financial institutions must use page three only if they: (1) share or use information in a manner that triggers an opt-out; or (2) choose to provide an opt-out (as disclosed in the table on page 1) in addition to what is required by law. The model opt-out form must be provided on a separate page of the model form.

(a) *Contact us*. The section describes three common methods by which a consumer exercises an opt-out – by telephone, on the Web, and by mail. Financial institutions may customize this section to provide for the particular opt-out methods and options the institution provides. For example, if an institution offers opting out by telephone and the Web but not by mail, it would provide only telephone and Web information as shown in the model form in the "Contact Us" box. Only institutions that allow more than 30 days after providing the notice before sharing information may change the number of days in the lower right hand section of the box.

(b) *Check your choices*. Institutions must display the applicable opt-out options in the "Check your choices" box shown on this page. If an institution chooses not to offer an opt-out by mail, it must delete the boxes for name, address, account number, and mailing directions in the lower right-hand corner of the model form. Financial institutions that only offer one or two of the opt-out options listed on the model form must list only those options

from the model form that apply to their practices and correspond accurately to the disclosures on page one. Thus, if an institution does not share in a manner that requires an opt-out for sharing with nonaffiliates, it must not include that opt-out option on page three of the model form. Institutions requiring information from consumers on the opt-out form other than an account number should modify that designation in the "Check your choices" box. Institutions that require customers with multiple accounts to identify each account to which the opt-out should apply should modify that portion of the model form.

(c) *Section 624 opt-out*. If the financial institution's affiliates use information for marketing pursuant to section 624 of the FCRA, and the institution elects to consolidate that opt-out notice in the model form, it must include that disclosure and opt-out election as shown in the model form. Institutions that elect to limit the time for the affiliate marketing opt-out, consistent with the requirements of section 624, must adhere to the requirements of that section and the Agencies' implementing rule with respect to any subsequent notice and opt-out. Institutions that elect to limit the opt-out period must include a statement in italics, as shown on the model form, that states the period of time for which the opt-out applies.

(d) *Additional opt-outs*. A financial institution that uses the disclosure table to indicate any opt-out choices available to consumers beyond those required by Federal law must include those opt-outs on page three of the model form. For example, if the financial institution discloses in the table that it offers an opt-out for joint marketing, the institution must revise the opt-out form on

page three to reflect the availability of an opt-out, such as by adding a check-off box with the words "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution chooses to offer its customers an opt-out for its marketing, it can provide for that option in the disclosure table and on the opt-out form by adding a check-off box with the words "Do not share [or use] my personal information to market to me."

7. Amend newly redesignated Appendix B by adding a new sentence immediately after the heading:

APPENDIX B TO PART 332-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided until the date that is on or before one year following the date of final publication of this rule. * * *

* * * * *

Office of Thrift Supervision

12 CFR Chapter V

Authority and Issuance

For the reasons set forth in the joint preamble, the Office of Thrift Supervision proposes to amend part 573 of Chapter V of title 12 of the Code of Federal Regulations as follows:

PART 573—PRIVACY OF CONSUMER FINANCIAL INFORMATION

1. The authority citation for part 573 continues to read as follows:

Authority: 12 U.S.C. 1462a; 1463, 1464, 1828; 15 U.S.C. 6801 et seq.

2. Revise § 573.2 to read as follows:

§ 573.2 Model privacy form and examples.

(a) Model privacy form. Use of the model privacy form in Appendix A of this part, consistent with the instructions in Appendix A, constitutes compliance with the notice content requirements of §§ 573.6 and 573.7 of this part, although use of the model privacy form is not required.

(b) Examples. The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

3. In § 573.6, revise paragraph (f) and add paragraph (g) to read as follows:

§ 573.6 Information to be included in privacy notices.

* * * * *

(f) Model privacy form. Pursuant to §573.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

(g) Sample clauses. Sample clauses illustrating some of the notice content required by this section are included in Appendix B of this part. Use of a sample clause in a privacy notice provided on or before [DATE ONE YEAR FOLLOWING THE DATE OF PUBLICATION OF THE FINAL RULE], to the extent applicable, constitutes compliance with this part.

4. In § 573.7, add paragraph (i) to read as follows:

§ 573.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model privacy form. Pursuant to §573.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

Appendix A [Redesignated as Appendix B]

5. Redesignate Appendix A as Appendix B.

6. Add new Appendix A to read as follows:

APPENDIX A TO PART 573-MODEL PRIVACY FORM

APPENDIX A. Model Privacy Form.

A. The model privacy form.

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ▪ Social Security number and income ▪ account balances and payment history ▪ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Contact Us	Call [toll-free telephone] or go to [web address]

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

Sharing practices	
How often does [name of financial institution] notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does [name of financial institution] protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does [name of financial institution] collect my personal information?	We collect your personal information, for example, when you ▪ open an account or deposit money ▪ pay your bills or apply for a loan ▪ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ▪ affiliates' everyday business purposes—information about your creditworthiness ▪ affiliates to market to you ▪ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ▪ processing transactions, mailing, and auditing services ▪ providing information to credit bureaus ▪ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ▪ *[affiliate information]*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ▪ *[nonaffiliate information]*
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ▪ *[joint marketing]*

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FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

If you want to limit our sharing	
Contact us	By telephone: [toll-free telephone] — our menu will prompt you through your choices On the web: [web address] By mail: mark your choices below, fill in and send form to: [mailing address] **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices	
Your choices will apply to everyone on your account.	**Check any/all you want to limit:** *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.

Your name		Mail to: [mailing address]
Your address		
Account number		

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B. General Instructions

1. How the model privacy form is used.

The model form may be used, at the option of a financial institution, including a group of financial holding company affiliates that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in sections 573.6 and 573.7 of this part.

(Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act [15 U.S.C. 1681 – 1681x] (FCRA), such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

2. The contents of the model privacy form.

The model form consists of two or three pages, depending on whether a financial institution shares in a manner that requires it to provide a third page with opt-out information.

(a) *Page One*. The first page consists of the following components:

(1) The title.

(2) The key frame (Why?, What?, How?).

(3) The disclosure table ("Reasons we can share your personal information").

(4) Contact information.

(b) *Page Two*. The second page consists of the following components:

(1) The title.

(2) The Frequently Asked Questions on sharing practices.

(3) The definitions.

(c) *Page Three*. The third page consists of a financial institution's opt-out form.

3. The format of the model privacy form.

The model form is a standardized form, including page layout, page content, format, style, pagination, and shading. No other information may be included in the model form, and the model form may be modified only as described below.

(a) *Easily readable type font.* Financial institutions that use the model form must use an easily readable type font. Easily readable type font includes a minimum of 10-point font and sufficient spacing between the lines of type.

(b) *Logo.* A financial institution may include a corporate logo on any page of the notice, so long as it does not interfere with the readability of the model form or the space constraints of each page.

(c) *Page size and orientation.* Each page of the model form must be printed on one side of an 8.5 by 11 inch paper in portrait orientation.

(d) *Color.* The model form may be printed on white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color may be used to achieve visual interest, so long as the color contrast is distinctive and the color does not detract from the readability of the model form.

C. Information Required in the Model Privacy Form

The model form is a standardized form, and institutions seeking to obtain the safe harbor through use of the model form may modify the form only as described below:

1. Name of the institution or group of affiliated institutions providing the notice. Include the name of the financial institution or group of affiliated institutions providing the notice on the form wherever **[name of financial institution]** appears. Contact information, such as the institution's toll-free telephone number, Web address, or mailing address, or other contact information, should be inserted as appropriate, wherever **[toll-free telephone]** or **[web address]** or **[mailing address]** appear.

2. **Page one.**

(a) *General instructions for the disclosure table.* There are reasons for sharing or using personal information listed in the left column of the disclosure table. Each of these reasons correlates to certain legal provisions described below. In the middle column, each institution must provide a "Yes" or "No" response in each box that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. Each institution also must complete each box in the right column as to whether a consumer can limit such sharing. If an institution answers "No" to sharing for a particular reason in the middle column, it must answer "We don't share" in the corresponding right column. If an institution answers "Yes" to sharing for a particular reason in the middle column, it must, in the right column, answer either "No" if it does not offer an opt-out or "Yes (Check your choices, p.3)" if it does offer an opt-out. Except for the sixth row ("For our affiliates to market to you"), an institution must list all reasons for sharing, and complete the middle and right columns of the disclosure table.

(b) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* Because all financial institutions share information for everyday business purposes, as contemplated by sections 573.14 and 573.15 of this part, the financial institution must answer "Yes" to the sharing of such information and "No" to the availability of an opt-out.

(2) *For our marketing purposes.* The financial institution must answer "Yes" or "No" in the middle column. An institution that does not

share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction. This provision includes service providers contemplated by section 573.13 of this part.

(3) *For joint marketing with other financial companies*. As contemplated by section 573.13 of this part, the financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences*. This provision applies to sharing of certain information with an institution's affiliates, as contemplated by sections 603(d)(2)(A)(i) and (ii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason may or may not elect to provide an opt-out and must provide

the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(5) *For our affiliates' everyday business purposes – information about creditworthiness*. This provision applies to the sharing of certain information with an institution's affiliates, as contemplated by section 603(d)(2)(A)(iii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason must provide an opt-out and must provide the appropriate answer in the right column as described in paragraph C.2.(a) of this Instruction.

(6) *For our affiliates to market to you.* This provision applies to information shared among affiliates that is used by those affiliates for marketing, as contemplated by section 624 of the FCRA. Following the effective date of the rules implementing section 624, institutions that elect to incorporate this provision into the model form to satisfy their obligations under this part must include this reason for sharing as set forth in the model form in order to obtain the benefit of the safe harbor. Institutions whose affiliates receive such information and use it for marketing must answer "Yes" in the middle column, and "Yes (Check your choices, p.3)" in the right column corresponding to the availability of an opt-out. Institutions whose affiliates receive such information and do not use it for marketing may elect to include this

provision in the model form and answer "No" in the middle column and "We don't share" in the right column; however, institutions whose affiliates receive such information and do not use it for marketing are not required to use this provision. Institutions that do not have affiliates and elect to include this provision in their notice will answer "No" in the middle column and "We don't share" in the right column.

(7) *For nonaffiliates to market to you.* This provision applies to sharing under sections 573.7 and 573.10(a) of this part. Financial institutions that do not share for this reason must answer "No" in the middle column and "We don't share" in the right column. Financial institutions that do share for this reason must answer "Yes" in the middle column and "Yes (check your choices, p. 3)" corresponding to the availability of an opt-out.

(8) *Additional opt-outs.* A financial institution may customize the model form to offer opt-outs beyond those required under Federal law, so long as the additional information falls within the space constraints of the model form. If the institution chooses to offer its customers an opt-out for its own marketing or for joint marketing, for example, it can provide for that option by stating: "Yes (Check your choices, p.3)" as to the availability of the opt-out.

3. Page two.

(a) *General instructions for the Definitions.*

The financial institution must customize the space below the last three definitions in this section (affiliates, nonafffiliates, and joint marketing). This specific information must be in italicized lettering to set off the information from the standardized definitions.

(b) *Affiliates*. As required by section 573.6(a)(3) of this part, the financial institution must identify the categories of its affiliates or state "[***name of financial institution***] *has no affiliates*" in italicized lettering where [***affiliate information***] appears. A financial institution that shares with affiliates must use, as applicable, the following format: *"Our affiliates include companies with a **[name of financial institution]** name; financial companies such as **[list companies]**; and nonfinancial companies, such as **[list companies]**."*

(c) *Nonaffiliates*. If the financial institution shares with nonaffiliated third parties outside the exceptions in sections 573.14 and 573.15 of this part, the institution must identify the types of nonaffiliated third parties with which it shares or state "[***name of financial institution***] *does not share with nonaffiliates so they can market to you.*" in italicized lettering where [***nonaffiliate information***] appears. A financial institution that shares with nonaffiliated third parties as described here must use, as applicable, the following format: *"Nonaffiliates we share with can include **[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]**."*

(d) *Joint Marketing*. As required by section 573.13 of this part, the financial institution must identify the types of financial institutions with which it engages in joint marketing or state *"**[name of financial institution]** doesn't*

jointly market." in italicized lettering where [***joint marketing***] appears. A financial institution that shares with joint marketing partners must use, as applicable, the following format: *"Our joint marketing partners include* ***[list categories of companies such as credit card companies]****."*

4. **Page three.**

Opt-out form. Financial institutions must use page three only if they: (1) share or use information in a manner that triggers an opt-out; or (2) choose to provide an opt-out (as disclosed in the table on page 1) in addition to what is required by law. The model opt-out form must be provided on a separate page of the model form.

(a) *Contact us*. The section describes three common methods by which a consumer exercises an opt-out – by telephone, on the Web, and by mail. Financial institutions may customize this section to provide for the particular opt-out methods and options the institution provides. For example, if an institution offers opting out by telephone and the Web but not by mail, it would provide only telephone and Web information as shown in the model form in the "Contact Us" box. Only institutions that allow more than 30 days after providing the notice before sharing information may change the number of days in the lower right hand section of the box.

(b) *Check your choices*. Institutions must display the applicable opt-out options in the "Check your choices" box shown on this page. If an institution chooses not to offer an opt-out by mail, it must delete the boxes for name, address, account number, and mailing directions in the lower right-hand corner of the model form. Financial institutions that only offer one or two of the opt-out options listed on the model form must list only those options

from the model form that apply to their practices and correspond accurately to the disclosures on page one. Thus, if an institution does not share in a manner that requires an opt-out for sharing with nonaffiliates, it must not include that opt-out option on page three of the model form. Institutions requiring information from consumers on the opt-out form other than an account number should modify that designation in the "Check your choices" box. Institutions that require customers with multiple accounts to identify each account to which the opt-out should apply should modify that portion of the model form.

(c) *Section 624 opt-out.* If the financial institution's affiliates use information for marketing pursuant to section 624 of the FCRA, and the institution elects to consolidate that opt-out notice in the model form, it must include that disclosure and opt-out election as shown in the model form. Institutions that elect to limit the time for the affiliate marketing opt-out, consistent with the requirements of section 624, must adhere to the requirements of that section and the Agencies' implementing rule with respect to any subsequent notice and opt-out. Institutions that elect to limit the opt-out period must include a statement in italics, as shown on the model form, that states the period of time for which the opt-out applies.

(d) *Additional opt-outs.* A financial institution that uses the disclosure table to indicate any opt-out choices available to consumers beyond those required by Federal law must include those opt-outs on page three of the model form. For example, if the financial institution discloses in the table that it offers an opt-out for joint marketing, the institution must revise the opt-out form on

page three to reflect the availability of an opt-out, such as by adding a check-off box with the words "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution chooses to offer its customers an opt-out for its marketing, it can provide for that option in the disclosure table and on the opt-out form by adding a check-off box with the words "Do not share [or use] my personal information to market to me."

7. Amend newly redesignated Appendix B by adding a new sentence immediately after the heading:

APPENDIX B TO PART 573-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided until the date that is on or before one year following the date of final publication of this rule. * * *

* * * * *

National Credit Union Administration

12 CFR Chapter V

Authority and Issuance

For the reasons set forth in the joint preamble, the National Credit Union Administration proposes to amend part 716 of Chapter V of title 12 of the Code of Federal Regulations as follows:

PART 716—PRIVACY OF CONSUMER FINANCIAL INFORMATION

1. The authority citation for part 716 continues to read as follows:

Authority: 12 U.S.C.1751 et seq.; 15 U.S.C. 6801 et seq.

2. Revise § 716.2 to read as follows:

§ 716.2 Model privacy form and examples.

(a) Model privacy form. Use of the model privacy form in Appendix A of this part, consistent with the instructions in Appendix A, constitutes compliance with the notice content requirements of §§ 716.6 and 716.7 of this part, although use of the model privacy form is not required.

(b) Examples. The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

3. In § 716.6, add paragraphs (f) and (g) to read as follows:

§ 716.6 Information to be included in privacy notices.

* * * * *

(f) Model privacy form. Pursuant to §716.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

(g) Sample clauses. Sample clauses illustrating some of the notice content required by this section are included in Appendix B of this part. Use of a sample clause in a privacy notice provided on or before [DATE ONE YEAR FOLLOWING THE DATE OF PUBLICATION OF THE FINAL RULE], to the extent applicable, constitutes compliance with this part.

4. In § 716.7 add paragraph (i) to read as follows:

§ 716.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model privacy form. Pursuant to §716.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

Appendix A [Redesignated as Appendix B]

5. Redesignate Appendix A as Appendix B.

6. Add new Appendix A to read as follows:

APPENDIX A TO PART 716-MODEL PRIVACY FORM

APPENDIX A. Model Privacy Form.

A. The model privacy form.

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ■ Social Security number and income ■ account balances and payment history ■ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Contact Us	Call [toll-free telephone] or go to [web address]

FACTS **WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?**

Sharing practices	
How often does [name of financial institution] notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does [name of financial institution] protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does [name of financial institution] collect my personal information?	We collect your personal information, for example, when you ■ open an account or deposit money ■ pay your bills or apply for a loan ■ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ■ affiliates' everyday business purposes—information about your creditworthiness ■ affiliates to market to you ■ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ■ processing transactions, mailing, and auditing services ■ providing information to credit bureaus ■ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ■ *[affiliate information]*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ■ *[nonaffiliate information]*
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ■ *[joint marketing]*

FACTS	**WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?**

If you want to limit our sharing	
Contact us	**By telephone: [toll-free telephone] — our menu will prompt you through your choices** **On the web: [web address]** **By mail: mark your choices below, fill in and send form to:** **[mailing address]** **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices			
Your choices will apply to everyone on your account.	**Check any/all you want to limit:** *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Your name		**Mail to:** **[mailing address]**
	Your address		
	Account number		

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B. **General Instructions**

1. **How the model privacy form is used.**

The model form may be used, at the option of a financial institution, including a group of affiliates that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in sections 716.6 and 716.7 of this part.

(Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act [15 U.S.C. 1681 – 1681x] (FCRA), such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

2. The contents of the model privacy form.

The model form consists of two or three pages, depending on whether a financial institution shares in a manner that requires it to provide a third page with opt-out information.

(a) *Page One*. The first page consists of the following components:

(1) The title.

(2) The key frame (Why?, What?, How?).

(3) The disclosure table ("Reasons we can share your personal information").

(4) Contact information.

(b) *Page Two*. The second page consists of the following components:

(1) The title.

(2) The Frequently Asked Questions on sharing practices.

(3) The definitions.

(c) *Page Three*. The third page consists of a financial institution's opt-out form.

3. The format of the model privacy form.

The model form is a standardized form, including page layout, page content, format, style, pagination, and shading. No other information may be included in the model form, and the model form may be modified only as described below.

(a) *Easily readable type font.* Financial institutions that use the model form must use an easily readable type font. Easily readable type font includes a minimum of 10-point font and sufficient spacing between the lines of type.

(b) *Logo.* A financial institution may include a corporate logo on any page of the notice, so long as it does not interfere with the readability of the model form or the space constraints of each page.

(c) *Page size and orientation.* Each page of the model form must be printed on one side of an 8.5 by 11 inch paper in portrait orientation.

(d) *Color.* The model form may be printed on white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color may be used to achieve visual interest, so long as the color contrast is distinctive and the color does not detract from the readability of the model form.

C. Information Required in the Model Privacy Form

The model form is a standardized form, and institutions seeking to obtain the safe harbor through use of the model form may modify the form only as described below:

1. Name of the institution or group of affiliated institutions providing the notice. Include the name of the financial institution or group of affiliated institutions providing the notice on the form wherever **[name of financial institution]** appears. Contact information, such as the institution's toll-free telephone number, Web address, or mailing address, or other contact information, should be inserted as appropriate, wherever **[toll-free telephone]** or **[web address]** or **[mailing address]** appear.

2. **Page one.**

(a) *General instructions for the disclosure table.* There are reasons for sharing or using personal information listed in the left column of the disclosure table. Each of these reasons correlates to certain legal provisions described below. In the middle column, each institution must provide a "Yes" or "No" response in each box that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. Each institution also must complete each box in the right column as to whether a consumer can limit such sharing. If an institution answers "No" to sharing for a particular reason in the middle column, it must answer "We don't share" in the corresponding right column. If an institution answers "Yes" to sharing for a particular reason in the middle column, it must, in the right column, answer either "No" if it does not offer an opt-out or "Yes (Check your choices, p.3)" if it does offer an opt-out. Except for the sixth row ("For our affiliates to market to you"), an institution must list all reasons for sharing, and complete the middle and right columns of the disclosure table.

(b) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* Because all financial institutions share information for everyday business purposes, as contemplated by sections 716.14 and 716.15 of this part, the financial institution must answer "Yes" to the sharing of such information and "No" to the availability of an opt-out.

(2) *For our marketing purposes.* The financial institution must answer "Yes" or "No" in the middle column. An institution that does not

share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction. This provision includes service providers contemplated by section 716.13 of this part.

(3) *For joint marketing with other financial companies.* As contemplated by section 716.13 of this part, the financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This provision applies to sharing of certain information with an institution's affiliates, as contemplated by sections 603(d)(2)(A)(i) and (ii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason may or may not elect to provide an opt-out and must provide

the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(5) *For our affiliates' everyday business purposes – information about creditworthiness*. This provision applies to the sharing of certain information with an institution's affiliates, as contemplated by section 603(d)(2)(A)(iii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason must provide an opt-out and must provide the appropriate answer in the right column as described in paragraph C.2.(a) of this Instruction.

(6) *For our affiliates to market to you*. This provision applies to information shared among affiliates that is used by those affiliates for marketing, as contemplated by section 624 of the FCRA. Following the effective date of the rules implementing section 624, institutions that elect to incorporate this provision into the model form to satisfy their obligations under this part must include this reason for sharing as set forth in the model form in order to obtain the benefit of the safe harbor. Institutions whose affiliates receive such information and use it for marketing must answer "Yes" in the middle column, and "Yes (Check your choices, p.3)" in the right column corresponding to the availability of an opt-out. Institutions whose affiliates receive such information and do not use it for marketing may elect to include this

provision in the model form and answer "No" in the middle column and "We don't share" in the right column; however, institutions whose affiliates receive such information and do not use it for marketing are not required to use this provision. Institutions that do not have affiliates and elect to include this provision in their notice will answer "No" in the middle column and "We don't share" in the right column.

(7) *For nonaffiliates to market to you.* This provision applies to sharing under sections 716.7 and 716.10(a) of this part. Financial institutions that do not share for this reason must answer "No" in the middle column and "We don't share" in the right column. Financial institutions that do share for this reason must answer "Yes" in the middle column and "Yes (check your choices, p. 3)" corresponding to the availability of an opt-out.

(8) *Additional opt-outs.* A financial institution may customize the model form to offer opt-outs beyond those required under Federal law, so long as the additional information falls within the space constraints of the model form. If the institution chooses to offer its customers an opt-out for its own marketing or for joint marketing, for example, it can provide for that option by stating: "Yes (Check your choices, p.3)" as to the availability of the opt-out.

3. Page two.

(a) *General instructions for the Definitions.*

The financial institution must customize the space below the last three definitions in this section (affiliates, nonafffiliates, and joint marketing). This specific information must be in italicized lettering to set off the information from the standardized definitions.

(b) *Affiliates*. As required by section 716.6(a)(3) of this part, the financial institution must identify the categories of its affiliates or state "[***name of financial institution***] *has no affiliates*" in italicized lettering where [***affiliate information***] appears. A financial institution that shares with affiliates must use, as applicable, the following format: *"Our affiliates include companies with a **[name of financial institution]** name; financial companies such as **[list companies]**; and nonfinancial companies, such as **[list companies]**."*

(c) *Nonaffiliates*. If the financial institution shares with nonaffiliated third parties outside the exceptions in sections 716.14 and 716.15 of this part, the institution must identify the types of nonaffiliated third parties with which it shares or state "[***name of financial institution***] *does not share with nonaffiliates so they can market to you.*" in italicized lettering where [***nonaffiliate information***] appears. A financial institution that shares with nonaffiliated third parties as described here must use, as applicable, the following format: *"Nonaffiliates we share with can include **[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]**."*

(d) *Joint Marketing*. As required by section 716.13 of this part, the financial institution must identify the types of financial institutions with which it engages in joint marketing or state *"**[name of financial institution]** doesn't*

jointly market." in italicized lettering where [***joint marketing***] appears. A financial institution that shares with joint marketing partners must use, as applicable, the following format: *"Our joint marketing partners include* ***[list categories of companies such as credit card companies]****."*

4. **Page three.**

Opt-out form. Financial institutions must use page three only if they: (1) share or use information in a manner that triggers an opt-out; or (2) choose to provide an opt-out (as disclosed in the table on page 1) in addition to what is required by law. The model opt-out form must be provided on a separate page of the model form.

(a) *Contact us*. The section describes three common methods by which a consumer exercises an opt-out – by telephone, on the Web, and by mail. Financial institutions may customize this section to provide for the particular opt-out methods and options the institution provides. For example, if an institution offers opting out by telephone and the Web but not by mail, it would provide only telephone and Web information as shown in the model form in the "Contact Us" box. Only institutions that allow more than 30 days after providing the notice before sharing information may change the number of days in the lower right hand section of the box.

(b) *Check your choices*. Institutions must display the applicable opt-out options in the "Check your choices" box shown on this page. If an institution chooses not to offer an opt-out by mail, it must delete the boxes for name, address, account number, and mailing directions in the lower right-hand corner of the model form. Financial institutions that only offer one or two of the opt-out options listed on the model form must list only those options

from the model form that apply to their practices and correspond accurately to the disclosures on page one. Thus, if an institution does not share in a manner that requires an opt-out for sharing with nonaffiliates, it must not include that opt-out option on page three of the model form. Institutions requiring information from consumers on the opt-out form other than an account number should modify that designation in the "Check your choices" box. Institutions that require customers with multiple accounts to identify each account to which the opt-out should apply should modify that portion of the model form.

(c) *Section 624 opt-out*. If the financial institution's affiliates use information for marketing pursuant to section 624 of the FCRA, and the institution elects to consolidate that opt-out notice in the model form, it must include that disclosure and opt-out election as shown in the model form. Institutions that elect to limit the time for the affiliate marketing opt-out, consistent with the requirements of section 624, must adhere to the requirements of that section and the Agencies' implementing rule with respect to any subsequent notice and opt-out. Institutions that elect to limit the opt-out period must include a statement in italics, as shown on the model form, that states the period of time for which the opt-out applies.

(d) *Additional opt-outs*. A financial institution that uses the disclosure table to indicate any opt-out choices available to consumers beyond those required by Federal law must include those opt-outs on page three of the model form. For example, if the financial institution discloses in the table that it offers an opt-out for joint marketing, the institution must revise the opt-out form on

page three to reflect the availability of an opt-out, such as by adding a check-off box with the words "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution chooses to offer its customers an opt-out for its marketing, it can provide for that option in the disclosure table and on the opt-out form by adding a check-off box with the words "Do not share [or use] my personal information to market to me."

7. Amend newly redesignated Appendix B by adding a new sentence immediately after the heading:

APPENDIX B TO PART 716-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided until the date that is on or before one year following the date of final publication of this rule. * * *

* * * * *

Federal Trade Commission

16 CFR Chapter I

Authority and Issuance

For the reasons set forth in the joint preamble, the Federal Trade Commission proposes to amend part 313 of chapter I of title 16 of the Code of Federal Regulations as follows:

PART 313—PRIVACY OF CONSUMER FINANCIAL INFORMATION

1. The authority citation for part 313 continues to read as follows:

Authority: 15 U.S.C. 6801 et seq.

2. Revise § 313.2 to read as follows:

§ 313.2 Model privacy form and rules of construction.

(a) Model privacy form. Use of the model privacy form in Appendix A of this part, consistent with the instructions in Appendix A, constitutes compliance with the notice content requirements of §§ 313.6 and 313.7 of this part, although use of the model privacy form is not required.

(b) Examples. The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

(c) Compliance. For non-federally insured credit unions, compliance with an example contained in 12 CFR 716, to the extent applicable, constitutes compliance with this part. For intrastate securities broker-dealers and investment advisors not registered with the Securities and Exchange Commission, compliance with an example contained in 17 CFR part 248, to the extent applicable, constitutes compliance with this part.

3. In § 313.6, revise paragraph (f) and add paragraph (g) to read as follows:

§ 313.6 Information to be included in privacy notices.

* * * * *

(f) Model privacy form. Pursuant to §313.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

(g) Sample clauses. Sample clauses illustrating some of the notice content required by this section are included in Appendix B of this part. Use of a sample clause in a privacy notice provided on or before [DATE ONE YEAR FOLLOWING THE DATE OF PUBLICATION OF THE FINAL RULE], to the extent applicable, constitutes compliance with this part.

4. In § 313.7 add paragraph (i) to read as follows:

§ 313.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model privacy form. Pursuant to §313.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

Appendix A [Redesignated as Appendix B]

5. Redesignate Appendix A as Appendix B.

6. Add new Appendix A to read as follows:

APPENDIX A TO PART 313-MODEL PRIVACY FORM

APPENDIX A. Model Privacy Form.

A. The model privacy form.

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ■ Social Security number and income ■ account balances and payment history ■ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Contact Us	Call [toll-free telephone] or go to [web address]

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

Sharing practices	
How often does [name of financial institution] notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does [name of financial institution] protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does [name of financial institution] collect my personal information?	We collect your personal information, for example, when you ▪ open an account or deposit money ▪ pay your bills or apply for a loan ▪ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ▪ affiliates' everyday business purposes—information about your creditworthiness ▪ affiliates to market to you ▪ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ▪ processing transactions, mailing, and auditing services ▪ providing information to credit bureaus ▪ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ▪ *[affiliate information]*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ▪ *[nonaffiliate information]*
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ▪ *[joint marketing]*

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

If you want to limit our sharing	
Contact us	**By telephone: [toll-free telephone]** — our menu will prompt you through your choices **On the web: [web address]** **By mail:** mark your choices below, fill in and send form to: **[mailing address]** **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices			
Your choices will apply to everyone on your account.	**Check any/all you want to limit:** *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Your name		Mail to: [mailing address]
	Your address		
	Account number		

p. 3 of 3

B. General Instructions

1. How the model privacy form is used.

The model form may be used, at the option of a financial institution, including a group of financial holding company affiliates that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in sections 313.6 and 313.7 of this part.

(Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act [15 U.S.C. 1681 – 1681x] (FCRA), such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

2. The contents of the model privacy form.

The model form consists of two or three pages, depending on whether a financial institution shares in a manner that requires it to provide a third page with opt-out information.

(a) *Page One*. The first page consists of the following components:

(1) The title.

(2) The key frame (Why?, What?, How?).

(3) The disclosure table ("Reasons we can share your personal information").

(4) Contact information.

(b) *Page Two*. The second page consists of the following components:

(1) The title.

(2) The Frequently Asked Questions on sharing practices.

(3) The definitions.

(c) *Page Three*. The third page consists of a financial institution's opt-out form.

3. The format of the model privacy form.

The model form is a standardized form, including page layout, page content, format, style, pagination, and shading. No other information may be included in the model form, and the model form may be modified only as described below.

(a) *Easily readable type font.* Financial institutions that use the model form must use an easily readable type font. Easily readable type font includes a minimum of 10-point font and sufficient spacing between the lines of type.

(b) *Logo.* A financial institution may include a corporate logo on any page of the notice, so long as it does not interfere with the readability of the model form or the space constraints of each page.

(c) *Page size and orientation.* Each page of the model form must be printed on one side of an 8.5 by 11 inch paper in portrait orientation.

(d) *Color.* The model form may be printed on white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color may be used to achieve visual interest, so long as the color contrast is distinctive and the color does not detract from the readability of the model form.

C. Information Required in the Model Privacy Form

The model form is a standardized form, and institutions seeking to obtain the safe harbor through use of the model form may modify the form only as described below:

1. Name of the institution or group of affiliated institutions providing the notice. Include the name of the financial institution or group of affiliated institutions providing the notice on the form wherever **[name of financial institution]** appears. Contact information, such as the institution's toll-free telephone number, Web address, or mailing address, or other contact information, should be inserted as appropriate, wherever **[toll-free telephone]** or **[web address]** or **[mailing address]** appear.

2. **Page one.**

(a) *General instructions for the disclosure table.* There are reasons for sharing or using personal information listed in the left column of the disclosure table. Each of these reasons correlates to certain legal provisions described below. In the middle column, each institution must provide a "Yes" or "No" response in each box that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. Each institution also must complete each box in the right column as to whether a consumer can limit such sharing. If an institution answers "No" to sharing for a particular reason in the middle column, it must answer "We don't share" in the corresponding right column. If an institution answers "Yes" to sharing for a particular reason in the middle column, it must, in the right column, answer either "No" if it does not offer an opt-out or "Yes (Check your choices, p.3)" if it does offer an opt-out. Except for the sixth row ("For our affiliates to market to you"), an institution must list all reasons for sharing, and complete the middle and right columns of the disclosure table.

(b) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* Because all financial institutions share information for everyday business purposes, as contemplated by sections 313.14 and 313.15 of this part, the financial institution must answer "Yes" to the sharing of such information and "No" to the availability of an opt-out.

(2) *For our marketing purposes.* The financial institution must answer "Yes" or "No" in the middle column. An institution that does not

share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction. This provision includes service providers contemplated by section 313.13 of this part.

(3) *For joint marketing with other financial companies.* As contemplated by section 313.13 of this part, the financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This provision applies to sharing of certain information with an institution's affiliates, as contemplated by sections 603(d)(2)(A)(i) and (ii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason may or may not elect to provide an opt-out and must provide

the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(5) *For our affiliates' everyday business purposes – information about creditworthiness*. This provision applies to the sharing of certain information with an institution's affiliates, as contemplated by section 603(d)(2)(A)(iii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason must provide an opt-out and must provide the appropriate answer in the right column as described in paragraph C.2.(a) of this Instruction.

(6) *For our affiliates to market to you*. This provision applies to information shared among affiliates that is used by those affiliates for marketing, as contemplated by section 624 of the FCRA. Following the effective date of the rules implementing section 624, institutions that elect to incorporate this provision into the model form to satisfy their obligations under this part must include this reason for sharing as set forth in the model form in order to obtain the benefit of the safe harbor. Institutions whose affiliates receive such information and use it for marketing must answer "Yes" in the middle column, and "Yes (Check your choices, p.3)" in the right column corresponding to the availability of an opt-out. Institutions whose affiliates receive such information and do not use it for marketing may elect to include this

provision in the model form and answer "No" in the middle column and "We don't share" in the right column; however, institutions whose affiliates receive such information and do not use it for marketing are not required to use this provision. Institutions that do not have affiliates and elect to include this provision in their notice will answer "No" in the middle column and "We don't share" in the right column.

(7) *For nonaffiliates to market to you.* This provision applies to sharing under sections 313.7 and 313.10(a) of this part. Financial institutions that do not share for this reason must answer "No" in the middle column and "We don't share" in the right column. Financial institutions that do share for this reason must answer "Yes" in the middle column and "Yes (check your choices, p. 3)" corresponding to the availability of an opt-out.

(8) *Additional opt-outs.* A financial institution may customize the model form to offer opt-outs beyond those required under Federal law, so long as the additional information falls within the space constraints of the model form. If the institution chooses to offer its customers an opt-out for its own marketing or for joint marketing, for example, it can provide for that option by stating: "Yes (Check your choices, p.3)" as to the availability of the opt-out.

3. Page two.

(a) *General instructions for the Definitions.*

The financial institution must customize the space below the last three definitions in this section (affiliates, nonafffiliates, and joint marketing). This specific information must be in italicized lettering to set off the information from the standardized definitions.

(b) *Affiliates*. As required by section 313.6(a)(3) of this part, the financial institution must identify the categories of its affiliates or state "[***name of financial institution***] *has no affiliates*" in italicized lettering where [***affiliate information***] appears. A financial institution that shares with affiliates must use, as applicable, the following format: *"Our affiliates include companies with a [**name of financial institution**] name; financial companies such as [**list companies**]; and nonfinancial companies, such as [**list companies**]."*

(c) *Nonaffiliates*. If the financial institution shares with nonaffiliated third parties outside the exceptions in sections 313.14 and 313.15 of this part, the institution must identify the types of nonaffiliated third parties with which it shares or state "[***name of financial institution***] *does not share with nonaffiliates so they can market to you.*" in italicized lettering where [***nonaffiliate information***] appears. A financial institution that shares with nonaffiliated third parties as described here must use, as applicable, the following format: *"Nonaffiliates we share with can include [**list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations**]."*

(d) *Joint Marketing*. As required by section 313.13 of this part, the financial institution must identify the types of financial institutions with which it engages in joint marketing or state *"[**name of financial institution**] doesn't*

jointly market." in italicized lettering where [***joint marketing***] appears. A financial institution that shares with joint marketing partners must use, as applicable, the following format: *"Our joint marketing partners include **[list categories of companies such as credit card companies]**."*

4. **Page three.**

Opt-out form. Financial institutions must use page three <u>only</u> if they: (1) share or use information in a manner that triggers an opt-out; or (2) choose to provide an opt-out (as disclosed in the table on page 1) in addition to what is required by law. The model opt-out form must be provided on a separate page of the model form.

(a) *Contact us*. The section describes three common methods by which a consumer exercises an opt-out – by telephone, on the Web, and by mail. Financial institutions may customize this section to provide for the particular opt-out methods and options the institution provides. For example, if an institution offers opting out by telephone and the Web but not by mail, it would provide only telephone and Web information as shown in the model form in the "Contact Us" box. Only institutions that allow more than 30 days after providing the notice before sharing information may change the number of days in the lower right hand section of the box.

(b) *Check your choices*. Institutions must display the applicable opt-out options in the "Check your choices" box shown on this page. If an institution chooses not to offer an opt-out by mail, it must delete the boxes for name, address, account number, and mailing directions in the lower right-hand corner of the model form. Financial institutions that only offer one or two of the opt-out options listed on the model form must list only those options

from the model form that apply to their practices and correspond accurately to the disclosures on page one. Thus, if an institution does not share in a manner that requires an opt-out for sharing with nonaffiliates, it must not include that opt-out option on page three of the model form. Institutions requiring information from consumers on the opt-out form other than an account number should modify that designation in the "Check your choices" box. Institutions that require customers with multiple accounts to identify each account to which the opt-out should apply should modify that portion of the model form.

(c) *Section 624 opt-out.* If the financial institution's affiliates use information for marketing pursuant to section 624 of the FCRA, and the institution elects to consolidate that opt-out notice in the model form, it must include that disclosure and opt-out election as shown in the model form. Institutions that elect to limit the time for the affiliate marketing opt-out, consistent with the requirements of section 624, must adhere to the requirements of that section and the Agencies' implementing rule with respect to any subsequent notice and opt-out. Institutions that elect to limit the opt-out period must include a statement in italics, as shown on the model form, that states the period of time for which the opt-out applies.

(d) *Additional opt-outs.* A financial institution that uses the disclosure table to indicate any opt-out choices available to consumers beyond those required by Federal law must include those opt-outs on page three of the model form. For example, if the financial institution discloses in the table that it offers an opt-out for joint marketing, the institution must revise the opt-out form on

page three to reflect the availability of an opt-out, such as by adding a check-off box with the words "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution chooses to offer its customers an opt-out for its marketing, it can provide for that option in the disclosure table and on the opt-out form by adding a check-off box with the words "Do not share [or use] my personal information to market to me."

7. Amend newly redesignated Appendix B by adding a new sentence immediately after the heading:

APPENDIX B TO PART 313-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided until the date that is on or before one year following the date of final publication of this rule. * * *

* * * * *

Commodity Futures Trading Commission

17 CFR Chapter I

Authority and Issuance

For the reasons set forth in the joint preamble, the Commodity Futures Trading Commission proposes to amend part 160 of chapter I of title 17 of the Code of Federal Regulations as follows:

PART 160—PRIVACY OF CONSUMER FINANCIAL INFORMATION

1. The authority citation for part 160 continues to read as follows:

Authority: 7 U.S.C. 7b-2 and 12a(5); 15 U.S.C. 6801 et seq.

2. Revise § 160.2 to read as follows:

§ 160.2 Model privacy form and rules of construction.

(a) Model privacy form. Use of the model privacy form in Appendix A of this part, consistent with the instructions in Appendix A, constitutes compliance with the notice content requirements of §§ 160.6 and 160.7 of this part, although use of the model privacy form is not required.

(b) Examples. The examples in this part are not exclusive. Compliance with an example, to the extent applicable, constitutes compliance with this part.

(c) Substituted compliance.

(1) Any person or entity otherwise subject to this part that is subject to and in compliance with the Securities and Exchange Commission Regulation S-P, 17 CFR part 248, will be deemed to be in compliance with this part.

(2) Any commodity trading advisor otherwise subject to this part that is registered or required to be registered as an investment adviser in the state in which it maintains its principal

office and place of business as defined in §275.203A-3 of this title, and that is subject to and in compliance with 16 CFR part 313, will be deemed to be in compliance with this part.

3. In § 160.6, revise paragraph (f) and add paragraph (g) to read as follows:

§ 160.6 Information to be included in privacy notices.

* * * * *

(f) Model privacy form. Pursuant to §160.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

(g) Sample clauses. Sample clauses illustrating some of the notice content required by this section are included in Appendix B of this part. Use of a sample clause in a privacy notice provided on or before [DATE ONE YEAR FOLLOWING THE DATE OF PUBLICATION OF THE FINAL RULE], to the extent applicable, constitutes compliance with this part.

4. In § 160.7 add paragraph (i) to read as follows:

§ 160.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model privacy form. Pursuant to §160.2(a) of this part, a model privacy form that meets the notice content requirements of this section is included in Appendix A of this part.

Appendix A [Redesignated as Appendix B]

5. Redesignate Appendix A as Appendix B.

6. Add new Appendix A to read as follows:

APPENDIX A TO PART 160-MODEL PRIVACY FORM

APPENDIX A. Model Privacy Form.

A. The model privacy form.

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ■ Social Security number and income ■ account balances and payment history ■ credit history and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Contact Us	Call [toll-free telephone] or go to [web address]

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

Sharing practices	
How often does [name of financial institution] notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does [name of financial institution] protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does [name of financial institution] collect my personal information?	We collect your personal information, for example, when you ■ open an account or deposit money ■ pay your bills or apply for a loan ■ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ■ affiliates' everyday business purposes—information about your creditworthiness ■ affiliates to market to you ■ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ■ processing transactions, mailing, and auditing services ■ providing information to credit bureaus ■ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ■ *[affiliate information]*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ■ *[nonaffiliate information]*
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ■ *[joint marketing]*

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
If you want to limit our sharing	
Contact us	By telephone: [toll-free telephone] — our menu will prompt you through your choices On the web: [web address] By mail: mark your choices below, fill in and send form to: [mailing address] **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices			
Your choices will apply to everyone on your account.	**Check any/all you want to limit:** *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Your name		Mail to: [mailing address]
	Your address		
	Account number		

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B. General Instructions

1. How the model privacy form is used.

The model form may be used, at the option of a financial institution, including a group of financial holding company affiliates that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in sections 160.6 and 160.7 of this part.

(Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act [15 U.S.C. 1681 – 1681x] (FCRA), such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

2. The contents of the model privacy form.

The model form consists of two or three pages, depending on whether a financial institution shares in a manner that requires it to provide a third page with opt-out information.

(a) *Page One*. The first page consists of the following components:

(1) The title.

(2) The key frame (Why?, What?, How?).

(3) The disclosure table ("Reasons we can share your personal information").

(4) Contact information.

(b) *Page Two*. The second page consists of the following components:

(1) The title.

(2) The Frequently Asked Questions on sharing practices.

(3) The definitions.

(c) *Page Three*. The third page consists of a financial institution's opt-out form.

3. The format of the model privacy form.

The model form is a standardized form, including page layout, page content, format, style, pagination, and shading. No other information may be included in the model form, and the model form may be modified only as described below.

(a) *Easily readable type font.* Financial institutions that use the model form must use an easily readable type font. Easily readable type font includes a minimum of 10-point font and sufficient spacing between the lines of type.

(b) *Logo.* A financial institution may include a corporate logo on any page of the notice, so long as it does not interfere with the readability of the model form or the space constraints of each page.

(c) *Page size and orientation.* Each page of the model form must be printed on one side of an 8.5 by 11 inch paper in portrait orientation.

(d) *Color.* The model form may be printed on white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color may be used to achieve visual interest, so long as the color contrast is distinctive and the color does not detract from the readability of the model form.

C. Information Required in the Model Privacy Form

The model form is a standardized form, and institutions seeking to obtain the safe harbor through use of the model form may modify the form only as described below:

1. Name of the institution or group of affiliated institutions providing the notice. Include the name of the financial institution or group of affiliated institutions providing the notice on the form wherever **[name of financial institution]** appears. Contact information, such as the institution's toll-free telephone number, Web address, or mailing address, or other contact information, should be inserted as appropriate, wherever **[toll-free telephone]** or **[web address]** or **[mailing address]** appear.

2. **Page one.**

(a) *General instructions for the disclosure table.* There are reasons for sharing or using personal information listed in the left column of the disclosure table. Each of these reasons correlates to certain legal provisions described below. In the middle column, each institution must provide a "Yes" or "No" response in each box that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. Each institution also must complete each box in the right column as to whether a consumer can limit such sharing. If an institution answers "No" to sharing for a particular reason in the middle column, it must answer "We don't share" in the corresponding right column. If an institution answers "Yes" to sharing for a particular reason in the middle column, it must, in the right column, answer either "No" if it does not offer an opt-out or "Yes (Check your choices, p.3)" if it does offer an opt-out. Except for the sixth row ("For our affiliates to market to you"), an institution must list all reasons for sharing, and complete the middle and right columns of the disclosure table.

(b) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* Because all financial institutions share information for everyday business purposes, as contemplated by sections 160.14 and 160.15 of this part, the financial institution must answer "Yes" to the sharing of such information and "No" to the availability of an opt-out.

(2) *For our marketing purposes.* The financial institution must answer "Yes" or "No" in the middle column. An institution that does not

share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction. This provision includes service providers contemplated by section 160.13 of this part.

(3) *For joint marketing with other financial companies*. As contemplated by section 160.13 of this part, the financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences*. This provision applies to sharing of certain information with an institution's affiliates, as contemplated by sections 603(d)(2)(A)(i) and (ii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason may or may not elect to provide an opt-out and must provide

the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(5) *For our affiliates' everyday business purposes – information about creditworthiness*. This provision applies to the sharing of certain information with an institution's affiliates, as contemplated by section 603(d)(2)(A)(iii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason must provide an opt-out and must provide the appropriate answer in the right column as described in paragraph C.2.(a) of this Instruction.

(6) *For our affiliates to market to you*. This provision applies to information shared among affiliates that is used by those affiliates for marketing, as contemplated by section 624 of the FCRA. Following the effective date of the rules implementing section 624, institutions that elect to incorporate this provision into the model form to satisfy their obligations under this part must include this reason for sharing as set forth in the model form in order to obtain the benefit of the safe harbor. Institutions whose affiliates receive such information and use it for marketing must answer "Yes" in the middle column, and "Yes (Check your choices, p.3)" in the right column corresponding to the availability of an opt-out. Institutions whose affiliates receive such information and do not use it for marketing may elect to include this

provision in the model form and answer “No” in the middle column and “We don’t share” in the right column; however, institutions whose affiliates receive such information and do not use it for marketing are not required to use this provision. Institutions that do not have affiliates and elect to include this provision in their notice will answer “No” in the middle column and “We don’t share” in the right column.

(7) *For nonaffiliates to market to you.* This provision applies to sharing under sections 160.7 and 160.10(a) of this part. Financial institutions that do not share for this reason must answer “No” in the middle column and “We don’t share” in the right column. Financial institutions that do share for this reason must answer “Yes” in the middle column and “Yes (check your choices, p. 3)” corresponding to the availability of an opt-out.

(8) *Additional opt-outs.* A financial institution may customize the model form to offer opt-outs beyond those required under Federal law, so long as the additional information falls within the space constraints of the model form. If the institution chooses to offer its customers an opt-out for its own marketing or for joint marketing, for example, it can provide for that option by stating: “Yes (Check your choices, p.3)” as to the availability of the opt-out.

3. Page two.

(a) *General instructions for the Definitions.*

The financial institution must customize the space below the last three definitions in this section (affiliates, nonafffiliates, and joint marketing). This specific information must be in italicized lettering to set off the information from the standardized definitions.

(b) *Affiliates.* As required by section 160.6(a)(3) of this part, the financial institution must identify the categories of its affiliates or state "[***name of financial institution***] *has no affiliates*" in italicized lettering where [***affiliate information***] appears. A financial institution that shares with affiliates must use, as applicable, the following format: *"Our affiliates include companies with a [**name of financial institution**] name; financial companies such as [**list companies**]; and nonfinancial companies, such as [**list companies**]."*

(c) *Nonaffiliates.* If the financial institution shares with nonaffiliated third parties outside the exceptions in sections 160.14 and 160.15 of this part, the institution must identify the types of nonaffiliated third parties with which it shares or state "[***name of financial institution***] *does not share with nonaffiliates so they can market to you.*" in italicized lettering where [***nonaffiliate information***] appears. A financial institution that shares with nonaffiliated third parties as described here must use, as applicable, the following format: *"Nonaffiliates we share with can include [**list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations**]."*

(d) *Joint Marketing.* As required by section 160.13 of this part, the financial institution must identify the types of financial institutions with which it engages in joint marketing or state *"[**name of financial institution**] doesn't*

jointly market." in italicized lettering where [***joint marketing***] appears. A financial institution that shares with joint marketing partners must use, as applicable, the following format: *"Our joint marketing partners include* ***[list categories of companies such as credit card companies]****."*

4. Page three.

Opt-out form. Financial institutions must use page three only if they: (1) share or use information in a manner that triggers an opt-out; or (2) choose to provide an opt-out (as disclosed in the table on page 1) in addition to what is required by law. The model opt-out form must be provided on a separate page of the model form.

(a) *Contact us*. The section describes three common methods by which a consumer exercises an opt-out – by telephone, on the Web, and by mail. Financial institutions may customize this section to provide for the particular opt-out methods and options the institution provides. For example, if an institution offers opting out by telephone and the Web but not by mail, it would provide only telephone and Web information as shown in the model form in the "Contact Us" box. Only institutions that allow more than 30 days after providing the notice before sharing information may change the number of days in the lower right hand section of the box.

(b) *Check your choices*. Institutions must display the applicable opt-out options in the "Check your choices" box shown on this page. If an institution chooses not to offer an opt-out by mail, it must delete the boxes for name, address, account number, and mailing directions in the lower right-hand corner of the model form. Financial institutions that only offer one or two of the opt-out options listed on the model form must list only those options

from the model form that apply to their practices and correspond accurately to the disclosures on page one. Thus, if an institution does not share in a manner that requires an opt-out for sharing with nonaffiliates, it must not include that opt-out option on page three of the model form. Institutions requiring information from consumers on the opt-out form other than an account number should modify that designation in the "Check your choices" box. Institutions that require customers with multiple accounts to identify each account to which the opt-out should apply should modify that portion of the model form.

(c) *Section 624 opt-out*. If the financial institution's affiliates use information for marketing pursuant to section 624 of the FCRA, and the institution elects to consolidate that opt-out notice in the model form, it must include that disclosure and opt-out election as shown in the model form. Institutions that elect to limit the time for the affiliate marketing opt-out, consistent with the requirements of section 624, must adhere to the requirements of that section and the Agencies' implementing rule with respect to any subsequent notice and opt-out. Institutions that elect to limit the opt-out period must include a statement in italics, as shown on the model form, that states the period of time for which the opt-out applies.

(d) *Additional opt-outs*. A financial institution that uses the disclosure table to indicate any opt-out choices available to consumers beyond those required by Federal law must include those opt-outs on page three of the model form. For example, if the financial institution discloses in the table that it offers an opt-out for joint marketing, the institution must revise the opt-out form on

page three to reflect the availability of an opt-out, such as by adding a check-off box with the words "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution chooses to offer its customers an opt-out for its marketing, it can provide for that option in the disclosure table and on the opt-out form by adding a check-off box with the words "Do not share [or use] my personal information to market to me."

7. Amend newly redesignated Appendix B by adding a new sentence immediately after the heading:

APPENDIX B TO PART 160-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided until the date that is on or before one year following the date of final publication of this rule. * * *

* * * * *

SECURITIES AND EXCHANGE COMMISSION

Statutory Authority

The Commission is proposing to amend Regulation S-P pursuant to authority set forth in section 728 of the Regulatory Relief Act [Pub.L. 109-351], section 504 of the GLB Act [15 U.S.C. 6804], section 23 of the Securities Exchange Act [15 U.S.C. 78w], section 38(a) of the Investment Company Act [15 U.S.C. 80a-37(a)], and section 211 of the Investment Advisers Act [15 U.S.C. 80b-11].

Text of Proposed Amendments

For the reasons set forth in the preamble, the Commission proposes to amend Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 248—REGULATION S-P: PRIVACY OF CONSUMER FINANCIAL INFORMATION

1. Revise the authority citation for part 248 to read as follows:

Authority: 15 U.S.C. 78q; 78w; 78mm; 80a-30(a); 80a-37; 80b-4; 80b-11; 1681w; and 6801-6809.

2. Revise § 248.2 to read as follows:

§ 248.2 Model privacy form; rule of construction.

(a) Model privacy form. Use of Form S-P (see Appendix A of this part), consistent with the instructions to the form, constitutes compliance with the notice content requirements of §§ 248.6 and 248.7 of this part, although use of Form S-P is not required.

(b) Examples. The examples in this part provide guidance concerning the rule's application in ordinary circumstances. The facts and circumstances of each individual situation, however, will determine whether compliance with an example, to the extent practicable, constitutes compliance with this part.

(c) Substituted compliance with CFTC financial privacy rules by futures commission merchants and introducing brokers. Except with respect to § 248.30(b), any futures commission merchant or introducing broker (as those terms are defined in the Commodity Exchange Act (7 U.S.C. 1, et seq.)) registered by notice with the Commission for the purpose of conducting business in security futures products pursuant to section 15(b)(11)(A) of the Securities Exchange Act of 1934 (15 U.S.C. 78o(b)(11)(A)) that is subject to and in compliance with the financial privacy rules of the Commodity Futures Trading Commission (17 CFR part 160) will be deemed to be in compliance with this part.

* * * * *

3. Amend § 248.6 by revising paragraph (f) and adding paragraph (g) to read as follows:

§ 248.6 Information to be included in privacy notices.

* * * * *

(f) Model Form S-P. Pursuant to § 248.2(a) and Appendix A of this part, Form S-P meets the notice content requirements of this section.

(g) Sample clauses. Sample clauses illustrating some of the notice content required by this section are included in Appendix B of this part. The sample clauses in Appendix B of this part provide guidance concerning the rule's application in ordinary circumstances in a privacy notice provided on or before [ONE YEAR FOLLOWING THE DATE OF PUBLICATION OF THE FINAL RULE]. The facts and circumstances of each individual situation, however, will determine whether compliance with a sample clause constitutes compliance with this part.

4. Amend § 248.7 by adding paragraph (i) to read as follows:

§ 248.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model Form S-P. Pursuant to § 248.2(a) and Appendix A of this part, Form S-P meets the notice content requirements of this section.

Appendix A [Redesignated as Appendix B]

5. Redesignate Appendix A to Part 248 as Appendix B.

6. Add new Appendix A to read as follows:

APPENDIX A TO PART 248 – FORM S-P

(1) Any person may obtain a copy of Form S-P prescribed for use in this part by written request to the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. Any person also may view this form at: [Web site URL].

(2) Use of Form S-P by brokers, dealers, and investment companies, and investment advisers registered with the Commission constitutes compliance with the notice content requirements of §§ 248.6 and 248.7 of this part.

7. Form S-P (referenced in Appendix A of this part) is added to read as follows:

Note: The text of Form S-P does not, and this amendment will not, appear in the Code of Federal Regulations.

Securities and Exchange Commission
Form S-P

A. Model Privacy Form

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?
Why?	Financial companies choose how they share your personal information. Federal law gives consumers the right to limit some but not all sharing. Federal law also requires us to tell you how we collect, share, and protect your personal information. Please read this notice carefully to understand what we do.
What?	The types of personal information we collect and share depend on the product or service you have with us. This information can include: ■ Social Security number and income ■ account balances and transaction history ■ assets, investment experience, credit history, and credit scores When you close your account, we continue to share information about you according to our policies.
How?	All financial companies need to share customers' personal information to run their everyday business—to process transactions, maintain customer accounts, and report to credit bureaus. In the section below, we list the reasons financial companies can share their customers' personal information; the reasons [name of financial institution] chooses to share; and whether you can limit this sharing.

Reasons we can share your personal information	Does [name of financial institution] share?	Can you limit this sharing?
For our everyday business purposes— to process your transactions, maintain your account, and report to credit bureaus		
For our marketing purposes— to offer our products and services to you		
For joint marketing with other financial companies		
For our affiliates' everyday business purposes— information about your transactions and experiences		
For our affiliates' everyday business purposes— information about your creditworthiness		
For our affiliates to market to you		
For nonaffiliates to market to you		

Contact Us	Call [toll-free telephone] or go to [web address]

FACTS	WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?

Sharing practices	
How often does [name of financial institution] notify me about their practices?	We must notify you about our sharing practices when you open an account and each year while you are a customer.
How does [name of financial institution] protect my personal information?	To protect your personal information from unauthorized access and use, we use security measures that comply with federal law. These measures include computer safeguards and secured files and buildings.
How does [name of financial institution] collect my personal information?	We collect your personal information, for example, when you ▪ open an account or deposit money ▪ buy or sell securities, pay your bills, or apply for a loan ▪ use your credit or debit card We also collect your personal information from others, such as credit bureaus, affiliates, or other companies.
Why can't I limit all sharing?	Federal law gives you the right to limit sharing only for ▪ affiliates' everyday business purposes—information about your creditworthiness ▪ affiliates to market to you ▪ nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing.

Definitions	
Everyday business purposes	The actions necessary by financial companies to run their business and manage customer accounts, such as ▪ processing transactions, mailing, and auditing services ▪ providing information to credit bureaus ▪ responding to court orders and legal investigations
Affiliates	Companies related by common ownership or control. They can be financial and nonfinancial companies. ▪ *[affiliate information]*
Nonaffiliates	Companies not related by common ownership or control. They can be financial and nonfinancial companies. ▪ *[nonaffiliate information]*
Joint marketing	A formal agreement between nonaffiliated financial companies that together market financial products or services to you. ▪ *[joint marketing]*

F A C T S	**WHAT DOES [name of financial institution] DO WITH YOUR PERSONAL INFORMATION?**
If you want to limit our sharing	
Contact us	**By telephone: [toll-free telephone]** — our menu will prompt you through your choices **On the web: [web address]** **By mail:** mark your choices below, fill in and send form to: **[mailing address]** **Unless we hear from you, we can begin sharing your information 30 days from the date of this letter. However, you can contact us at any time to limit our sharing.**

Check your choices			
Your choices will apply to everyone on your account.	**Check any/all you want to limit:** *(See page 1)* ☐ Do not share information about my creditworthiness with your affiliates for their everyday business purposes. ☐ Do not allow your affiliates to use my personal information to market to me. *(I will receive a renewal notice for this use for marketing in 5 years.)* ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Your name		**Mail to:** **[mailing address]**
	Your address		
	Account number		

B. General Instructions

1. How the model privacy form is used.

The model form may be used, at the option of a financial institution, including a group of financial holding company affiliates that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in sections 248.6 and 248.7 of this part.

(Note that disclosure of certain information, such as assets, income, and information from a consumer reporting agency, may give rise to obligations under the Fair Credit Reporting Act [15 U.S.C. 1681 – 1681x] (FCRA), such as a requirement to permit a consumer to opt out of disclosures to affiliates or designation as a consumer reporting agency if disclosures are made to nonaffiliated third parties.)

2. The contents of the model privacy form.

The model form consists of two or three pages, depending on whether a financial institution shares in a manner that requires it to provide a third page with opt-out information.

(a) *Page One*. The first page consists of the following components:

(1) The title.

(2) The key frame (Why?, What?, How?).

(3) The disclosure table ("Reasons we can share your personal information").

(4) Contact information.

(b) *Page Two*. The second page consists of the following components:

(1) The title.

(2) The Frequently Asked Questions on sharing practices.

(3) The definitions.

(c) *Page Three*. The third page consists of a financial institution's opt-out form.

3. The format of the model privacy form.

The model form is a standardized form, including page layout, page content, format, style, pagination, and shading. No other information may be included in the model form, and the model form may be modified only as described below.

(a) *Easily readable type font.* Financial institutions that use the model form must use an easily readable type font. Easily readable type font includes a minimum of 10-point font and sufficient spacing between the lines of type.

(b) *Logo.* A financial institution may include a corporate logo on any page of the notice, so long as it does not interfere with the readability of the model form or the space constraints of each page.

(c) *Page size and orientation.* Each page of the model form must be printed on one side of an 8.5 by 11 inch paper in portrait orientation.

(d) *Color.* The model form may be printed on white or light color paper (such as cream) with black or suitable contrasting color ink. Spot color may be used to achieve visual interest, so long as the color contrast is distinctive and the color does not detract from the readability of the model form.

C. Information Required in the Model Privacy Form

The model form is a standardized form, and institutions seeking to obtain the safe harbor through use of the model form may modify the form only as described below:

1. **Name of the institution or group of affiliated institutions providing the notice.** Include the name of the financial institution or group of affiliated institutions providing the notice on the form wherever **[name of financial institution]** appears. Contact information, such as the institution's toll-free telephone number, Web address, or mailing address, or other contact information, should be inserted as appropriate, wherever **[toll-free telephone]** or **[web address]** or **[mailing address]** appear.

2. **Page one.**

(a) *General instructions for the disclosure table.* There are reasons for sharing or using personal information listed in the left column of the disclosure table. Each of these reasons correlates to certain legal provisions described below. In the middle column, each institution must provide a "Yes" or "No" response in each box that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. Each institution also must complete each box in the right column as to whether a consumer can limit such sharing. If an institution answers "No" to sharing for a particular reason in the middle column, it must answer "We don't share" in the corresponding right column. If an institution answers "Yes" to sharing for a particular reason in the middle column, it must, in the right column, answer either "No" if it does not offer an opt-out or "Yes (Check your choices, p.3)" if it does offer an opt-out. Except for the sixth row ("For our affiliates to market to you"), an institution must list all reasons for sharing, and complete the middle and right columns of the disclosure table.

(b) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* Because all financial institutions share information for everyday business purposes, as contemplated by sections 248.14 and 248.15 of this part, the financial institution must answer "Yes" to the sharing of such information and "No" to the availability of an opt-out.

(2) *For our marketing purposes.* The financial institution must answer "Yes" or "No" in the middle column. An institution that does not

share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction. This provision includes service providers contemplated by section 248.13 of this part.

(3) *For joint marketing with other financial companies.* As contemplated by section 248.13 of this part, the financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that shares for this reason may or may not elect to provide an opt-out and must provide the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This provision applies to sharing of certain information with an institution's affiliates, as contemplated by sections 603(d)(2)(A)(i) and (ii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason may or may not elect to provide an opt-out and must provide

the corresponding answer in the right column as described in paragraph C.2.(a) of this Instruction.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This provision applies to the sharing of certain information with an institution's affiliates, as contemplated by section 603(d)(2)(A)(iii) of the FCRA. The financial institution must answer "Yes" or "No" in the middle column. An institution that does not share for this reason must answer "We don't share" in the right column. An institution that does not have any affiliates will also use this answer. Institutions that share for this reason must provide an opt-out and must provide the appropriate answer in the right column as described in paragraph C.2.(a) of this Instruction.

(6) *For our affiliates to market to you.* This provision applies to information shared among affiliates that is used by those affiliates for marketing, as contemplated by section 624 of the FCRA. Following the effective date of the rules implementing section 624, institutions that elect to incorporate this provision into the notice required under this part must include this reason for sharing as set forth in the model form. Institutions whose affiliates receive such information and use it for marketing must answer "Yes" in the middle column, and "Yes (Check your choices, p.3)" in the right column corresponding to the availability of an opt-out. Institutions whose affiliates receive such information and do not use it for marketing may elect to include this provision in the model form and answer "No" in the middle column

and "We don't share" in the right column; however, institutions whose affiliates receive such information and do not use it for marketing are not required to use this provision. Institutions that do not have affiliates and elect to include this provision in their notice will answer "No" in the middle column and "We don't share" in the right column.

(7) *For nonaffiliates to market to you.* This provision applies to sharing under sections 248.7 and 248.10(a) of this part. Financial institutions that do not share for this reason must answer "No" in the middle column and "We don't share" in the right column. Financial institutions that do share for this reason must answer "Yes" in the middle column and "Yes (check your choices, p. 3)" corresponding to the availability of an opt-out.

(8) *Additional opt-outs.* A financial institution may customize the model form to offer opt-outs beyond those required under Federal law, so long as the additional information falls within the space constraints of the model form. If the institution chooses to offer its customers an opt-out for its own marketing or for joint marketing, for example, it can provide for that option by stating: "Yes (Check your choices, p.3)" as to the availability of the opt-out.

3. Page two.

(a) *General instructions for the Definitions.*

The financial institution must customize the space below the last three definitions in this section (affiliates, nonafffiliates, and joint marketing).

This specific information must be in italicized lettering to set off the information from the standardized definitions.

(b) *Affiliates*. As required by section 248.6(a)(3) of this part, the financial institution must identify the categories of its affiliates or state "[***name of financial institution***] *has no affiliates*" in italicized lettering where [***affiliate information***] appears. A financial institution that shares with affiliates must use, as applicable, the following format: *"Our affiliates include companies with a [**name of financial institution**] name; financial companies such as [**list companies**]; and nonfinancial companies, such as [**list companies**]."*

(c) *Nonaffiliates*. If the financial institution shares with nonaffiliated third parties outside the exceptions in sections 248.14 and 248.15 of this part, the institution must identify the types of nonaffiliated third parties with which it shares or state "[***name of financial institution***] *does not share with nonaffiliates so they can market to you.*" in italicized lettering where [***nonaffiliate information***] appears. A financial institution that shares with nonaffiliated third parties as described here must use, as applicable, the following format: *"Nonaffiliates we share with can include [**list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations**]."*

(d) *Joint Marketing*. As required by section 248.13 of this part, the financial institution must identify the types of financial institutions with which it engages in joint marketing or state *"[**name of financial institution**] doesn't jointly market."* in italicized lettering where [***joint marketing***] appears. A financial institution that shares with joint marketing partners must use, as applicable, the following format: *"Our joint marketing partners include **[list categories of companies such as credit card companies]**."*

4. **Page three.**

Opt-out form. Financial institutions must use page three <u>only</u> if they: (1) share or use information in a manner that triggers an opt-out; or (2) choose to provide an opt-out (as disclosed in the table on page 1) in addition to what is required by law. The model opt-out form must be provided on a separate page of the model form.

(a) *Contact us.* The section describes three common methods by which a consumer exercises an opt-out – by telephone, on the Web, and by mail. Financial institutions may customize this section to provide for the particular opt-out methods and options the institution provides. For example, if an institution offers opting out by telephone and the Web but not by mail, it would provide only telephone and Web information as shown in the model form in the "Contact Us" box. Only institutions that allow more than 30 days after providing the notice before sharing information may change the number of days in the lower right hand section of the box.

(b) *Check your choices.* Institutions must display the applicable opt-out options in the "Check your choices" box shown on this page. If an institution chooses not to offer an opt-out by mail, it must delete the boxes for name, address, account number, and mailing directions in the lower right-hand corner of the model form. Financial institutions that only offer one or two of the opt-out options listed on the model form must list only those options from the model form that apply to their practices and correspond accurately to the disclosures on page one. Thus, if an institution does not share in a manner that requires an opt-out for sharing with nonaffiliates, it must not include that opt-out option on page three of the model form. Institutions requiring information from consumers on the opt-out form other than an account number should modify that designation in the "Check your choices" box. Institutions that require customers with multiple accounts to identify each account to which the opt-out should apply should modify that portion of the model form.

(c) *Section 624 opt-out*. If the financial institution's affiliates use information for marketing pursuant to section 624 of the FCRA, and the institution elects to consolidate that opt-out notice in the model form, it must include that disclosure and opt-out election as shown in the model form. Institutions that elect to limit the time for the affiliate marketing opt-out, consistent with the requirements of section 624, must adhere to the requirements of that section and the Agencies' implementing rule with respect to any subsequent notice and opt-out. Institutions that elect to limit the opt-out period must include a statement in italics, as shown on the model form, that states the period of time for which the opt-out applies.

(d) *Additional opt-outs*. A financial institution that uses the disclosure table to indicate any opt-out choices available to consumers beyond those required by Federal law must include those opt-outs on page three of the model form. For example, if the financial institution discloses in the table that it offers an opt-out for joint marketing, the institution must revise the opt-out form on page three to reflect the availability of an opt-out, such as by adding a check-off box with the words "Do not share my personal information with other financial institutions to jointly market to me." Likewise, if a financial institution chooses to offer its customers an opt-out for its marketing, it can provide for that option in the disclosure table and on the opt-out form by adding a check-off box with the words "Do not share [or use] my personal information to market to me."

8. Amend newly designated Appendix B by adding a new sentence immediately after the heading to read as follows:

APPENDIX B TO PART 248—SAMPLE CLAUSES

This appendix provides guidance only for privacy notices provided on or before [ONE YEAR AFTER THE PUBLICATION DATE OF THE FINAL RULE]. * * *

* * * * *

Dated: March 9, 2007

John C. Dugan

Comptroller of the Currency

By order of the Board of Governors of the Federal Reserve System, March 16, 2007.

Jennifer J. Johnson

Secretary of the Board

By Order of the Board of Directors

Dated at Washington, D.C., this 20th day of March, 2007

Federal Deposit Insurance Corporation.

Robert E. Feldman

Executive Secretary

Dated: March 19, 2007

By the Office of Thrift Supervision

John M. Reich

Director

By the National Credit Union Administration Board on March 15, 2007.

Mary Rupp

Secretary of the Board

The Federal Trade Commission.

Dated: March 20, 2007

By Direction of the Commission

Donald S. Clark

Secretary

Dated: March 20, 2007

Eileen A. Donovan

Acting Secretary of the Commodity Futures Trading Commission

By the Securities and Exchange Commission.

Florence E. Harmon

Florence E. Harmon

Deputy Secretary

Dated: March 20, 2007

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200 and 232

[Release No. 34-55502]

Technical Amendment to Regulation S-T

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; technical amendments.

SUMMARY: The Securities and Exchange Commission ("Commission") is amending Regulation S-T to make a correction with respect to mandated electronic submissions and to include persons or entities that submit filings for review by the Division of Market Regulation as persons or entities that are subject to the electronic filing requirements of Regulation S-T. The amendment will clarify that a filing submitted on an electronic filing system other than the Electronic Data Gathering, Analysis, and Retrieval ("EDGAR") system is not a mandated submission under Regulation S-T and will clarify that filers who submit forms on EDGAR for review by the Division of Market Regulation are subject to the requirements of Regulation S-T. The Commission is also amending the Rules of Organization and Program Management to delegate authority to the Director of the Division of Market Regulation to adjust the filing date of an electronic submission and to grant or deny a continuing hardship exemption from electronic filing under Regulation S-T. The amendment will conserve Commission resources and will allow the Commission to make such adjustments and to grant or deny such exemptions in a timely manner.

EFFECTIVE DATE: [Insert 30 days from the date of publication in the Federal Register].

Document 28 of 42

FOR FURTHER INFORMATION CONTACT: Jerry Carpenter, Assistant Director, or Catherine Moore, Special Counsel, (202) 551-5710, Division of Market Regulation, Securities and Exchange Commission, 100 F Street, NE, Washington, DC, 20549-6628.

SUPPLEMENTARY INFORMATION:

I. BACKGROUND

On October 4, 2004, the Securities and Exchange Commission ("Commission") adopted an amendment to Rule 19b-4[1] to require that Form 19b-4[2] be filed electronically on the Commission's Electronic Form 19b-4 Filing System ("EFFS").[3] At the same time, the Commission amended Rule 101(a) of Regulation S-T[4] to mandate that Form 19b-4 be submitted to the Commission in electronic format and amended Rule 101(c)(9) of Regulation S-T to except Form 19b-4 from the requirement that filings submitted to the Division of Market Regulation be submitted in paper format. However, Regulation S-T only applies to electronic filings that are submitted on EDGAR, and Form 19b-4 is not submitted through EDGAR. As a result, Rules 101(a) and 101(c)(9) of Regulation S-T should not have been amended with respect to Form 19b-4. The Commission is making a technical amendment to remove the reference to Form 19b-4 in Rule 101(a) and to revise Rule 101(c)(9) to clarify that forms submitted for review by the Division of Market Regulation electronically, whether on EDGAR or on another electronic filing system such as EFFS, do not have to be submitted in paper format.

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1 17 CFR 240.19b-4.

2 17 CFR 249.819.

3 Securities Exchange Act Release No. 50486, 69 FR 60287 (October 8, 2004) [File No. S7-18-04].

4 17 CFR 232 et seq.

Additionally, the Commission is making a technical amendment to Rule 100 of Regulation S-T to include persons or entities that submit filings for review by the Division of Market Regulation as persons and entities that are subject to the electronic filing requirements of Regulation S-T. Because the EDGAR system was initially designed for the electronic submission of documents that are subject to review by the Divisions of Corporation Finance and Investment Management, Rule 100 currently only applies to registrants whose filings are submitted for review by those divisions and to such registrant's joint or third party filers. To reflect the fact that the Commission has recently added Forms 25, TA-1, TA-2, and TA-W, which are submitted for review by the Division of Market Regulation, to the list of mandated electronic filings in Section 101(a) of Regulation S-T, the Commission is amending Rule 100 to include the filers of any other forms that are submitted through EDGAR for review by the Division of Market Regulation as persons or entities that are subject to the electronic filing requirements of Regulation S-T.

The Commission is amending Rule 30-3 of the Rules of Organization and Program Management[5] to add new paragraphs (j) and (k) to delegate to the Director of the Division of Market Regulation authority to grant or deny a request submitted under Regulation S-T to adjust the filing date of an electronic filing and to grant or deny, as appropriate, a continuing hardship exemption to an electronic filer under Rule 202 of Regulation S-T. The delegation of authority to the Director of the Division of Market Regulation is designed to conserve Commission resources by permitting staff to adjust the filing date of an electronic filing and to grant or to deny exemptions where appropriate and in a timely manner. Nevertheless, the staff may submit matters to the Commission for consideration, as it deems appropriate. The Directors of the

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5 17 CFR 200.30-3, Delegation of authority to the Director of Division of Market Regulation.

Divisions of Corporation Finance and of Investment Management have previously been delegated such authority.[6]

II. CERTAIN FINDINGS

Under the Administrative Procedure Act ("APA"), notice of proposed rulemaking is not required "(A) [for] interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice; or (B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefore in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest."[7] The Commission is making technical amendments to Regulation S-T to correct Rule 101 and to make a conforming change to Rule 100 with respect to forms submitted for review by the Division of Market Regulation and therefore, notice and public procedure is unnecessary. Specifically, Rule 101(a) is being amended to remove the reference to Form 19b-4 and Rule 101(c) is being amended to clarify that only forms which are not submitted electronically are required to be filed in paper. Additionally, Rule 100 is being amended to add a new paragraph (d) which will define filers whose filings are subject to review by the Division of Market Regulation as persons or entities that are subject to Regulation S-T. The amendment reflects the fact that the Commission currently mandates that Forms 25, TA-1, TA-2, and TA-W be filed electronically on EDGAR and that the filers of these forms should be (and probably believe that they are) subject to the requirements and protections of Regulation S-T. For these reasons, the

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6 17 CFR 200.30-1(j) and (k) and 200.30-6(j) and (k).

7 5 U.S.C. 553(b).

Commission finds that publishing the changes for comment is unnecessary.[8] The amendment to Rule 30-3 of the Commission's Rules of Organization and Program Management relates solely to agency organization, procedure, or practice. As such, notice of proposed rulemaking is not required.

III. STATUTORY AUTHORITY

The Commission is adopting amendments § 200.30-3 under the authority set forth in sections 4A(a) and 23(a) of the Securities Exchange Act.[9] The Commission is adopting amendments to Regulation S-T under authority set forth in sections 19(a) of the Securities Act and 23(a) of the Securities Exchange Act.[10] The amendments to § 200.30-3 and to Regulation S-T are adopted under Chapter II of Title 17 of the Code of Federal Regulations in the manner set forth below.

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies), Organization and functions (Government agencies).

17 CFR Part 232

Reporting and recordkeeping requirements.

Text of Amendment

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8 For similar reasons, the amendments do not require analysis under the Regulatory Flexibility Act or analysis of major status under the Small Business Regulatory Enforcement Fairness Act. See 5 U.S.C. 601(2) (for purposes of Regulatory Flexibility analyses, the term "rule" means any rule for which the agency publishes a general notice of proposed rulemaking) and 5 U.S.C. 804(3)(C) (for purposes of congressional review of agency rulemaking, the term "rule" does not include any rule of agency organization, procedure, or practice that does not substantially affect the rights or obligations of non-agency parties).

9 15 U.S.C. 78d-1(a) and 78w(a).

10 15 U.S.C. 78s(a) and 78w(a).

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

PART 200--ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

Subpart A--Organization and Program Management

1. The authority citation for Part 200, subpart A, continues to read, in part, as follows:

Authority: 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

* * * * *

2. Section 200.30-3 is amended by redesignating paragraph (j) as paragraph (l) and adding new paragraphs (j) and (k) to read as follows:

§ 200.30-3 Delegation of authority to Director of Division of Market Regulation.

* * * * *

(j) With respect to the Securities Act of 1933 (15 U.S.C. 77a et seq.), the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.), and Regulation S-T thereunder (part 232 of this chapter), to grant or deny a request submitted pursuant to Rule 13(b) of Regulation S-T (§ 232.13(b) of this chapter) to adjust the filing date of an electronic filing.

(k) With respect to the Securities Act of 1933 (15 U.S.C. 77a et seq.), the Securities Exchange Act of 1934 (15 U.S.C.) 78a et seq.), the Trust Indenture Act of 1939 (15 U.S.C. 77aaa et seq.), and Regulation S-T thereunder (part 232 of this chapter) to set the terms of, and grant or deny as appropriate, continuing hardship exemptions, pursuant to Rule 202 of Regulation S-T (§ 232.202 of this chapter), from the electronic submission requirements of Regulation S-T (part 232 of this chapter).

* * * * *

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

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

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

* * * * *

4. Section 232.100 is amended by:

a. Removing the word "and" at the end of paragraph (b);

b. Redesignating paragraph (c) as paragraph (d);

c. Adding new paragraph (c); and

d. Revising the term “registrant” in newly redesignated paragraph (d) to read “person or entity”.

The addition reads as follows:

§ 232.100 Persons and entities subject to mandated electronic filing.

* * * * *

(c) Persons or entities whose filings are subject to review by the Division of Market Regulation; and

* * * * *

5. Section 232.101 is amended by:

a. Removing paragraph (a)(1)(x);

b. Redesignating paragraph (a)(1)(xi) and (a)(1)(xii) as paragraphs (a)(1)(x) and (a)(1)(xi); and

c. Revising paragraph (c)(9).

The revision reads as follows:

§ 232.101 Mandated electronic submissions and exceptions.

* * * * *

(c) * * *

(9) Exchange Act filings submitted to the Division of Market Regulation other than those that are submitted in electronic format as mandated or permitted electronic submissions under paragraph (a) and (b) of this section or that are submitted electronically in a filing system other than EDGAR.

* * * * *

By the Commission.

Florence E. Harmon

Florence E. Harmon
Deputy Secretary

March 21, 2007

1018

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 55511 / March 22, 2007

Admin. Proc. File No. 3-12329

In the Matter of

AMERICA'S SPORTS VOICE, INC.
(N/K/A MILAGRO HOLDINGS, INC.)
c/o Samy M. Salem, Interim President
53 Finch Drive
Roslyn, New York 11576

OPINION OF THE COMMISSION

SECTION 12(j) PROCEEDING

Grounds for Remedial Action

Failure to Comply with Periodic Filing Requirements

Company failed to file periodic reports in violation of Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13. Held, it is necessary and appropriate for the protection of investors to revoke the registration of company's securities.

APPEARANCES:

Samy M. Salem, for America's Sports Voice, Inc. (n/k/a Milagro Holdings, Inc.).

Carl A. Tibbetts and Stephen R. Herm, for the Division of Enforcement.

Appeal filed: August 16, 2006
Last brief received: October 23, 2006

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I.

America's Sports Voice, Inc., n/k/a Milagro Holdings, Inc. (the "Company"), appeals from an administrative law judge's decision finding that the Company had violated Section 13(a) of the Securities Exchange Act of 1934 and Exchange Act Rules 13a-1 and 13a-13 thereunder by failing to file its required annual and quarterly reports for the past five years and, on that basis, revoking the registration of the Company's securities. 1/ We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

This case concerns repeated failures by the Company to comply with Exchange Act periodic reporting requirements from 2001 onward. The Company became subject to these reporting requirements based on the registration of its common stock pursuant to Exchange Act Section 12(g). 2/ The relevant facts are as follows.

On November 15, 1999, the Company filed a Form 10-SB to register its common stock under the Exchange Act. According to the Form 10-SB, the Company was "a development stage company which was incorporated under the laws of the state of New York" and whose "objective [was] to create an organization to impact the sports industry by representing the interests of its sports fan members with owners of sport franchises, as well as the players themselves." The Form 10-SB disclosed that, "[a]s a result of the accumulated deficit of $408,485 at June 30, 1999, lack of operating revenues and its minimal capital resources then available to meet obligations which were normally expected to be incurred by similar companies, there [was] a substantial doubt about the Company's ability to continue as a going concern . . . ."

1/ Exchange Act Section 13(a) requires issuers of securities registered pursuant to Exchange Act Section 12 to file periodic reports with the Commission in accordance with the rules established by the Commission. 15 U.S.C. § 78m(a). Rule 13a-1, 17 C.F.R. § 240.13a-1, requires issuers to file annual reports with the Commission, and Rule 13a-13, 17 C.F.R. § 240.13a-13, requires issuers to file quarterly reports with the Commission.

2/ 15 U.S.C. § 78l(g).

The Company's Form 10-KSB 3/ for the fiscal year ended June 30, 2000 was filed on October 16, 2000. 4/ The Form 10-KSB disclosed that the Company was a development-stage company with a plan to operate varied businesses in the future. Its audited financial statements for that year indicated zero revenues and a $1,418,009 net loss from the Company's inception on February 12, 1997 through June 30, 2000, and contained another "going concern" statement from its auditors.

On August 15, 2001, the Company filed a Form 10-KSB for the fiscal year ended June 30, 2001 that lacked financial statements. 5/ According to this Form 10-KSB, the Company stated that it was "acting as a Holding Company while still operating as a high technology, multi-media marketing company utilizing both the Internet and publishing businesses to accomplish its business objectives."

The Company's last public filing of any type was a Form 8-K, filed on October 17, 2001. The Form 8-K disclosed that the Company's Form 10-KSB for the fiscal year ended June 30, 2001, which, as indicated, was filed in August lacking financial statements, had not been completed due to an "electric fire and the removal of equipment from the company's location at

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3/ Forms 10-KSB and 10-QSB may be filed, in lieu of Forms 10-K and 10-Q, by a company that is a "small business issuer." See 17 C.F.R. § 228.10(a)(1). This regulation defines a "small business issuer" as a company that, among other requirements, has revenues of less than $25 million and is not an investment company. The Company qualified as a "small business issuer" under these requirements.

4/ Exchange Act Rule 13a-1, 17 C.F.R. § 240.13a-1, provides that "[a]nnual reports shall be filed within the period specified in the appropriate form." General Instruction A to Form 10-KSB requires that "[a]nnual reports on this form shall be filed within 90 days after the end of the fiscal year covered by the report." We take official notice of the fact that, on September 29, 2000, the Company filed with the Commission a notice on Form 12b-25 of its intent to file this Form 10-KSB after the filing deadline. Exchange Act Rule 12b-25 requires that issuers provide notification of their inability to file a Form 10-KSB, or other periodic report, along with supporting reasons, by filing a Form 12b-25 "no later than one business day after the due date" for such report. 17 C.F.R. § 240.12b-25(a); see 17 C.F.R. § 249.322 (Form 12b-25). An issuer that files a Form 12b-25 by this deadline will have its late-filed periodic report "deemed to be filed on the prescribed due date for such report" if, among other things, it files the late report by the deadline set out in Rule 12b-25(b)(2)(ii), 17 C.F.R. § 240.12b-25(b)(2)(ii). In the case of a late-filed Form 10-KSB, the report must be filed "no later than the fifteenth calendar day following the prescribed due date."

5/ On August 2, 2001, the Company filed a Form 12b-25 seeking an extension to file its annual report on Form 10-KSB for the fiscal year ended June 30, 2001 due to the Company being "in the process of relocation."

270 Broadway, Huntington, New York" and a change of auditors in the middle of its fiscal year. According to the Company, its new accounting firm was attempting to reconstruct the data for the June 30, 2001 fiscal year in order to complete its audit of the Company's financial statements. In this Form 8-K, the Company noted that it had requested an extension to complete its audit and to file the omitted financial statements for its Form 10-KSB. 6/ The Company never filed these audited financial statements. The Company admits, and our records confirm, that it has not filed any annual or quarterly reports since the incomplete Form 10-KSB for the fiscal year ended June 30, 2001.

According to the Company's brief, in January 2004, America's Sports Voice, Inc. was acquired by Milagro Holdings, Inc. through a "reverse merger." 7/ Soon thereafter, however, the Company's management learned that America's Sports Voice, Inc. had been "dissolved by the State of New York by Proclamation prior to th[e] merger." 8/ Samy Salem, who states that he is the Company's "interim president," subsequently "reinstated the Company with the State of New York as Milagro Holdings, Inc."

The Company asserts in its brief that it "had no business from 2001 until conveyed in January 2004 . . . [and that it] is presently in the process of reorganizing under a new administration." It further states that it has had no income since January 2004 "and is presently in the process of compiling all expenditures." The Company contends that "for all intent and purpose [it] is a new company existing since January 2004."

On June 15, 2006, we issued an order, pursuant to Exchange Act Section 12(k), temporarily suspending trading in several companies, including the Company, from June 15, 2006 through June 28, 2006. 9/ In our suspension order, we found that "there is a lack of current

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6/ This is presumably a reference to the Form 12b-25 filed by the Company on August 2, 2001. See supra note 5.

7/ A "reverse merger" is a method by which a private company arranges to be acquired by a public company with minimal assets through a merger of the companies, with the shell company surviving and the former shareholders of the private business controlling the surviving entity. See Use of Form S-8, Form 8-K, and Form 20-F by Shell Companies, Securities Act Rel. No. 8587 (July 15, 2005), 85 SEC Docket 3698; see also SEC v. Cavanagh, 445 F.3d 105, 108 n.4 (2d Cir. 2006) (discussing mechanics of a reverse merger).

8/ The Company claims that the "merger was engineered by Investment Bankers that unfortunately did not do a proper due diligence."

9/ Exchange Act Section 12(k) provides, in relevant part, that "[i]f in its opinion the public interest and the protection of investors so require, the Commission is authorized by order

(continued...)

and accurate information concerning the [Company's] securities . . . because it has not filed a periodic report since the period ended June 30, 2001 . . . [and] that the public interest and the protection of investors require a suspension of trading." 10/

III.

Exchange Act Section 13(a) requires issuers of securities registered under Exchange Act Section 12 to file periodic and other reports containing such information as the Commission's rules prescribe. Exchange Act Rules 13a-1 and 13a-13 require such issuers to file annual and quarterly reports. 11/ The Company admits that it has failed to file annual or quarterly reports for any period after June 30, 2001. 12/ We, accordingly, find that the Company has violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

Exchange Act Section 12(j) authorizes the Commission, "as it deems necessary or appropriate for the protection of investors," to suspend for a period not exceeding twelve months, or revoke, the registration of a security, if it finds that the issuer of such security has failed to comply with any provision of the Exchange Act or its rules and regulations. 13/ Our determination of what sanctions will ensure that investors will be adequately protected "turns on

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9/ (...continued)
. . . summarily to suspend trading in any security . . . for a period not exceeding 10 business days."

10/ Securities Exchange Act Rel. No. 53985 (June 15, 2006), 88 SEC Docket 682.

11/ 17 C.F.R. §§ 240.13a-1 and 240.13a-13.

The financial statements included in annual reports on Form 10-KSB must be prepared in conformity with generally accepted accounting principles and audited by an independent accountant in accordance with generally accepted auditing standards. See Item 7 of Form 10-KSB (17 C.F.R. § 249.310b), and Item 310(a) of Regulation S-B (17 C.F.R. § 228.310(a)); see also United States v. Arthur Young & Co., 465 U.S. 805, 810 (1984) (observing that "[c]orporate financial statements are one of the primary sources of information available to guide the decisions of the investing public").

12/ It is unnecessary for us to find that the Company was aware of, or intentionally ignored, its reporting obligations as scienter is not necessary to establish an issuer's liability under Exchange Act Section 13(a) and Rules 13a-1 and 13a-13, although there is no evidence, and the Company does not argue, that its failure to file was inadvertent or otherwise without intent. See Ponce v. SEC, 345 F.3d 722, 737 n.10 (9th Cir. 2003); SEC v. McNulty, 137 F.3d 732, 740-41 (2d Cir. 1998).

13/ 15 U.S.C. § 78l(j).

the effect on the investing public, including both current and prospective investors, of the issuer's violations, on the one hand, and the Section 12(j) sanctions, on the other hand." 14/ Factors we consider in making this determination include the seriousness of the issuer's violations, the isolated or recurrent nature of the violations, the degree of culpability involved, the extent of the issuer's efforts to remedy its past violations and ensure future compliance, and the credibility of its assurances, if any, against further violations. 15/

Based on our consideration of those factors, we believe that the protection of investors requires revoking the Section 12(g) registration of the Company's common stock. The Company's filing failures are numerous and extend over a lengthy period. It has now failed to file twenty-two straight periodic reports since its incomplete 2001 Form 10-KSB. The Company is more than sixty-five months late in filing the financial statements for its Form 10-KSB for the fiscal year ended June 30, 2001. The Company is more than twenty-nine months late in filing its Form 10-KSB for the fiscal year ended June 30, 2004 -- the first year that the Company's current management assumed control -- and more than seventeen months late in filing its Form 10-KSB for the fiscal year ended June 30, 2005 -- the first full fiscal year under the current management. In the three years that its current management has been running its operations, the Company has not filed any of its required reports. Neither the change of management, the institution of these proceedings, nor our June 2006 order temporarily suspending trading in the Company's stock has made any difference in the Company's long history of ignoring its reporting obligations. We thus find that the Company's violations were very serious, recurrent, and evidenced a high degree of culpability.

We also find that a consideration of the other relevant factors -- the issuer's efforts, if any, to return to compliance and the credibility of management's assurances against further violations -- supports revocation. Although it does not dispute its past violations, the Company now claims that it "has all the necessary information and documentation to complete [its deficient] filings" and that it will "fulfill all its obligations" if we "grant the Company 90 days" to do so. According to the Company, because the "legal, accounting and edgarization costs . . . to complete these filings . . . are about $50,000" and because it "has [generated] no income from January 2004 to the present," the Company "did not want to expend these funds unless it was given a 90-day window" to return to compliance.

14/ Gateway Int'l Holdings, Inc., Exchange Act Rel. No. 53907 (May 31, 2006), 88 SEC Docket 430.

15/ Id. at 438-39.

We believe that the Company's position reflects a highly troubling attitude towards Commission reporting requirements. Compliance with those requirements is mandatory and may not be subject to conditions from the registrant. 16/ The Company's position indicates that it does not appreciate the significant public policy objectives the requirements are intended to serve, i.e., providing the public, particularly current and prospective shareholders, with material, timely, and accurate information about an issuer's business. 17/ It also suggests that the Company lacks the resources to prepare the requisite filings. 18/ In either case, the Company's filing history and current attitude suggest the strong likelihood of continuing or future violations.

The Company claims that revocation will harm its shareholders whom, it asserts, strongly support the Company's "endeavors with the Securities and Exchange Commission to allow belated filings." 19/ We previously have recognized, however, that, "in any deregistration

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16/ As long as an issuer's securities are registered under Section 12(g) of the Exchange Act, Exchange Act Section 13(a) mandates that the issuer "shall file with the Commission" all required reports. If an issuer subject to Exchange Act Section 12(g) periodic reporting requirements wishes to terminate this obligation, it must do so, pursuant to the provisions of Exchange Act Rule 12g-4, 17 C.F.R. § 240.12g-4, by filing a Form 15 with the Commission. The issuer must certify on the Form 15 that the number of stockholders of record is less than three hundred, or less than five hundred when its total assets have not exceeded $10 million on the last day of each of its most recent three fiscal years. See 17 C.F.R §§ 240.12g-4(a) and 249.323. Upon the filing of a certification on Form 15, an issuer's duty to file any reports required under Exchange Act Section 13(a) that arose because of an issuer's Section 12(g) registration is suspended immediately, and its registration under Exchange Act Section 12(g) is terminated ninety days thereafter. See 17 C.F.R § 240.12g-4(b).

17/ The reporting requirements are "the primary tool[s] which Congress has fashioned for the protection of investors from negligent, careless, and deliberate misrepresentations in the sale of stock and securities." SEC v. Beisinger Indus. Corp., 552 F.2d 15, 18 (1st Cir. 1977).

18/ According to the Company, "[t]he accounts from the Company from January 2004 to March 2005 are available and the accounting for the subsequent periods are in the process of being done." However, the Company has failed to file any reports covering the January 2004 through March 2005 period notwithstanding its assertion that its accounts for this period are available and notwithstanding institution of these proceedings and the law judge's determination to revoke the Company's registration. In addition, the Company admits that it is seeking new corporate counsel, and it has not furnished any evidence indicating that it has hired an auditor.

19/ According to the Company, it has contacted over 80% of the stockholders who, it states,
(continued...)

current shareholders could be harmed by a diminution in the liquidity and value of their stock by virtue of the deregistration." 20/ We also have held that "[t]he extent of any harm that may result to existing shareholders cannot be the determining factor in our analysis." 21/ In evaluating what is necessary or appropriate to protect investors, "regard must be had not only for existing stockholders of the issuer, but also for potential investors." 22/ Indeed, we have emphasized the significant interests of prospective investors who can be substantially hindered in their ability to evaluate an issuer in the absence of current filings. 23/ In any event, both existing and prospective shareholders are harmed by the continuing lack of current and reliable financial information for the Company. 24/

19/ (...continued)
"are aware of these attenuating circumstances" and support management's efforts to retain the Company's registered status.

20/ Eagletech Communications, Inc., Exchange Act Rel. No. 54095 (July 5, 2006), 88 SEC Docket 1225, 1230.

21/ Gateway Int'l Holdings, 88 SEC Docket at 443. We note that, in Gateway, we determined that revocation was warranted notwithstanding the fact that Gateway, unlike the Company, had taken significant steps to return to compliance.

22/ Id.

23/ Id. (stating that, in the context of NASD listing decisions, the Commission has emphasized the interests of future investors rather than the interests of existing shareholders and noting that "similar policy considerations are applicable in a Section 12(j) proceeding"). We have, nevertheless, observed that existing shareholders may also be harmed by an issuer's failure to have its financial statements audited since, for example, "in the absence of an audit, an existing shareholder could be forced to determine whether to sell his stock based on financial statements that give an inaccurate view of the issuer's financial situation." Id. Similar considerations apply, of course, in the case of prospective stockholders who are deciding whether to purchase stock.

24/ See Eagletech Communications, 88 SEC Docket at 1230. We also note that, as we previously have observed, revocation proceedings under Exchange Act Section 12(j), such as this one, play an important role in the Commission's enforcement program because many publicly traded companies that fail to file on a timely basis are "shell companies" and, as such, attractive vehicles for fraudulent stock manipulation schemes. Revocation under Section 12(j) can make such issuers less appealing to persons who would put them to fraudulent use. e-Smart Tech., Inc., Exchange Act Rel. No. 50514 (Oct. 12, 2004), 83 SEC Docket 3586, 3590-91 n.14.

Here, the Company's failure to comply with its reporting obligations has deprived the investing public of vital information about the Company's operations and financial condition for a period of more than five years, three years of which occurred after current management assumed control of the Company. During this five year period, the Company has provided no data regarding its current finances or future prospects. Nor, despite its purported willingness to return to compliance under certain circumstances, has the Company provided any evidence that it in fact is capable of doing so. Moreover, the Company has demonstrated a lack of commitment to the Commission's reporting requirements and the important role those requirements play in keeping the public fully informed about an issuer's current business and future prospects. Under the circumstances, we believe that revoking the Section 12(g) registration of the Company's common stock is warranted for the protection of investors. 25/

An appropriate order will issue. 26/

By the Commission (Chairman COX and Commissioners ATKINS, CAMPOS, NAZARETH, and CASEY).

Nancy M. Morris
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

25/ The Division's motion for summary affirmance is denied. See Rule of Practice 411(e)(2), 17 C.F.R. § 201.411(e)(2) (authorizing the granting of "summary affirmance if [the Commission] finds that no issue raised in the initial decision warrants consideration by the Commission of further oral or written argument"); see also Richard Kern, Exchange Act Rel. No. 51115 (Feb. 1, 2005), 84 SEC Docket 2923, 2924 (observing that "summary affirmance is rare, given that generally we have an interest in articulating our views on important matters of public interest") (citations omitted).

26/ 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. 55511/March 22, 2007

Admin. Proc. File No. 3-12329

In the Matter of

AMERICA'S SPORTS VOICE, INC.
(N/K/A MILAGRO HOLDINGS, INC.)
c/o Samy M. Salem, Interim President
53 Finch Drive
Roslyn, New York 11576

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's Opinion issued this day, it is

ORDERED that the registration of all classes of the registered securities of America's Sports Voice, Inc. under Section 12(g) of the Securities Exchange Act of 1934, be, and it hereby is, revoked pursuant to Exchange Act Section 12(j).

By the Commission.

Florence E. Harmon

Nancy M. Morris
Secretary

By: Florence E. Harmon
Deputy Secretary

Fil.

Commissioners Nazareth and Casey Not Participating

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55508 / March 22, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12595

In the Matter of **RICHARD ROBINSON,** **Respondent.**	**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**

I.

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

II.

In anticipation of the institution of these proceedings, Robinson has submitted an Offer of Settlement of Richard Robinson ("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 Robinson and the subject matter of these proceedings, which are admitted, Robinson 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 ("Order"), as set forth below.

Document 30 of 42

III.

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

A. RESPONDENT

Richard Robinson, age 51, resides in Monroe Township, New Jersey. From 1998 until March 2003, Robinson was a vice president of the American Stock Exchange LLC ("Amex") and was responsible for overseeing the Amex's Derivatives Trading Analysis Department ("DTA") within the Amex's Member Firm Regulation Department. DTA was responsible for the Amex's regulatory surveillance programs for the derivatives and options markets.

B. RELEVANT ENTITY

American Stock Exchange LLC, located in New York, New York, is a national securities exchange registered with the Commission pursuant to Section 6 of the Exchange Act. From 1998 until December 31, 2004, the Amex was a subsidiary of the National Association of Securities Dealers, Inc. ("NASD"). On December 31, 2004, the NASD completed the sale of its interest in the Amex and transferred control to the Amex Membership Corporation. The Amex trades over 800 stocks, various types of options, and over 100 exchange traded funds.

C. SUMMARY

From at least 1999 until at least 2003, the Amex failed to enforce adequately certain options order handling rules and to comply with its record keeping obligations. As a result of its failure adequately to surveil for and investigate violations of, and to enforce, certain options order handling rules, the Amex violated Section 19(g) of the Exchange Act. In addition, the Amex failed to furnish accurate records and, as a result, violated Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1. Robinson, the individual responsible for managing the Amex's surveillance program for derivatives and options, was a cause of the Amex's violations by failing to oversee properly the Amex's surveillance program for derivatives and options and by signing and submitting an affirmation to the Commission on behalf of the Amex which contained inaccurate representations relating to the Amex's regulatory program.

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

D. FACTS

1. Prior Commission Action

On September 11, 2000, the Commission issued an order ("September 2000 Order") against the Amex and three other options exchanges, finding, in relevant part, that the Amex had failed to surveil for, or to take appropriate action with respect to evidence of, violations of firm quote,[2] customer priority,[3] limit order display,[4] and trade reporting rules.[5]

The Commission ordered the Amex to enhance and improve its regulatory programs for surveillance, investigation, and enforcement of the options order handling rules, including the limit order display, priority, trade reporting, and firm quote rules. The Amex further was required to provide Commission staff with annual affirmations detailing its progress in complying with the September 2000 Order.

At the time of the September 2000 Order, Robinson oversaw the Amex's Derivatives Trading Analysis Department ("DTA") which was responsible for the Amex's surveillance of

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[2] The firm quote rule generally requires options specialists to trade options at the prices and in the amounts that they quote. During most of the period relevant to this Order, the firm quote rule for options was set forth in Exchange Act Rule 11Ac1-1, which had a compliance date of April 2001, and Amex Rule 958A. With the Commission's adoption of Regulation NMS in August 2005, the Commission's firm quote rule was redesignated as Exchange Act Rule 602. Under Exchange Act Rule 602, its predecessor Exchange Act Rule 11Ac1-1, and Amex Rule 958A, responsible brokers or dealers are required, with a few exceptions, to execute options transactions with customers at prices at least as favorable as their published bids or offers at the time the orders are presented and in any amount of contracts up to their published sizes.

[3] With certain exceptions, the priority rules generally require that a customer limit order be executed prior to the execution of any other order if it has the best price, i.e., the highest bid or lowest offer. See Amex Rules 126 and 950(d). If there is more than one customer order at the best price, the customer order that arrives first has priority.

[4] The obligation to display limit orders generally requires that a customer limit order that is priced better than the highest bid or the lowest ask price currently quoted on the exchange immediately be displayed in the quotations. As discussed infra at III.D.2.c., at the time of the September 2000 Order, specialists were required to display such limit orders as part of their due diligence obligations. In January 2005, the Commission approved, and the Amex thereafter implemented, a limit order display rule specifically applicable to options.

[5] The trade reporting rule generally requires that transactions be reported within a specified time after execution. The Amex's trade reporting rule, adopted in August 2000, requires that options transactions are to be reported to the Amex Options Market Data System within 90 seconds of execution and that transactions not reported within that time are to be designated as late. See Amex Rule 992.

Amex specialists' compliance with firm quote, customer priority, trade reporting, limit order display, as well as, other options order handling rules. Robinson knew of the Amex's obligations to enhance and improve its regulatory programs for surveillance, investigation, and enforcement of the options order handling rules. During the relevant time, Robinson continued to oversee DTA which had responsibility for implementing many rules, policies and programs created by the Amex in response to the September 2000 Order's mandate that the Amex improve its regulatory programs for surveillance, investigation, and enforcement of the options order handling rules.

2. Inadequate Surveillance, Investigatory, and Enforcement Programs for Options Trading

As late as 2003, there remained significant deficiencies in the Amex's surveillance, investigatory, and disciplinary programs regarding the firm quote, customer priority, trade reporting, limit order display, as well as, other options order handling rules.

a. The Firm Quote Rule

The firm quote rule generally requires a responsible broker or dealer[6] to trade options at the prices and in the amounts that he or she quotes. The Amex through DTA improperly applied the rule, established unreasonable surveillance parameters, and failed adequately to pursue disciplinary actions for violations of the rule.

For example, when it initially began reviewing surveillance reports, the Amex simply concluded without investigation that if the quote changed in the thirty seconds following receipt of an order, the specialist was in the process of changing the quote when he or she received the order. The thirty-second period was an unreasonably long period to use in this analysis, because it may have permitted the precise type of conduct that the firm quote rule was designed to prohibit. Within thirty seconds, a specialist could receive an order, revise the quote to an inferior price, and either not execute the order or execute it at an inferior price without being cited for a violation of the firm quote rule. Robinson, who was responsible for implementing this thirty-second review parameter, knew or should have known that such a parameter was inappropriate.

The Amex also excused violations of the firm quote rule based on rationales not recognized under any exception to the rule. For example, the Amex improperly excused some violations in which a customer limit order was executed at the limit price rather than at an Amex quote that represented a better price. It also excused some violations in which a specialist paired off a customer's order with another customer order even though, at the time, there was a posted quote at a better price. As head of DTA, Robinson ultimately was responsible for the investigation and

[6] A responsible broker or dealer is a member of an exchange who communicates quotes to other members of the exchange. See Exchange Act Rule 602(b)(65). The responsible broker or dealer frequently is the specialist for the subject security.

analysis by Amex analysts conducting firm quote surveillance and knew or should have known that analysts were improperly excusing violations.

The Amex also failed to investigate conduct that its surveillance reports identified as potential firm quote violations. One surveillance report that the Amex used to identify potential violations of the rule was the "Executable Orders Unexecuted" report. The report was generated on a daily basis and captured instances in which an Amex specialist failed to execute a market or limit order after the order became executable. As such, all orders captured on the report represented potential violations of the rule. The Amex, however, did not review all of the orders that appeared on the report. In certain instances, for example, the Amex reviewed only those orders that were unexecuted for more than two minutes. Even reviewing only select exceptions, analysts were continuously backlogged in reviewing the Executable Orders Unexecuted report. As head of DTA, Robinson knew or should have known that only select exceptions were being reviewed and knew or should have known that the review of the Executable Orders Unexecuted report was severely backlogged. Therefore, Robinson knew or should have known that the Amex was not adequately surveilling for firm quote violations.

Under the Amex's Minor Rule Violation Plan, when an Amex analyst concluded that a firm quote violation had occurred, DTA could refer the matter either to the Amex's Minor Floor Violation Disciplinary Committee ("MFV Disciplinary Committee") or to the Enforcement Department, which had the authority to impose more severe sanctions than the MFV Disciplinary Committee. However, when it made referrals, DTA referred almost all potential firm quote violations to the MFV Disciplinary Committee. Because of the backlog in reviewing the Executable Orders Unexecuted report, by the time DTA referred matters to the MFV Disciplinary Committee, often a significant amount of time had passed since the order at issue. This further impeded disciplinary actions, because the committee's evaluation of the conduct depended in part on the memory of the specialist. After the committee complained about the delay, in August 2002, DTA stopped referring potential violations of the firm quote rule to the MFV Disciplinary Committee. Robinson knew that DTA had stopped referring potential firm quote rule violations to the MFV Disciplinary Committee.

b. Trading Ahead

The Amex's trading ahead rules require a specialist to give precedence to an order entrusted to him or her as agent before executing at the same price any transaction in the same option for an account in which the specialist has an interest.[7] The parameters the Amex set through DTA for its trading ahead surveillance report essentially gave Amex specialists a sixty-second grace period to trade ahead of a customer's order and thereby receive a better price than the

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[7] See Amex Rules 155 and 950(a). The Amex also had a rule that required a registered options trader, when establishing or increasing a position for an account in which he or she had an interest, to give precedence to off-floor orders. See Amex Rule 111(d). A registered options trader is a participant on the exchange trading for his or her own or firm's account who is responsible for making two-sided markets.

customer received. The Amex also failed to review numerous instances of potential trading ahead violations identified on its surveillance report. Robinson was responsible for implementing the sixty-second parameter in the Amex's trading ahead report and additionally knew or should have known that only select exceptions were being reviewed. Therefore, Robinson knew or should have known that the Amex was not adequately surveilling for trading ahead violations.

c. Limit Order Display

Pursuant to its rules, the Amex required specialists to exercise due diligence in handling customer orders.[8] As part of their due diligence obligations, specialists immediately were to display customer limit orders that improved Amex quotes. The Amex's surveillance, investigative, and enforcement programs relating to the limit order display obligation were deficient. The Amex through DTA limited its surveillance to the conduct of specialist units rather than individual specialists and employed a flawed method for calculating compliance rates which resulted in inflated compliance rates. Robinson was responsible for overseeing surveillance for limit order display violations and knew or should have known about these deficiencies in the Amex's surveillance for limit order display violations.

d. Other Order Handling Rules

The Amex's surveillance and enforcement with respect to trade reporting and stopped orders were also inadequate. The trade reporting rule requires that transactions be reported within a specified time after execution.[9] The Amex through DTA inappropriately limited its review of potential violations of the trade reporting rule to instances in which a specialist unit reported more than five percent of its trades late. In determining whether the five-percent threshold was exceeded, the Amex also included trades that were automatically reported, rather than just trades that were not reported automatically. This practice gave the appearance of a higher compliance rate than was warranted.[10]

Separately, the Amex through DTA did not monitor for compliance by option class and thus was generally unable to determine whether there were patterns of late trade reporting in particular options classes. The Amex further did not surveil for transactions that were reported late but that were not designated as such when the transactions were reported.[11]

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[8] See Amex Rules 156 and 950(g).

[9] See supra note 5.

[10] At the relevant time, the Amex estimated that approximately sixty percent to seventy percent of options transactions were electronically routed and executed orders that were reported immediately.

[11] Pursuant to Amex Rule 992(b), a transaction not reported within ninety seconds of execution was to be designated as late. When that occurred, the specialist was supposed to add to the trade report a modifier designating the trade as late.

The Amex's "stopped order" rule essentially requires a specialist to provide execution assurances under certain circumstances.[12] A member whose customer wants to buy or sell an option at a better price than the price currently available can ask the specialist to "stop" the member's order and to attempt to obtain a better price. If the specialist agrees, the specialist then is obligated to execute the member's order at a better price or, if one cannot be obtained, at the market price at the time of the stop. The Amex through DTA generally did not review all exceptions on its surveillance report for monitoring stopped orders and/or excused instances in which specialists executed stopped orders at prices that were worse than the market prices at the time of the stop.

As head of DTA, Robinson was responsible for overseeing the Amex's surveillance regarding trade reporting and stopped orders and knew or should have known about these deficiencies in the Amex's surveillance for trade reporting and stopped orders.

3. Failure to Make, Keep, and Furnish Complete and Accurate Records

The Amex also failed to make and keep certain of the required records relating to its surveillance, investigatory, and enforcement activities and further furnished the Commission with an inaccurate document.

a. Inadequate Documentation

The Amex lacked documentation sufficient to support its options surveillance, investigatory, and enforcement activities. DTA, for example, failed uniformly to maintain in its case files the surveillance reports that gave rise to investigations and failed to make or keep records of floor official approval and customer consent to busted and adjusted trades. Not only were DTA investigative files incomplete, but during an internal review in 2003, the Amex was unable to locate many investigative files. In some instances, there were documents in case files that were dated after DTA's case tracking log reflected that the matters had been closed. In other instances, case files lacked documentation of how the matters were resolved, but DTA logs reflected that the matters had been referred to the MFV Disciplinary Committee.

The Amex's documentation relating to enforcement actions taken by the MFV Disciplinary Committee was also inadequate. Some of the minutes failed even to include references to the types of violations that the committee considered. Other minutes were unclear as to which violations the committee considered or on which violations the committee acted. In other instances, the minutes did not include a discussion of some matters that purportedly were on the agenda for those meetings.

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[12] See Amex Rules 109, 154, and 950(f), (o).

As head of DTA, Robinson was responsible for reviewing and maintaining DTA's investigative files relating to the Amex's surveillance for options order handling rules. In addition, Robinson was responsible for keeping and maintaining the minutes of the MFV Disciplinary Committee meetings. Accordingly, Robinson knew or should have known that DTA's investigative files and the minutes of the MFV Disciplinary Committee meetings were incomplete and inadequate.

b. The Failure to Furnish a Complete and Accurate Affirmation

Affirmations detailing the Amex's compliance with the September 2000 Order were due annually on September 11.

The first affirmation, signed by Robinson, included the following representations:

(1) the Amex's Enforcement Department was reviewing all matters that DTA was proposing to submit to the MFV Disciplinary Committee before they were presented to the MFV Disciplinary Committee;

(2) firm quote violations "will be forwarded to the Enforcement Department for their review and action unless there are extenuating circumstances";

(3) in early September 2001, a Trading Ahead of Customer Orders Report and an Executable Orders Unexecuted Report had been incorporated into the Amex's routine surveillance;

(4) the Amex was utilizing the following surveillance reports: (a) Lack of Traders Trading in Between the Markets and (b) Specialists Routinely Being the Only Contra-Side on a Trade; and

(5) the Amex had incorporated a Trade Reporting Report into its routine surveillance program.

None of these representations was accurate. At the time of the Amex's first affirmation, the Enforcement Department was not reviewing all matters that DTA was proposing to submit to the MFV Disciplinary Committee, nor did the Enforcement Department ever review routinely all matters that DTA was proposing to submit to the MFV Disciplinary Committee. At the time of the first affirmation, DTA also was not forwarding routinely firm quote violations to the Enforcement Department, nor did DTA ever forward routinely firm quote violations to the Enforcement Department. Instead, DTA referred most firm quote violations to the MFV Disciplinary Committee. In addition, the Trading Ahead of Customer Orders Report and the Executable Orders Unexecuted report were still in testing in September 2001 and were not actually implemented until approximately January 2002. Similarly, the reports for the Lack of Traders Trading in Between the Markets and for Specialists Routinely Being the Only Contra-Side on a Trade also were still in development at the time of the affirmation. Neither report was used for surveillance. In addition, requirements for the Trade Reporting Report did not start to be developed until February 2002. Robinson knew or should have known these representations were inaccurate.

E. DISCUSSION

1. Violation of Section 19(g)(1) of the Exchange Act

Section 19(g)(1) of the Exchange Act obligates the Amex as a self-regulatory organization to comply with the Exchange Act, the Exchange Act rules and regulations, and the Amex's rules. Section 19(g)(1) further obligates the Amex, absent reasonable justification or excuse, to enforce compliance with these provisions by its members and persons associated with those members. In carrying out its duty to enforce compliance, the Amex was required to develop and maintain surveillance over its members and to "be vigilant in surveilling for, evaluating, and effectively addressing issues that could involve violations" of the securities laws.[13] The Amex failed to surveil for and investigate violations of, and to enforce compliance with options trading rules by Amex members and therefore violated Section 19(g)(1) of the Exchange Act. By implementing unreasonable parameters in the Amex's surveillance reports, by failing to ensure that Amex analysts were not excusing order handling violations based on improper grounds, and by failing to ensure that Amex analysts were reviewing all exceptions on Amex surveillance reports and reviewing exception reports in a timely manner, Robinson was a cause of the Amex's violations of Section 19(g)(1) of the Exchange Act.

2. Violation of Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1

Section 17(a)(1) of the Exchange Act requires an exchange such as the Amex to make and keep for prescribed periods, and then to furnish the Commission with a copy of, such records as the Commission prescribes as necessary or appropriate in the public interest, for the protection of investors, or for other purposes set forth in the Exchange Act. Exchange Act Rule 17a-1(a) further requires an exchange to keep and preserve at least one copy of all correspondence, records, and other documents made or received by it in its business and in the conduct of its self-regulatory activity. Rule 17a-1(c) requires an exchange promptly to furnish the Commission with a copy of any such document that the Commission requests. The requirement that an exchange keep and furnish records to the Commission includes the requirement that any accompanying explanation of those records be complete and accurate and that those materials be furnished on a timely basis.

The Amex failed to keep and furnish records with respect to its surveillance and investigatory functions as well as its enforcement activities. By submitting the first affirmation late and with inaccuracies, the Amex further failed to satisfy its obligation to furnish the Commission with such documents as it requests.[14] By failing to maintain properly the Amex's investigative files

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[13] National Ass'n of Sec. Dealers, Inc., Exchange Act Rel. No. 37538, at 3 (Aug. 8, 1996).

[14] The affirmation, which was required by the September 2000 Order, was prepared in the course of the Amex's activity as a self-regulatory organization and is a record within the meaning of Section 17(a) of

regarding its options order handling surveillance and by signing and submitting an affirmation to the Commission on behalf of the Amex, which Robinson knew or should have known contained inaccurate representations, Robinson was a cause of the Amex's violations of Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1.

IV.

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

Accordingly, it is hereby ORDERED that Richard Robinson cease and desist from causing any violations and any future violations of Sections 17(a)(1) and 19(g)(1) of the Exchange Act and Exchange Act Rule 17a-1.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

the Exchange Act and Exchange Act Rule 17a-1.

Commissioners Nazareth and Casey Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
March 22, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12596

In the Matter of

SALVATORE F. SODANO,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 19(h) OF THE SECURITIES EXCHANGE ACT OF 1934 AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate in the public interest and for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 19(h)(4) of the Securities Exchange Act of 1934 ("Exchange Act") against Salvatore F. Sodano ("Sodano" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. **Salvatore F. Sodano**, age 51, resides in Nissequogue, New York. From September 1999 until January 2005, Sodano was Chairman and Chief Executive Officer ("CEO") of the American Stock Exchange LLC. Sodano resigned as CEO in January 2005 and as Chairman in April 2005.

B. RELEVANT ENTITY

2. **American Stock Exchange LLC** ("Amex" or "Exchange"), located in New York, New York, is a national securities exchange registered with the Commission pursuant to Section 6 of the Exchange Act. From 1998 until December 2004, the Amex was a subsidiary of NASD, Inc. ("NASD"). At all relevant times, however, the Amex was its own self-regulatory organization ("SRO") with all of an SRO's attendant obligations under the Exchange Act. Simultaneous with the

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filing of these proceedings, the Commission is filing a settled Order Instituting Public Administrative Proceedings Pursuant to Sections 19(h)(1) and 21C of the Exchange Act against the Amex making findings, ordering compliance with undertakings and imposing a censure and cease-and-desist order for violations of Sections 17(a)(1) and 19(g)(1) of the Exchange Act and Exchange Act Rule 17a-1.

C. FACTS

Summary

3. As an SRO, the Amex is a quasi-governmental body that has responsibilities fundamental to the enforcement of the federal securities laws. The Amex and its officers have an obligation to comply, and to enforce compliance by its members, with the Exchange Act, the rules and regulations thereunder, and the Exchange's own rules. As the Amex's Chairman and CEO, Sodano failed to enforce compliance with federal securities laws, rules and regulations ("federal securities laws"), and Amex rules by the Amex's members and persons associated with the Amex's members.

4. In September 2000, the Commission, prompted by a 1999 inspection report by the Commission's Office of Compliance Inspections and Examinations ("OCIE"), instituted a settled administrative proceeding against the Amex in which the Commission found, among other things, that the Amex had failed to adequately enforce certain option order handling rules including critical customer-protection rules relating to firm quote and trading ahead ("September 2000 Order"). Although the Commission's order required the Amex to enhance and improve its regulatory programs for enforcing these rules, an inspection by OCIE ending in June 2003 revealed that, years later, the Amex had failed to do so. Additional internal reviews revealed similar failures. In fact, several of the Amex's representations made to OCIE staff following the September 2000 Order regarding steps the Amex purportedly had taken to improve its regulatory function in its options markets proved to be inaccurate and misleading.

5. Amex's regulation of its equities markets and its floor brokers had shortcomings similar to those in the Amex's options regulation. Many of these shortcomings remained after OCIE inspection reports alerted the Amex to them years earlier. These deficiencies in both the options and equities markets were emblematic of Sodano's failure to ensure that the Amex maintained an adequate regulatory program.

6. The Amex's regulatory deficiencies resulted in large part from Sodano's failure to pay adequate attention to regulation, to put in place an oversight structure, to ensure the regulatory staff was properly trained, and to dedicate sufficient resources to ensure that the Exchange was meeting its regulatory obligations. These failures were particularly significant with respect to the options market because Sodano knew the Exchange was subject to the September 2000 Order, which identified numerous regulatory failures in that area. Sodano's inattention to and apparent lack of interest in regulation filtered down the management chain creating an environment in which

regulation was not a priority and, therefore, compliance with the securities laws and Amex's rules was not enforced.

7. Notwithstanding numerous red flags throughout the period 1999 to 2004, Sodano failed to fulfill his responsibilities as an officer of the Exchange to enforce compliance with federal securities laws and the Amex's rules.

Sodano's Overall Responsibility

8. Pursuant to the Exchange Act, Sodano, as an officer of the Amex, had an obligation to enforce compliance with the federal securities laws and regulations and the Amex's rules by Amex members and persons associated with members. In addition, Sodano had numerous responsibilities that impacted the Amex and its employees' ability to discharge the Amex's regulatory responsibilities.

9. At all relevant times, Sodano was in charge of ensuring that the Amex had a viable, properly working oversight structure for its regulatory department. Sodano was also responsible for approving budgets, including those related to personnel and technology. In addition, Sodano was responsible for ensuring that regulatory personnel were adequately trained at all levels and that managers were qualified and prepared to oversee the regulatory departments. Sodano also was responsible for ensuring the Amex's compliance with its undertakings agreed to as part of the September 2000 Order, as well as with other commitments the Amex had made to Commission staff in response to numerous OCIE reports.

10. As described in more detail below, Sodano failed to carry out his regulatory responsibilities. As a result, the Amex was not adequately enforcing the federal securities laws and the Amex's rules. In sum, Sodano without reasonable justification or excuse, failed to enforce compliance with the federal securities laws and the Amex's rules by Amex members and persons associated with those members.

The Amex's Regulatory Failures

Prior Commission Action

11. On September 11, 2000, the Commission issued the above-referenced September 2000 Order, to which the Amex consented, finding, in relevant part, that the Amex had failed effectively to enforce compliance by its members with Exchange rules, policies, or procedures relating to options order handling and the federal securities laws more broadly. See In the Matter of Certain Activities of Options Exchanges, Exchange Act Rel. No. 43268 (Sept. 11, 2000) (September 2000 Order against the Amex and three other options exchanges).

12. In the September 2000 Order, the Commission found that the Amex had failed to surveil for, or to take appropriate action with respect to evidence of, violations of the firm quote rule, the customer priority rule, the limit order display rule, and the trade reporting rules. These

rules were designed to protect investors and provide some of the primary safeguards against execution abuses by specialists on the Amex's trading floor. In addition, the Commission found that, in many instances where violations were found, the Amex did not impose adequate sanctions.

13. The Amex consented to the issuance of the September 2000 Order and to specific undertakings. The relevant undertakings included requirements that the Amex promptly enhance and improve its surveillance, investigative, and enforcement processes and activities with respect to options order handling rules, including the duty of best execution with respect to the handling of orders after the broker-dealer routes the order to the Exchange, compliance with the limit order display rules, priority rules, trade reporting and firm quote rules. The undertakings also required the Amex to provide Commission staff with annual affirmations detailing the Amex's progress in complying with the September 2000 Order. Sodano, as CEO and Chairman of the Board, participated in the Amex's decision to consent to these and other undertakings and was responsible for ensuring the Amex's compliance with its obligations. Nonetheless, the Amex failed to comply with these obligations.

Inadequate Surveillance, Investigatory, and Enforcement Programs Related to the Amex's Options Markets

14. From at least 1999, Sodano was on notice that the Amex's surveillance, investigatory, and enforcement programs were inadequate. In July 1999, OCIE issued an inspection report ("July 1999 OCIE Report") in which the staff concluded that the Amex had failed to fulfill its regulatory responsibility to effectively enforce compliance by its members with Exchange rules and federal securities laws relating to order handling practices. The Amex's regulatory program, most of which was overseen and executed through the Amex's Member Firm Regulation Department ("MFR"), had significant deficiencies in surveillance for and enforcement of numerous critical investor protection rules. The OCIE staff made numerous recommendations on how the Amex could remedy the staff's principal findings. Sodano received this report and personally responded to it.

15. Sodano was put on notice of additional problems with the Exchange's derivatives and equities surveillance and enforcement programs a few months later when OCIE issued an additional inspection report in November 1999 ("November 1999 OCIE Report"). Thus, Sodano was on notice that the Amex's regulatory problems were widespread and not limited just to the Amex's options market.

16. Notwithstanding the September 2000 Order and the July and November 1999 OCIE Reports, as late as 2004, there remained significant deficiencies in the Amex's surveillance, investigatory, and disciplinary programs within the Amex's MFR. These deficiencies were most acute regarding the firm quote, customer priority, trade reporting, limit order display, as well as other options order handling rules. Many of the same deficiencies persisted from 1999 to 2004 without adequate remedial efforts by Sodano.

17. During the relevant time, the Derivatives Trading Analysis Department ("DTA") was a department within MFR primarily responsible for the Amex's regulatory surveillance

program for the derivatives and options markets. In January 2002, the Amex formed the Best Execution Department ("Best Ex") within DTA specifically to conduct surveillance reviews and investigations into whether Amex members complied with options order handling rules. Best Ex was responsible for reviewing surveillance reports for violations of the firm quote, trading ahead, trade reporting, and stopped order rules, and the limit order display obligation. DTA failed to adequately fulfill its regulatory function in many critical respects.

18. When Best Ex was formed, the Amex contemplated that the department would have five individuals to carry out its functions. During the relevant time, however, Best Ex never had a staff of five. It initially had a staff of four and thereafter had four or fewer individuals (including a period of only two). The lack of staff in Best Ex was a significant contributing factor to the Amex's inadequate surveillance, investigative, and enforcement programs for options order handling rules.

19. At all relevant times, Sodano was responsible for approval of personnel and technology budgets. Sodano ordered and/or approved hiring freezes and other budgetary constraints and poorly managed technology spending, which contributed to Best Ex's and DTA's failures. In addition, Sodano failed to ensure that regulatory personnel were adequately trained and similarly failed to take other basic management steps to oversee these regulatory departments. These failures allowed the regulatory deficiencies to persist unabated in the wake of the September 2000 Order and repeated negative OCIE inspection reports.

20. From 2000 through 2003, Sodano failed to enforce compliance with the Exchange's firm quote rule, priority rules, limit order display rule, trade reporting rule, busted and adjusted trades rule, stopped order rule, and related Exchange Act rules, as described in an OCIE staff inspection report issued in June 2003 ("June 2003 OCIE Report").

21. Although the Commission's September 2000 Order required the Amex to enhance and improve its regulatory programs for enforcing the option order handling rules, the Amex failed to do so. The Amex did not comply with the September 2000 Order to promptly enhance and improve its surveillance, investigative, and enforcement processes with respect to compliance with the options order handling rules.

22. Although the June 2003 OCIE Report detailed multiple, specific findings, notably the staff found that the Amex had not meaningfully enforced the firm quote rule since it became effective in April 2001. The report also detailed serious deficiencies in the Amex's regulatory programs related to trade reporting, trading ahead, limit order display, and best execution, as well as significant deficiencies with respect to the documentation maintained in the Amex's surveillance and investigative files.

23. The regulatory problems related to options order handling were so fundamental that the Amex even lacked basic documentation supporting its options surveillance, investigatory, and enforcement activities. The Amex, for example, failed to uniformly maintain in its case files the surveillance reports that gave rise to investigations, lacked audit trail data to support the potential applicability of exceptions to the firm quote rule, failed to maintain analyses and supporting documentation related to reviews of certain surveillance reports, and failed to make or keep records

of floor official approval and customer consent to busted and adjusted trades. Not only were Amex investigative files incomplete, but in an internal review in 2003, the Amex was unable even to locate many investigative files. In some instances, documents in case files were dated after the Amex's case tracking log reflected that the matters had been closed. In other instances, case files lacked documentation of how the matters were resolved. The Amex's record keeping problems are a result of, and provide further evidence of, Sodano's significant inattention to regulation.

24. Notwithstanding a specific undertaking pursuant to the September 2000 Order, the Amex failed to furnish complete, timely or accurate affirmations detailing the Amex's compliance with the Order. Sodano took no action to timely comply with this requirement and otherwise failed to ensure that the Amex undertook its responsibilities under the September 2000 Order, as detailed in the June 2003 OCIE Report. Without notice or a request for an extension of time, the Amex submitted the first affirmation (for 2001) almost five months late and did not even begin work on it until after its due date. The second affirmation (for 2002) was also submitted almost five months late. In addition, the first affirmation contained numerous false representations, and the second affirmation, which was short and conclusory in nature, did not correct these misrepresentations.

25. The affirmations are another example of an Amex obligation under the September 2000 Order for which Sodano abdicated responsibility. Sodano did not make specific delegations of responsibility or establish a framework to comply with this important obligation, and he took no action to ensure that affirmations to Commission staff under the Commission Order were made timely, accurately, or completely. Sodano's poor management over this process led to confusion and inaction by Amex staff, which ultimately led to the Amex's violations related to the affirmations.

26. Sodano failed to enforce numerous rules related to the Amex's options markets as detailed in the June 2003 OCIE Report, and he had no reasonable justification or excuse for failing to do so.

Inadequate Compliance With Rules Related to Equity Trading and Floor Brokers

27. The Amex also failed adequately to surveil for and enforce compliance with certain equity trading rules by its specialists, including the limit order display rule, trading ahead rule, and the firm quote rule. The majority of the Amex's other equity trading surveillances had similar deficiencies in that they were not performed, were conducted only sporadically, or had parameters that did not result in sufficient surveillance. These failures persisted until at least 2004.

28. Many of these deficiencies were brought to the Amex's attention in the November 1999 OCIE Inspection Report. This report detailed widespread problems within the Equity Trading Analysis division ("ETA"), including inadequate surveillance procedures and automation, as well as problems related to disciplinary processes and procedures, enforcement problems, and the Exchange's failures to implement several previous staff recommendations. These deficiencies

involved many of the same issues identified as problematic with respect to the options market in 1999, including the priority rules, limit order display rule, and trade reporting rule.

29. Many of these problems in the Exchange's equities surveillance programs still persisted as late as the middle of 2004.

30. Surveillance for floor broker trading was also inadequate. Several of the floor broker surveillances, including surveillance for frontrunning (when a trader takes a position in a security to profit from advance, nonpublic knowledge of an imminent order that may affect the market price of that security) either were not conducted at all or were conducted sporadically.

31. Many of these deficiencies were brought to Sodano's attention in a January 2001 OCIE inspection report. Although the report details specific findings, notably the OCIE staff found that the Amex did not even have a surveillance program in place to review floor broker equity trading, and that the surveillance programs related to floor broker options trading were inadequate. The staff also found that the Exchange infrequently and insufficiently conducted floor-broker examinations. The staff informed the Amex that these examination deficiencies contributed to a lack of floor-broker compliance with applicable federal securities laws and Exchange rules pertaining to books and records retention.

32. Many of these problems in the Amex's surveillance programs related to floor brokers still persisted as late as the middle of 2004.

33. As with its options market regulation, the Amex similarly failed to maintain complete and accurate documentation regarding its equity and floor-broker regulatory programs. For example, documentation relating to several surveillances in these areas was missing, and the Amex was unable to electronically generate accurate surveillance logs. A lack of qualified individuals and insufficient supervision and proper training of those individuals contributed to the Amex's failure to make and keep accurate records of its surveillances. All these deficiencies contributed to the Amex's failure adequately to surveil for violations by equity specialists and floor brokers. The Amex's record keeping problems are a result of, and provide further evidence of, Sodano's significant inattention to regulation.

34. Sodano failed to discharge his obligations to enforce compliance with the Amex's equity trading and floor broker rules, and there was no reasonable justification or excuse for these failures. In addition, Sodano did not take meaningful steps in response to the significant issues pointed out to him about the Amex's surveillance and enforcement regarding equity trading and floor broker rules.

<u>Sodano's Specific Failures Related to the Amex's Regulatory Program</u>

35. The failures described above were the result of ineffective oversight by Sodano over the Amex's regulatory program.

36. During the relevant time, Sodano devised a three-person management entity, which he called the Office of the Chairman ("OOC"). The OOC was comprised of Sodano as Chief Executive Officer, the General Counsel, and the Amex's President. There existed no formal delegation within the OOC assigning its members specific responsibility for particular areas of the Amex, which created confusion at the Amex regarding who reported to whom and contributed significantly to the mismanagement of the regulatory division.

37. A principal reason the Amex's regulatory program was so deficient, and remained so, was Sodano's failure to exercise basic oversight over regulation. These failures were particularly unreasonable given the Amex's lack of steady leadership in MFR and the undertakings the Amex had agreed to in the September 2000 Order. Following the September 2000 Order, MFR had three different directors in three years. One director only worked part-time at the Amex, while another had insufficient experience in options regulation. Another director of MFR was terminated for cause after only eighteen months. These circumstances should have triggered even greater oversight over MFR by Sodano than normally might have been expected. During a time of known regulatory problems, Sodano failed to adequately review or oversee MFR's regulatory programs.

38. Evidence of Sodano's lack of oversight includes the fact that he neither requested nor received any regular reporting regarding regulation, such as statistics on the number of investigations the Amex opened, the length of time investigations were open, the types of violations occurring, compliance rates of various members, compliance regarding various rules, the number of referrals to the Enforcement Department, the number of referrals to the MFV Disciplinary Committee, and the disposition of cases. Without such information, Sodano had no measure of the effectiveness of the Amex's regulatory program. These omissions are remarkable against the backdrop of the repeated critical OCIE inspection reports he received indicating that the Amex had serious regulatory problems and was failing even to fulfill its commitments from prior reports.

39. Further evidence of Sodano's failure to adequately oversee regulation includes the lack of any centralized tracking system for monitoring the Amex's commitments to regulators. This was true, for example, regarding inspection reports generally and even for the Exchange's undertakings in the September 2000 Order. Because no one was monitoring the Amex's compliance with its regulatory commitments, many of them were ignored. Ultimate responsibility within the Amex for the regulatory commitments belonged to Sodano, who neglected these responsibilities without reasonable justification or excuse.

40. Poor management of the Amex's technology spending also contributed to its regulatory failures. Although Sodano authorized significant expenditures for technology, those sums were both inadequate and poorly managed. As a result, the Amex's trading systems, audit trails, and surveillance remained outdated throughout Sodano's tenure while millions of dollars were wasted on temporary solutions to ongoing problems.

41. Another contributing factor to the Amex's regulatory failures included Sodano's failure to ensure that Amex staff was properly trained. New personnel had limited training

available, and there was no regular, ongoing training program for regulatory personnel. In fact, Sodano did not require mandatory training for the regulatory staff until after the June 2003 OCIE Report.

42. Despite regulation being a fundamental responsibility for the head of an SRO, Sodano paid scant attention to the Amex's regulatory program. Instead, Sodano set a consistent tone that business initiatives were the Amex's top priority and that regulation was relatively unimportant. This message was felt throughout MFR and caused significant morale issues within MFR. The morale issues were brought to Sodano's attention.

43. Sodano ignored the morale problems caused by his inattention to regulation, which further exacerbated the regulatory problems. Even when Sodano was demanding that Amex employees make sacrifices through budget cuts and hiring freezes, Sodano exempted the OOC from these strictures. Not only did Sodano receive pay raises, substantial bonuses, and maintain his perquisites, but his conduct exacerbated the feeling of employees that the OOC did not view themselves as part of the same team as the rest of the Exchange. The fact that Sodano failed to heed specific warnings about significant morale issues caused by his actions and inattention to regulation further demonstrates Sodano's lack of concern for regulatory issues.

44. Throughout Sodano's tenure as CEO, there were continuous red flags that the Amex was failing to meet its regulatory responsibilities. The most significant such red flag was the September 2000 Order. Sodano also received over an extended period of time highly critical OCIE inspection reports covering many areas of the Amex's regulatory program. Many of these reports also pointed out the Amex's failure to correct deficiencies already highlighted in previous reports. These inspection reports alone should have alerted Sodano to the extensive problems in MFR. Even internally at the Amex, specific problems regarding the Amex's regulatory program were brought to Sodano's attention. Particularly in the wake of the September 2000 Order, however, Sodano, as CEO of the Amex, was obligated to take affirmative steps to ensure that the Amex substantially improved its regulation specifically regarding options order handling.

45. There existed multiple red flags that the Amex was failing specifically to comply with the September 2000 Order. From shortly after the September 2000 Order until OCIE's June 16, 2003 inspection report, the Amex received continuing negative feedback in many forms from OCIE staff regarding the Amex's compliance with the September 2000 Order. In at least one meeting and one letter to the Exchange, OCIE staff raised specific concerns about the Amex's insufficient progress in implementing the undertakings. Sodano also learned that OCIE staff shared their concerns with NASD management regarding the Amex's lack of commitment to implementing the undertakings. In addition, three OCIE inspection reports received by Sodano in 2001 and 2002 detailed additional, serious problems with the Amex's regulation, which should have triggered attention by Sodano to the Amex's regulatory program. Amex staff similarly brought to management's attention, including Sodano, that serious regulatory problems existed. Sodano, however, failed to take reasonable steps to ensure that the Amex was progressing in its compliance with the September 2000 Order.

46. Sodano used the regulatory problems for his own financial gain. In a January 2001 memo to the NASD (the parent company of the Amex), Sodano acknowledged that the Amex's regulatory function needed to be completely reinvented and upgraded with staff, technology, rule changes, and policies. Sodano identified these regulatory problems as one of the significant issues facing Amex senior management. Sodano, however, used them, not to secure assistance from the NASD to fix these problems, but rather as a justification for seeking additional employment benefits for himself and the other members of the OOC. Yet despite exploiting these issues to secure greater compensation, Sodano did little to actually address the regulatory problems he had acknowledged and had responsibility for fixing.

47. Beginning in 2002, Sodano's focus away from regulation became even more acute when he began focusing increasingly on finding a buyer for the Amex. Under his contract, Sodano stood to make millions of dollars in the event of a merger, consolidation, other reorganization, or sale of the Amex's assets.

48. The severe budget restrictions implemented by the OOC between 2001 and 2002 were an additional impediment to the Amex's regulatory program. Throughout 2001 and 2002, Sodano sent out multiple memoranda to Amex managers announcing severe budget restrictions, salary freezes, and hiring freezes. Notwithstanding the September 2000 Order and the Amex's responsibilities as an SRO, Sodano made clear that all Amex departments were subject to these budget restrictions, which included regulation. Even MFR had to demonstrate how hiring an individual would save the Amex costs or generate revenues when requesting staff replacements. On its own, meeting regulatory responsibilities was not a valid business justification.

49. More generally, from 2000-2003, critical areas within MFR were continuously understaffed. During this period, some managers in MFR continued to push for more hiring and tried to create business justifications for hiring, but they believed Sodano's mandate made trying to fill positions fruitless. As a result of the hiring restrictions, regulatory headcounts decreased in many significant departments.

50. Despite the severe cost-cutting measures across the Amex, including salary freezes, the OOC did not have its budget or perquisites reduced. To the contrary, Sodano's compensation continued to increase. Initially, he was guaranteed a minimum of $1.5 million per year plus an additional bonus after two years equal to two years annual salary. His salary and bonus were raised in 2001 and substantial additional retirement benefits were added. In 2002, at the height of Sodano's hiring freeze and budget restrictions, his contract was amended again to provide additional lucrative benefits including a second "additional benefit" equal to two years salary payable on December 31, 2004. In addition, throughout his tenure, Sodano continued to enjoy additional perquisites such as club memberships and the use of a luxury automobile and driver.

D. VIOLATIONS

As a result of the conduct described above, Sodano, as the Chairman and CEO of the Amex, without reasonable justification or excuse, failed to enforce compliance with the Exchange Act, the rules and regulations thereunder, and the Amex's rules. Therefore, it is necessary and appropriate in the public interest, for the protection of investors and in furtherance of the purposes of the Exchange Act, to bring this proceeding under Section 19(h)(4) of the Exchange Act against Sodano.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Sodano pursuant to Section 19(h)(4) of the Exchange Act.

IV.

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

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

This Order shall be served forthwith upon Sodano 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

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

Commissioners Nazareth and Casey Not Participating

UNITED STATES OF AMERICA

Before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55507 / March 22, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12594

In the Matter of **American Stock Exchange LLC,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS, A CENSURE, AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 19(h)(1) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate in the public interest and for the protection of investors that public administrative and cease-and desist proceedings be, and hereby are, instituted pursuant to Sections 19(h)(1) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against the American Stock Exchange LLC ("Amex" or "Respondent").

II.

In anticipation of the institution of these proceedings, the Amex has submitted an Offer of Settlement ("Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over the Amex and the subject matter of these proceedings, which are admitted, the Amex consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions, a Censure, and a Cease-and-Desist Order Pursuant to Sections 19(h)(1) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

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

A. SUMMARY

This matter involves the failure by the Amex adequately to enforce certain order handling rules and to comply with its record keeping obligations. From at least 1999 through June 2004, the Amex had critical deficiencies in its surveillance, investigative, and enforcement programs for assuring compliance with its rules as well as the federal securities laws. The Amex did not conduct adequate surveillance for certain types of violations by its specialists and floor brokers. This was primarily because the Amex's surveillance programs were inadequate to detect such violations. When the surveillance programs detected possible order handling rule violations, the Amex did not adequately review the surveillance reports, investigate the potential violations reflected in those reports, or did not complete certain investigations in a timely manner. When the Amex did detect violations, it sometimes failed to make referrals for disciplinary action or improperly excused the conduct.

The Amex's continual regulatory deficiencies during this time period resulted in large part from its failures to pay adequate attention to regulation, to put in place an oversight structure, or to dedicate sufficient resources to ensure that the exchange was meeting its regulatory obligations. These failures were particularly significant with respect to the options market because the Amex was under a Commission order to improve its surveillance and enforcement of the options order handling rules. As a result of its failure adequately to surveil for and investigate violations of, and to enforce, certain options order handling rules, the Amex violated Section 19(g) of the Exchange Act. In addition, the Amex failed to furnish accurate records and, as a result, violated Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1.

In December 2004, the Amex was sold to its members, and in 2005, prior senior management was replaced. All of the conduct at issue occurred under prior senior management.

B. RESPONDENT

American Stock Exchange LLC, located in New York, New York, is a national securities exchange registered with the Commission pursuant to Section 6 of the Exchange Act. From 1998 until December 31, 2004, the Amex was a subsidiary of the National Association of Securities Dealers, Inc. ("NASD"). On December 31, 2004, the NASD completed the sale of its interest in the Amex and transferred control to the Amex Membership Corporation. New management has

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

assumed senior executive positions at the Amex, including the Chairman/Chief Executive Officer. The Amex trades over 800 stocks, various types of options, and over 100 exchange-traded funds.

C. FACTS

1. Prior Commission Action

From at least 1999, the Amex was on notice that its surveillance, investigatory, and enforcement programs were inadequate. On September 11, 2000, the Commission issued an order ("September 2000 Order"), to which the Amex consented, finding, in relevant part, that the Amex had failed effectively to enforce compliance by its members with exchange rules, policies, or procedures relating to options order handling.[2] Specifically, the Commission found that the Amex had failed to surveil for, or to take appropriate action with respect to evidence of, violations of firm quote,[3] customer priority,[4] limit order display,[5] and trade reporting rules[6]. These rules were designed to protect investors and provide some of the primary safeguards against execution abuses by specialists.

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[2] See In the Matter of Certain Activities of Options Exchanges, Exchange Act Rel. No. 43268 (Sept. 11, 2000). The Commission issued its order against the Amex and three other options exchanges.

[3] The firm quote rule generally requires options specialists to trade options at the prices and in the amounts that they quote. During most of the period relevant to this Order, the firm quote rule for options was set forth in Exchange Act Rule 11Ac1-1, which had a compliance date of April 2001, and Amex Rule 958A. With the Commission's adoption of Regulation NMS in August 2005, the Commission's firm quote rule was redesignated as Exchange Act Rule 602. Under Exchange Act Rule 602, its predecessor Exchange Act Rule 11Ac1-1, and Amex Rule 958A, responsible brokers or dealers are required, with a few exceptions, to execute options transactions with customers at prices at least as favorable as their published bids or offers at the time the orders are presented and in any amount of contracts up to their published sizes.

[4] With certain exceptions, the priority rules generally require that a customer limit order be executed prior to the execution of any other order if it has the best price, i.e., the highest bid or lowest offer. See Amex Rules 126 and 950(d). If there is more than one customer order at the best price, the customer order that arrives first has priority.

[5] The obligation to display limit orders generally requires that a customer limit order that is priced better than the highest bid or the lowest ask price currently quoted on the exchange immediately be displayed in the quotations. As discussed infra at III.C.2.c., at the time of the September 2000 Order, specialists were required to display such limit orders as part of their due diligence obligations. In January 2005, the Commission approved, and the Amex thereafter implemented, a limit order display rule specifically applicable to options.

[6] The trade reporting rule generally requires that transactions be reported within a specified time after execution. The Amex's trade reporting rule, adopted in August 2000, requires that options transactions are to be reported to the Amex Options Market Data System within 90 seconds of execution and that transactions not reported within that time are to be designated as late. See Amex Rule 992.

The Commission ordered the Amex to enhance and improve its regulatory programs for surveillance, investigation, and enforcement of the options order handling rules, including compliance with the limit order display, priority, trade reporting, and firm quote rules. The Amex further was required to provide Commission staff with annual affirmations detailing its progress in complying with the September 2000 Order. The Amex failed to comply with these obligations.

2. Inadequate Surveillance, Investigatory, and Enforcement Programs for Options Trading

Notwithstanding the September 2000 Order, as late as 2003, there remained significant deficiencies in the Amex's surveillance, investigatory, and disciplinary programs regarding the firm quote, customer priority, trade reporting, limit order display, as well as, other options order handling rules. During the relevant time, the Amex's Derivatives Trading Analysis Department ("DTA") was primarily responsible for the Amex's regulatory surveillance program for the derivatives and options markets. In January 2002, the Amex formed the Best Execution Department ("Best Ex") within the DTA specifically to conduct surveillance reviews and investigations into whether Amex members complied with options order handling rules. Best Ex was responsible for reviewing surveillance reports for violations of the firm quote, trading ahead, trade reporting, and stopped order rules, as well as, the limit order display obligation.

When Best Ex was formed, the Amex contemplated that the department would have five individuals to carry out its functions. During the relevant time, however, Best Ex never had a staff of five. It initially had a staff of four and thereafter had four or fewer individuals. The lack of staff in Best Ex was a significant contributing factor to the Amex's inadequate surveillance, investigative, and enforcement programs for options order handling rules.

a. The Firm Quote Rule

The firm quote rule is one of the primary means of ensuring that investors receive the best price available for their orders. Notwithstanding the importance of the rule, there were multiple deficiencies in the Amex's surveillance, investigatory, and enforcement programs related the rule. The Amex improperly applied the rule, established unreasonable surveillance parameters, and failed adequately to pursue disciplinary actions for violations of the rule.

The firm quote rule, in part, requires a responsible broker or dealer[7] to stand by the quoted price up to the full quoted size for each option series.[8] As such, when a responsible broker or

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[7] A responsible broker or dealer is a member of an exchange who communicates quotes to other members of the exchange. See Exchange Act Rule 602(b)(65). The responsible broker or dealer frequently is the specialist for the subject security.

[8] Options of the same class that have the same exercise price and expiration date are an option series.

dealer receives several executable orders in different series simultaneously, the responsible broker or dealer must fill orders up to the quoted size at the quoted price for each option series. The Amex, however, improperly applied the rule and permitted a responsible broker or dealer to back away from the quote in every option series within a class after executing an order of any size in any series within the class.

The Amex also employed incorrect parameters in reviewing exception reports to determine whether there was an applicable exception to the firm quote rule.[9] For example, when it initially began reviewing these reports, the Amex simply concluded without investigation that if the quote changed in the thirty seconds following receipt of an order, the specialist was in the process of changing the quote when he or she received the order. The thirty-second period was an unreasonably long period to use in this analysis, because it permitted the precise type of conduct that the firm quote rule was designed to prohibit. Specifically, within thirty seconds, a specialist could receive an order, revise the quote to an inferior price, and either not execute the order or execute it at an inferior price without being cited for a violation of the firm quote rule.

Shortly after it began using the thirty-second review parameter, the Amex expanded the time frame to seventy seconds. The Amex took this action because of the possibility that there could be a delay of up to forty seconds between the time when an order entered the Amex's electronic systems and the time when the order was displayed on the specialist's order book. The seventy-second period, however, afforded specialists even more time to revise quotes and then either not execute orders or execute them at inferior prices without the risk of review of their conduct and possible disciplinary action.

The Amex also excused violations of the firm quote rule based on rationales not recognized under any exception to the rule. For example, the Amex improperly excused violations when a customer limit order was executed at the limit price rather than at an Amex quote that represented a better price. It also excused violations when a specialist paired off a customer's order with another customer order even though, at the time, there was a posted quote at a better price. Excusing violations of the firm quote rule based on non-existent exceptions potentially deprived investors of the execution prices to which they were entitled.

In addition to incorrectly applying the firm quote rule and using unreasonable surveillance parameters, the Amex failed to investigate conduct that its surveillance reports identified as potential rule violations. One surveillance report that the Amex used to identify

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[9] A responsible broker or dealer is excused from the firm quote obligation if (1) prior to the presentation of the order, a revised quote was communicated to the Exchange, (2) at the time of presentation of the order, a transaction is in the process of being effected and a revised quote is communicated to the Exchange immediately thereafter, or (3) the Exchange is experiencing "unusual market conditions" such that it is "incapable of collecting, processing, and making available to quotation vendors" quotation data that accurately reflect the state of the market on the Exchange. See Exchange Act Rule 602(a)(3)(i), (b)(3)(i); former Exchange Act Rule11Ac1-1(b)(3)(i), (c)(3)(i); Amex Rule 958A(c), (d).

potential violations of the rule was the "Executable Orders Unexecuted" report. The report was generated on a daily basis and captured instances in which an Amex specialist failed to execute a market or limit order after the order became executable. As such, all orders captured on the report represented potential violations of the rule. The Amex, however, did not review all of the orders that appeared on the report. In certain instances, for example, the Amex reviewed only those orders that were unexecuted for more than two minutes. This practice was adopted in part due to the extraordinarily limited resources of Best Ex. By December 2002, Best Ex was so backlogged in its review that it was only reviewing orders from August 2002. By March 2003, Best Ex had slightly decreased the backlog, but was still over two months behind in its review. The delay in reviewing the Executable Orders Unexecuted report impeded further investigation of potential violations and their ultimate referral for disciplinary action, because of the difficulty the specialist and other witnesses had recalling the details of an order placed months in the past.

When it made referrals, the DTA referred almost all potential violations to its Minor Floor Violation Disciplinary Committee ("MFV Disciplinary Committee"). The delay in making the referrals to the MFV Disciplinary Committee further impeded disciplinary actions because the committee's evaluation of the conduct also depended on the memory of the specialist. After the committee complained about the delay, the DTA, in August 2002, stopped referring potential violations of the firm quote rule to the MFV Disciplinary Committee.

Even when the MFV Disciplinary Committee considered referrals, it improperly applied the firm quote rule. In some instances, committee members did not understand what were valid exceptions to the rule and in other instances, committee members excused conduct based on improper analysis. For example, in determining whether a violation had occurred, committee members considered the prior disciplinary history of the specialist, whether the violation was intentional, and whether the specialist was busy. None of these factors represents a valid exception, and the MFV Disciplinary Committee's reliance on these factors contributed to the Amex's failure to enforce the firm quote rule.

b. Trading Ahead

The Amex's trading ahead rules require a specialist to give precedence to an order entrusted to him or her as agent before executing at the same price any transaction in the same option for an account in which the specialist has an interest.[10] To monitor for violations of these rules, the Amex created the "Trading Ahead Report." There were, however, significant deficiencies in the parameters of the Trading Ahead Report and also in the Amex's review of the report.

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[10] See Amex Rules 155 and 950(a). The Amex also had a rule that required a registered options trader, when establishing or increasing a position for an account in which he or she had an interest, to give precedence to off-floor orders. See Amex Rule 111(d). A registered options trader is a participant on the exchange trading for his or her own or firm's account who is responsible for making two-sided markets.

The Trading Ahead Report captured only those potential trading ahead violations in which a specialist's execution occurred at least sixty seconds after receipt of the customer's order. This parameter essentially gave the specialist a sixty-second grace period to trade ahead of a customer's order and thereby receive a better price than the customer then received. There is no justification for permitting a specialist to trade ahead of a customer's order within sixty seconds of receipt of the order. The Trading Ahead Report also did not capture instances in which a specialist traded ahead for his or her own account at the same price as a customer order held on the specialist's book. This conduct, which deprives the customer of the opportunity to receive a timely execution, is also prohibited by the Amex's rules.

With respect to the review and analysis of the information on the Trading Ahead Report, the Amex again did not review all instances of potential trading ahead violations identified on the report. It instead reviewed only selected instances of potential violations. In several instances, the Amex excused what appear to be clear violations, such as when a specialist traded for his or her account at a better price than the specialist's customer received.[11] Accordingly, the Amex's surveillance, investigatory, and enforcement programs related to violations of the trading ahead rules were deficient.

c. Limit Order Display

Pursuant to its rules, the Amex required specialists to exercise due diligence in handling customer orders.[12] As part of their due diligence obligations, specialists immediately were to display customer limit orders that improved Amex quotes.[13] The immediate display of such orders is an important means of enabling investors to receive the best executions for their orders. However, the Amex's surveillance, investigative, and enforcement programs relating to the limit order display obligation were deficient.

Following issuance of the September 2000 Order, the Amex developed the "Limit Order Display" report which was supposed to capture instances in which a specialist failed immediately to display a customer order that improved the Amex quote. The Amex, however, inappropriately

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[11] The Amex rules do allow a specialist or registered options or equity trader to trade ahead of a customer order in limited circumstances, such as when the registered trader is closing a position. These exceptions do not appear to have been a factor in the analysts' review of the Trading Ahead Report.

[12] See Amex Rules 156 and 950(g).

[13] In January 2005, the Commission approved, and the Amex thereafter implemented, a limit order display rule that was specifically applicable to options. See Self-Regulatory Organizations; Order Approving a Proposed Rule Change and Amendments No. 1, 2, 3, 4, 5, and 6 Thereto, and Notice of Filing and Order Granting Accelerated Approval to Amendments No. 7 and 8 Thereto by the American Stock Exchange LLC to Require the Immediate Display of Customer Options Limit Orders, Exchange Act Rel. No. 51062 (Jan. 21, 2005). The role of a limit order display rule is described generally supra at note 5.

limited its surveillance to the conduct of specialist units.[14] By limiting its surveillance in this manner, however, the Amex overlooked misconduct by individual specialists. This was an unreasonable practice because it is the individual specialist who is responsible for displaying limit orders, and specialists not infrequently change firms. Limiting its surveillance to the conduct of specialist units also meant that the Amex was unable to detect patterns of limit order display violations in options classes.

Even to the extent that it did surveil for violations of the limit order display obligation, the Amex employed a flawed method of determining compliance rates. The Amex measured compliance by calculating the orders not displayed as a percentage of all marketable orders received by the specialist unit.[15] Marketable orders, however, do not improve published quotes and, accordingly, are not subject to the display requirement. As a result, the Amex's calculation of compliance rates was inflated.

d. Trade Reporting

The trade reporting rule requires that transactions be reported within a specified time after execution.[16] Reliable trade reporting enhances the transparency of the markets and effective surveillance and enforcement with respect to order handling and other rules. Similar to its surveillance relating to the limit order display obligation, the Amex inappropriately limited its review of potential violations of the trade reporting rule to instances in which a specialist unit reported more than five percent of its trades late. In determining whether the five-percent threshold was exceeded, trades that were automatically reported were included, rather than just trades that were not reported automatically. This practice gave the appearance of a higher compliance rate than was warranted.[17]

Separately, the Amex did not monitor for compliance by option class and thus was unable to determine whether there were patterns of late trade reporting in particular options classes. The Amex further did not surveil for transactions that were reported late but that were not designated as

[14] A specialist unit is comprised of several individual specialists employed by a specialist firm.

[15] A marketable order is an order that is executable immediately either because it is an order to buy or sell at the current market price or because it is a limit order that is executable at the currently published quote, i.e. a buy limit order priced at or higher than the published offer or a sell limit order priced at or below the published bid. Market orders, marketable limit orders, and certain other orders were not subject to the display requirement.

[16] See supra note 6.

[17] At the relevant time, the Amex estimated that approximately sixty percent to seventy percent of options transactions were electronically routed and executed orders that were reported immediately.

such when the transactions were reported.[18] As a result of these deficiencies, the Amex inadequately surveilled for and investigated violations of, and enforced, the trade reporting rule.

e. Busted and Adjusted Trades

The improper cancellation of trades can be a means by which specialists or other market participants avoid their firm quote and other regulatory obligations. Amex Rule 135, in effect for options during the period in question, prohibited exchange members from busting or adjusting a trade unless the transaction was made in error or the bust or adjust was made for other proper reasons. The rule further required both parties to the trade to agree to the bust or adjust. Amex Rule 22 additionally requires that there be a written record of all floor official rulings on busting or adjusting trades and that, at the end of each day, the ruling records be submitted to the exchange.

Continuing at least through 2004, the Amex allowed trades to be busted and adjusted without necessarily obtaining the approval of both parties to the transactions. The Amex's records, moreover, had no clear indication whether floor officials had approved busted or adjusted trades or whether the parties to the transactions had agreed to the bust or adjust.[19] Without this information, the Amex could not assess whether violations of the relevant rules had occurred. Accordingly, the Amex failed to surveil for violations of, and enforce, its rules for busting or adjusting trades.

f. Stopped Orders

The Amex's "stopped order" rule essentially requires a specialist to provide execution assurances under certain circumstances.[20] An exchange member who wants to buy or sell an option at a better price than the price currently available can ask the specialist to "stop" the member's order and to attempt to obtain a better price. If the specialist agrees, the specialist then is obligated to execute the member's order at a better price or, if one cannot be obtained, at the market price at the time of the stop. The Amex developed a "Stopping Orders Report" that captured orders that specialists stopped at the Amex quote or at prices inferior to the Amex quote. The Amex was to review the report for instances in which a stopped order was executed at a price below the Amex quote at the time of the stop.[21] As with other surveillance reports, the Amex did

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[18] Pursuant to Amex Rule 992(b), a transaction not reported within ninety seconds of execution was to be designated as late. When that occurred, the specialist was supposed to add to the trade report a modifier designating the trade as late.

[19] The lack of documentation also is a violation of the Amex's record keeping obligations, which are discussed infra.

[20] See Amex Rules 109, 154, and 950(f), (o).

[21] The execution of an order at a price inferior to the Amex quote at the time of the stop order also may constitute a violation of the firm quote rule.

not review all potential violations reflected on the Stopping Orders Report but only selected transactions. In addition, instances in which specialists executed stopped orders at prices that were worse than the market prices at the time of the stop were excused. The Amex thus unreasonably failed to surveil for and investigate violations of, and to enforce, the stopped order rule.

3. Inadequate Surveillance for Equity Trading and Floor Brokers

The Amex also failed adequately to surveil for compliance with certain equity trading rules by its specialists. For example, from at least January 2003 until June 2004, the Amex did not conduct any surveillance for limit order display rule compliance for equities. During that same time, the Amex failed to generate its trading ahead surveillance reports for approximately seven months. Furthermore, the Amex's surveillance with respect to firm quote violations used inappropriate review parameters which excluded categories of potential violations. Specifically, to determine whether there were potential violations of the firm quote rule, the Amex inappropriately looked at the quote in effect at an order's time of execution rather than the earlier time when the order was presented to the specialist. The majority of the Amex's other equity trading surveillances had similar deficiencies in that they were not done, were conducted only sporadically, or had parameters that did not result in sufficient surveillance.

Surveillance for floor broker trading were also inadequate. Several of the floor broker surveillances, including surveillance for frontrunning,[22] either were not conducted at all or were conducted sporadically.

4. Failure to Make, Keep, and Furnish Complete and Accurate Records

The Amex also failed to make and keep certain of the required records relating to its surveillance, investigatory, and enforcement activities and further furnished the Commission with inaccurate documents.

a. Inadequate Documentation

(i) Options

The Amex lacked documentation sufficient to support its options surveillance, investigatory, and enforcement activities. The Amex, for example, failed uniformly to maintain in its case files the surveillance reports that gave rise to investigations, lacked audit trail data to support the potential applicability of exceptions to the firm quote rule, failed to maintain analyses and supporting documentation related to reviews of the Trading Ahead and Stopping Orders

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[22] Frontrunning involves a trader taking a position in a security to profit from advance, nonpublic knowledge of an imminent order that may affect the market price of that security. See Amex Rules 111, commentary .03(c) and 950(c).

Reports, and failed to make or keep records of floor official approval and customer consent to busted and adjusted trades. Not only were Amex investigative files incomplete, but in an internal review in 2003, the Amex was unable to locate many investigative files. In some instances, documents in case files were dated after the Amex's case tracking log reflected that the matters had been closed. In other instances, case files lacked documentation of how the matters were resolved, but logs reflected that the matters had been referred to the MFV Disciplinary Committee.

Documentation related to enforcement actions taken by the MFV Disciplinary Committee was also inadequate. The minutes of the meetings of the committee were vague and conclusory and did not provide sufficient information to evaluate the committee's actions. The minutes, for example, included records of the committee's decisions, but did not contain a discussion of the rationales for those decisions. Some of the minutes, moreover, failed even to include references to the types of violations that the committee considered. Other minutes were unclear as to which violations the committee considered or on which the violations the committee acted. In other instances, the minutes did not include a discussion of some matters that purportedly were on the agenda for those meeting.

(ii) Equities and Floor Brokers

The Amex similarly failed to maintain complete and accurate documentation regarding its equity and floor broker regulatory programs. For example, documentation relating to several surveillances in these areas was missing. For some surveillances, due to deficiencies in technology, the Amex maintained inaccurate data and was unable to electronically generate accurate surveillance logs. A lack of qualified individuals and insufficient supervision of those individuals also contributed to the Amex's failure to make and keep accurate records of its surveillances. All these deficiencies contributed to the Amex's failure adequately to surveil for violations by equity specialists and floor brokers.

b. The Failure to Furnish Timely, Complete, and Accurate Affirmations

The Amex furnished affirmations required by the September 2000 Order that were late, inaccurate, and incomplete. Affirmations detailing the Amex's compliance with the September 2000 Order were due annually on September 11. Without notice or a request for an extension of time, the Amex submitted the first affirmation (for 2001) almost five months late, on January 31, 2002, and the second affirmation (for 2002) again almost five months late, on February 7, 2003.

The first affirmation included the following representations:

(1) the Amex's Enforcement Department was reviewing all matters that the DTA was proposing to submit to the MFV Disciplinary Committee before they were presented to the MFV Disciplinary Committee;

(2) firm quote violations "will be forwarded to the Enforcement Department for their review and action unless there are extenuating circumstances";

(3) in early September 2001, a Trading Ahead of Customer Orders Report and an Executable Orders Unexecuted Report had been incorporated into the Amex's routine surveillance;

(4) the Amex was utilizing the following surveillance reports: (a) Lack of Traders Trading in Between the Markets and (b) Specialists Routinely Being the Only Contra-Side on a Trade;

(5) the Amex had incorporated a Trade Reporting Report into its routine surveillance program; and

(6) a Floor Broker Order Handling Summary Report had been incorporated into the Amex's routine surveillance.

None of these representations was accurate. At the time of the Amex's first affirmation, the Enforcement Department was not reviewing all matters that the DTA was proposing to submit to the MFV Disciplinary Committee, nor did the Enforcement Department ever review routinely all matters that the DTA was proposing to submit to the MFV Disciplinary Committee. The DTA also was not forwarding routinely firm quote violations to the Enforcement Department, nor did the DTA ever forward routinely firm quote violations to the Enforcement Department. Instead, the DTA referred most firm quote violations to the MFV Disciplinary Committee. In addition, the Trading Ahead of Customer Orders Report and the Executable Orders Unexecuted report were still in testing in September 2001 and were not actually implemented until approximately January 2002. Similarly, the reports for the Lack of Traders Trading in Between the Markets and for Specialists Routinely Being the Only Contra-Side on a Trade were also still in development at the time of the affirmation. Indeed, after March 2002, work on these reports ceased. Neither report was used for surveillance. In addition, requirements for the Trade Reporting Report did not start to be developed until February 2002, and a Floor Broker Order Handling Summary Report was never developed.

In its second affirmation, the Amex referenced the first affirmation, stating "[a]s reported in the Exchange's previous affirmation, during the first year following the issuance of the Commission's order, the Exchange implemented a significant number of initiatives . . .", but the second affirmation failed to correct the inaccuracies in the first affirmation. The second affirmation itself was less than three pages in length. It was conclusory in nature and provided little detail of improvements to the Amex's regulatory program.

D. DISCUSSION

As a self-regulatory organization, an exchange such as the Amex is a quasi-governmental body that has a responsibility that is fundamental to the enforcement of the federal securities laws.[23] It must have the capacity to comply, and to enforce compliance by its members, with the Exchange Act, the rules and regulations thereunder, and the exchange's own rules.[24] When an exchange fails to comply or to enforce compliance with these provisions, the Commission may take actions that it deems appropriate. The Amex violated provisions of the Exchange Act and Exchange Act rules and failed to enforce compliance by its members.

The Amex's regulatory deficiencies resulted in large part from its failures to pay adequate attention to regulation, to put in place an oversight structure, or to dedicate sufficient resources to ensure that the exchange was meeting its regulatory obligations. These failures were particularly significant with respect to the options market because the exchange was subject to the September 2000 Order.

1. Violation of Section 19(g)(1) of the Exchange Act

Section 19(g)(1) of the Exchange Act obligates the Amex as a self-regulatory organization to comply with the Exchange Act, the Exchange Act rules and regulations, and the Amex's rules. Section 19(g)(1) further obligates the Amex, absent reasonable justification or excuse, to enforce compliance with these provisions by its members and persons associated with those members. In carrying out its duty to enforce compliance, the Amex was required to develop and maintain surveillance over its members and to "be vigilant in surveilling for, evaluating, and effectively addressing issues that could involve violations" of the securities laws.[25] The conduct described above reflects a significant failure by the Amex to surveil for and investigate violations of, and to enforce compliance with, options and equities trading rules by Amex members. Particularly in light of the Amex's undertaking in the September 2000 Order to enhance and improve its surveillance, investigative, and enforcement processes with respect to the option order handling rules, there is no reasonable justification or excuse for the Amex's conduct. Under these circumstances, the Amex violated Section 19(g)(1) of the Exchange Act.

2. Violation of Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1

Section 17(a)(1) of the Exchange Act requires an exchange such as the Amex to make and keep for prescribed periods, and then to furnish the Commission with a copy of, such records as the

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[23] See Regulation of Exchanges and Alternative Trading Systems, Exchange Act Rel. No. 40760, at 63 (Dec. 8, 1998).

[24] See Exchange Act § 6(b), 15 U.S.C. § 78f(b).

[25] National Ass'n of Sec. Dealers, Inc., Exchange Act Rel. No. 37538, at 3 (Aug. 8, 1996).

Commission prescribes as necessary or appropriate in the public interest, for the protection of investors, or for other purposes set forth in the Exchange Act. Exchange Act Rule 17a-1(a) further requires an exchange to keep and preserve at least one copy of all correspondence, records, and other documents made or received by it in its business and in the conduct of its self-regulatory activity. Rule 17a-1(c) requires an exchange promptly to furnish the Commission with a copy of any such document that the Commission requests. The requirement that an exchange keep and furnish records to the Commission includes the requirement that any accompanying explanation of those records be complete and accurate and that those materials be furnished on a timely basis.

The preparation, maintenance, and furnishing of complete and accurate records are essential to the proper functioning of an exchange as a self-regulatory organization. As described above, the Amex failed to keep and furnish records with respect to its surveillance and investigatory functions as well as its enforcement activities. By submitting the affirmations late and with inaccuracies, the Amex further failed to satisfy its obligation promptly to furnish the Commission with such documents as it requests.[26] Under these circumstances, the Amex violated Section 17(a)(1) of the Exchange Act and Exchange Act Rule 17a-1.

E. SUBSEQUENT DEVELOPMENTS RELATING TO THE AMEX

In determining to accept the Offer, the Commission has considered the remedial actions that the Amex has taken, including the Amex's agreement to comply with the undertakings described in Section III.F. below and the replacement of senior management responsible for regulatory compliance during the period in which the violations discussed herein occurred.

F. UNDERTAKINGS

The Amex has agreed to comply with the following undertakings:

1. The Amex shall, within 60 days after issuance of the Order, file with the Commission a proposed rule change that complies with Section 19(b) of the Exchange Act to identify and implement enhancements, to the extent practicable, to its trading systems for equities and options reasonably designed to prevent specialists from violating the Amex's priority rules, such that when a specialist is in the process of executing a specialist's proprietary trade while in possession of a customer order that could trade in place of some or all of the specialist's side of the trade, the Amex system will systemically prevent the reporting of the execution and enable the specialist to allocate the appropriate portion of the specialist's trade to the customer order, unless the trade meets a specified exemption in the Amex's rules. Inappropriate use of any such exemption shall be subject to surveillance by

[26] The affirmations, which were required by the September 2000 Order, were prepared in the course of the Amex's activity as a self-regulatory organization and are records within the meaning of Section 17(a) of the Exchange Act and Exchange Act Rule 17a-1.

the Amex. The Amex shall also require that the system enhancements adopted in compliance with this undertaking may not be disabled by the specialists. The Amex shall fully implement this undertaking within 180 days of the date of this Order, subject to Commission approval of the relevant proposed rule changes.

2. The Amex shall, within 90 days after issuance of the Order, enhance its existing training programs as necessary to implement a mandatory annual training program for all Floor Members and members of the Amex's regulatory staff responsible for surveillance, investigation, examination, and discipline of Floor Members that addresses compliance with the federal securities laws and the Amex's rules in place to prevent and deter unlawful trading by Floor Members.

3. The Amex shall

(a) Commencing in 2007, and for each of the successive two-year periods thereafter (for a total of three two-year periods), retain a Third Party Auditor ("Auditor"), not unacceptable to the Commission staff, to conduct a comprehensive audit of the Amex's surveillance, examination, investigation and disciplinary programs relating to trading applicable to all Floor Members in order to achieve the following audit objectives:

(i) to determine whether the Amex's policies and procedures are reasonably designed and effective to ensure compliance with, and to detect and deter violations of, the federal securities laws and the Amex's rules relating to trading; and

(ii) to determine whether the Amex is in compliance with (1) the policies and procedures identified in section III.F.3(a)(i), above; (2) any outstanding commitments made by the Amex in relation to the written recommendations made by the Commission's Office of Compliance Inspections and Examinations ("OCIE") or the Division of Market Regulation relating to compliance with trading rules or surveillance for trading rule violations; and (3) any undertakings contained in this Order or section IV.B.f. of the September 2000 Order.

(b) Require the Auditor and other qualified persons hired by the Auditor ("qualified persons") to have or acquire within a reasonable period of time adequate knowledge and understanding of the Amex's regulatory programs, policies and procedures and to possess sufficient competence and resources necessary to assess the Amex's surveillance, examination, investigation, and disciplinary programs.

(c) Require the Auditor to develop a written audit plan of sufficient scope and detail to achieve the audit objectives described in section III.F.3(a) above and to identify regulatory areas in need of special consideration. The Amex further shall require that, in performing the audit, the Auditor and the qualified persons shall exercise due professional care and independence.

(d) Require the Auditor to formulate an opinion based on sufficient competent evidential matter that is obtained through, among other things, (i) inspection of documents, including written procedures, rules, and staff files; (ii) observation of trading processes and the Amex's regulatory systems and practices; (iii) interviews of regulatory staff, floor members, and other relevant persons; and (iv) case studies and testing of various regulatory functions and trading practices.

(e) Cooperate fully with the Auditor and qualified persons and provide the Auditor and qualified persons with access to its files, books, records, and staff as reasonably requested for the audit.

(f) Require that each audit be concluded within 180 days of the field work. No later than 45 days after each audit is concluded, the Amex shall require the Auditor to submit an audit opinion as to its assessment of the Amex's surveillance, examination, investigation, and disciplinary programs to the Amex's Board of Governors and to the following officials at the Commission (the "Commission Officials"): (i) the Director of OCIE; and (ii) the Director of the Division of Market Regulation. The audit opinion shall also be included in the Amex's annual report.

(g) No later than 45 days after each audit is concluded, require the Auditor also to submit an audit report to the Amex's Board of Governors and to the Commission Officials (i) describing the purpose, scope and nature of the audit; and (ii) identifying any significant deficiencies or weaknesses in the Amex's policies and procedures, or the Amex's compliance with these policies and procedures, OCIE recommendations, and the undertakings described in section III.F.1., 2, and 3.(a), above.

(h) No later than 90 days after the date of the audit report, review all significant deficiencies or weaknesses identified in the audit report and develop a written plan of corrective actions to address each deficiency or weakness, including a date by which each corrective action shall be implemented. The Amex shall maintain a copy of such plan for the entire period of this undertaking and shall provide the plan to the Commission staff upon request.

(i) Bear the full expense of each audit. Within 45 days after issuance of this Order, the Amex shall set aside a reserve fund of $3 million ($1 million per audit) for the establishment, retention and payment of the Auditor for the three audits. If the expenses for the audits exceed the funds in the reserve fund, the Amex shall use additional funds to pay the costs of the audits. If

any funds remain after completion of the three audits described in section III.F.3.(a) above, those funds shall be used for future audits that the Commission may direct.

(j) Require the Auditor to provide the Commission staff with any documents or other information the Commission requests regarding the Auditor's work pursuant to this undertaking. The Amex shall not assert, and shall require the Auditor to agree not to assert, privilege or work product claims in response to any of the Commission staff's requests.

(k) Require the Auditor to enter into an agreement that provides that for the period of the engagement and for a period of two years from completion of the engagement, the Auditor shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with the Amex, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Auditor 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 Auditor in performance of his/her duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with the Amex, 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.

4. The Amex shall implement the enumerated undertakings within the time specified herein unless, upon written request and for good cause shown by the Amex, the Commission staff grants the Amex such additional time as the Commission staff deems reasonable and necessary to implement any of the enumerated undertakings.

IV.

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

Accordingly, pursuant to Sections 19(h)(1) and 21C of the Exchange Act, it is hereby ORDERED, that

A. Respondent Amex be, and hereby is, censured;

B. Respondent Amex cease and desist from committing or causing any violations and any future violations of Sections 17(a)(1) and 19(g)(1) of the Exchange Act and Exchange Act Rule 17a-1; and

C. Respondent Amex shall comply with the undertakings enumerated in Section III.F. above.

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
Release No. 55510 / March 22, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12392

In the Matter of Paul E. Johnson, Respondent.	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b)(6) OF THE SECURITES EXCHANGE ACT OF 1934**

I.

On August 11, 2006, the Securities and Exchange Commission ("Commission") instituted public administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Paul E. Johnson ("Johnson" or the "Respondent").

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent consents to the Commission's jurisdiction over him and over the subject matter of these proceedings, and further consents to the entry of this Order Making Findings and Imposing Remedial Sanctions Pursuant to Section 15(b) of the Securities Exchange Act of 1934 (the "Order"), as set forth below.

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III.

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

1. Respondent, age 46, resides in New York, New York. From 1994 until June 2002, Respondent was a managing director and senior equity analyst at Robertson Stephens, Inc. ("RSI"), a broker-dealer registered with the Commission pursuant to Section 15(b) of the Exchange Act.

2. On July 24, 2006, a final judgment was entered against Respondent in the civil action entitled *Securities and Exchange Commission v. Paul E. Johnson*, Civil Action Number 03-0177, by the United States District Court for the Southern District of New York, enjoining him for a period of five years 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.

3. The Commission's Complaint alleged that, in 1999, 2000, and 2001, Respondent failed to properly disclose his financial interest in three companies that he covered as a research analyst.

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 be, and hereby is barred from association with any broker or dealer with the right to reapply for association after five (5) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) the disgorgement ordered against the Respondent in the Amended Final Judgment, in the civil action entitled *Securities and Exchange Commission v. Paul E. Johnson*, Civil Action Number 03-0177, by the United States District Court for the Southern District of New York; (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

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UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55512 / March 22, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12597

In the Matter of **BARRY HERTZ,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE THE SECURITIES EXCHANGE ACT OF 1934 , MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Barry Hertz ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934 , Making Findings, and Imposing Remedial Sanctions (" Order"), as set forth below.

III.

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

1. Hertz was the chairman and chief executive officer of Track Data Corporation ("Track Data"), a financial services company that supplies electronically delivered financial

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information to institutional and individual investors. The company also owns and operates an electronic communications network, provides a proprietary internet-based online trading system to institutional and individual traders, and distributes news and third-party database information to its customers from worldwide sources. Hertz, who was a registered options principal, a general securities representative, a general securities principal, and an equity trader limited representative, was also the president of Track Data Securities Corp., a registered broker-dealer and wholly-owned subsidiary of Track Data. Hertz, 57 years old, is a resident of Brooklyn, New York.

2. On March 16, 2007, a final judgment was entered by consent against Hertz, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled Securities and Exchange Commission v. Barry Hertz, Civil Action Number 05-2848, filed on June 14, 2005, in the United States District Court for the Eastern District of New York.

3. The Commission's complaint alleged that Hertz illegally traded in Track Data stock while he possessed material, nonpublic information concerning (i) Track Data's negative financial results prior to the company's public announcement of its revenues and earnings for the second and third quarters of 2003 and (ii) the development of a plan during the summer of 2003 to issue a first-time dividend to the company's stockholders.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act, that Respondent Hertz be, and hereby is barred from association with any broker or dealer, with the right to reapply for association after two years to the appropriate self-regulatory organization, or if there is none, to the Commission;

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

By the Commission.

Nancy M. Morris
Secretary

By: J. Lynn Taylor

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55523 / March 26, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2580 / March 26, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12600

In the Matter of **ERNST & YOUNG LLP,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Ernst & Young LLP ("Respondent" or "E&Y") pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over E&Y and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public

[1] Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may censure a person . . . who is found by the Commission . . . to have engaged in unethical or improper professional conduct.

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Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

A. SUMMARY

This action concerns violations of auditor independence standards by E&Y. During 2001, E&Y, through one of its National Office partners, compromised its professional independence by assisting one client, American International Group, Inc. ("AIG"), in its development and marketing of an accounting-driven financial product and then advising an audit client, The PNC Financial Services Group, Inc. ("PNC"), on the accounting treatment for a version of that product in PNC's financial statements, without E&Y performing a meaningful analysis of the accounting separate from the analysis that the National Office partner had performed.[3]

The accounting-driven financial product purported to enable a company to transfer volatile financial assets to a special purpose entity ("SPE") and thereby to remove those assets from the company's financial statements. AIG sold three such products to PNC in 2001, and as a result, PNC improperly excluded certain assets from its consolidated financial statements. E&Y advised PNC on the accounting for each transaction. In January 2002, PNC announced that it would restate its financial statements for the second and third quarters of 2001, and revised its previously announced financial results for the fourth quarter and year-end of 2001, to include the previously excluded assets.

Through the National Office partner, E&Y advised PNC, in connection with E&Y's work as PNC's auditor, on the appropriateness of the accounting treatment of the SPE product that the National Office partner had assisted AIG to develop and market. Accordingly, as a result of the actions of the National Office partner, E&Y compromised its auditor independence required by generally accepted auditing standards ("GAAS") and Regulation S-X of the Commission's rules and regulations. Additionally, the reporting provisions of the federal securities laws require that quarterly financial statements be reviewed by an independent accountant. Because E&Y was not

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

[3] The Commission previously brought settled proceedings against PNC, AIG, Thomas F. Garbe, and Michael S. Joseph, the National Office partner, related to their roles in these matters. PNC Financial Services Group, Inc., Securities Act Release No. 8112, Securities Exchange Act Release No. 46225, Accounting and Auditing Enforcement Release No. 1597 (July 18, 2002); SEC v. American International Group, Inc., No. 1:04CV02070 (GK) (D.D.C. judgment entered Dec. 7, 2004); In the Matter of Thomas F. Garbe, Securities Exchange Act Release No. 54906, Accounting and Auditing Enforcement Release No. 2522, Administrative Proceeding No. 3-12501 (Dec. 11, 2006); In the Matter of Michael S. Joseph, CPA, Securities Act Release No. 8759, Securities Exchange Act Release No. 54907, Accounting and Auditing Enforcement Release No. 2523, Administrative Proceeding No. 3-12502 (Dec. 11, 2006).

independent in its review of PNC's financial statements for the second and third quarters of 2001, E&Y was a cause of PNC's violations of the reporting provisions.

B. RESPONDENT

Ernst & Young LLP is a national accounting firm with its headquarters in New York, New York. At all relevant times, E&Y provided auditing services to PNC. Specifically, E&Y was responsible for, among other things, the audit of PNC's consolidated financial statements, interim reviews of quarterly financial statements, and reviews and consultations pertaining to filings with the SEC. While serving as auditor for and advisor to PNC, E&Y also was employed as an advisor to AIG with responsibility for assisting AIG in addressing generally accepted accounting principles ("GAAP") compliance issues during the design stage of an SPE product, a version of which was used in transactions between AIG and PNC.

C. OTHER RELEVANT ENTITIES

American International Group, Inc. is a Delaware corporation with its principal place of business in New York, New York. Through its subsidiaries, AIG is engaged in a broad range of insurance-related and asset management activities in the United States and abroad.

The PNC Financial Services Group, Inc. is a Pennsylvania corporation with its principal place of business in Pittsburgh, Pennsylvania. PNC is a bank holding company that is regulated by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of Cleveland (together the "Federal Reserve") and has a national bank subsidiary that is regulated by the Comptroller of the Currency.

D. FACTS

1. Development and Marketing of C-GAITS Product

In early 2001, AIG engaged one of E&Y's National Office partners to assist it in developing an accounting-driven financial product, known as a Contributed Guaranteed Alternative Investment Trust Security ("C-GAITS"). The C-GAITS product purported to enable a public company to reduce the earnings impact of troubled or other potentially volatile financial assets by transferring those assets from the public company's balance sheet to an SPE established by AIG. Under the C-GAITS structure, the SPE was to be consolidated onto AIG's balance sheet.

The National Office partner issued reports to AIG pursuant to Statement on Auditing Standards No. 50, *Reports on the Application of Accounting Principles* ("SAS 50 letters")[4], over

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[4] A "SAS 50" letter is a report issued by an accounting firm that provides guidance to a non-audit client. A SAS 50 letter could relate to the type of opinion that may be rendered on a specific entity's financial statements, the application of accounting principles to specific proposed or completed transactions, or the application of accounting principles to hypothetical transactions. These letters frequently were used for marketing purposes by non-audit clients. SAS No. 50 was amended in June 2002 by Statement on Auditing Standards No. 97, *Amendment to Statement on Auditing Standards No.*

E&Y's firm signature, representing that the favorable nonconsolidation accounting treatment for the SPE established in a hypothetical C-GAITS transaction was an appropriate application of GAAP. As intended, AIG used the E&Y SAS 50 letters to promote the C-GAITS product. AIG also relied extensively on the E&Y National Office partner's accounting advice as it attempted to sell the product. For example, AIG referred to E&Y's accounting advice in its marketing materials and referred potential buyers directly to the E&Y National Office partner to answer accounting-related questions. The National Office partner reviewed and edited term sheets for at least two proposed C-GAITS deals. On several occasions, the National Office partner also participated in conference calls with AIG when AIG marketed the C-GAITS product to potential purchasers.

From March 2001 through January 2002, AIG marketed the C-GAITS product to several public companies, with the assistance of the National Office partner. Despite its marketing effort, AIG ultimately closed only the three C-GAITS transactions with PNC. These transactions were referred to respectively as "PAGIC I," "PAGIC II," and "PAGIC III" (and collectively as the "PAGIC transactions").

2. PNC's Second Quarter 2001

Around the beginning of June 2001, AIG marketed the C-GAITS product to PNC using a SAS 50 letter written by the National Office partner that addressed the accounting for a C-GAITS structure. Throughout its negotiations with AIG that month, PNC management consulted frequently with the E&Y audit engagement team, which, in turn, consulted with the National Office partner, to determine the accounting treatment for the transaction that PNC was contemplating. In fact, when PNC began considering PAGIC I, PNC senior management contacted the E&Y coordinating partner for the PNC audit account and requested formal written guidance on the accounting treatment for the transaction. The coordinating partner assigned the technical partner on the engagement to prepare a guidance letter. That partner then contacted the National Office partner, with the knowledge of PNC.

The National Office partner provided an existing SAS 50 letter to the technical partner for use as a template for the PNC guidance letter. The National Office partner thereafter reviewed drafts of the guidance letter and discussed accounting issues related to the PAGIC I transaction with the technical partner.

Without performing a meaningful analysis, the E&Y engagement team incorporated virtually verbatim into the guidance letter the accounting analysis and conclusions that the National Office partner had included in the SAS 50 letter.[5] The National Office partner reviewed and approved the guidance letter before it was issued to PNC. The guidance letter was issued

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50, Reports on the Application of Accounting Principles. Accountants are now prohibited from providing a report on accounting principles concerning hypothetical transactions.

[5] Each guidance letter for each of the three PAGIC transactions included a factual description of the particular transaction for which the guidance letter was written and a discussion of accounting issues. The factual descriptions in the letters differed, but the discussion of the accounting issues was largely identical to the corresponding discussion in the SAS 50 letter.

over the E&Y firm signature and stated that it was E&Y's view that PNC's nonconsolidation of the SPE conformed with GAAP. On June 28, 2001, AIG and PNC closed the first of the three PAGIC transactions.

E&Y performed a review of PNC's financial statements for the second quarter of 2001. E&Y, however, did not perform any separate analysis of PNC's accounting for the PAGIC I transaction in the course of that review. In evaluating the accounting for the transaction, E&Y instead incorporated and relied on the National Office partner's analysis, including the written guidance letter issued to PNC, which mirrored the SAS 50 letters provided to AIG. E&Y's conclusion on the appropriateness of PNC's accounting was largely based on work performed by the National Office partner for AIG during the design of the product.

On August 14, 2001, PNC filed its Form 10-Q for the second quarter of 2001 with the Commission. The Form 10-Q included the second quarter financial statements that E&Y had reviewed. In those financial statements, PNC excluded from its balance sheet the assets it transferred to the SPE in the PAGIC I transaction. The financial statements reflected that PNC had $374 million in nonperforming loan assets and $16 million in other nonperforming assets. These figures did not include $84 million in nonperforming loan assets among the $257 million of loan assets that PNC had transferred to the SPE. PNC's second quarter Form 10-Q did not provide any disclosure concerning the PAGIC I transaction.

3. PNC's Third Quarter 2001

E&Y continued to assist AIG in its efforts to market the C-GAITS product. In September 2001, the National Office partner accompanied an AIG marketing team to assist in AIG's marketing of the C-GAITS product to another public company. Also in September 2001, E&Y advised PNC on the accounting for the PAGIC II transaction, which closed on September 27, 2001. PNC again relied on the National Office partner's advice in connection with its evaluation of the applicable accounting. Once again, E&Y provided PNC with a written guidance letter stating that it was E&Y's view that nonconsolidation was the appropriate accounting treatment for PAGIC II. As before, E&Y incorporated virtually verbatim into the guidance letter the accounting analysis and conclusions that the National Office partner had included in the SAS 50 letter. The National Office partner once again reviewed and approved the guidance letter before it was issued to PNC.

E&Y performed a review of PNC's financial statements for the third quarter of 2001. E&Y again, however, did not perform any separate analysis of PNC's accounting for the PAGIC II transaction in the course of that review. In evaluating the accounting for the transaction, E&Y incorporated and relied on the National Office partner's analysis, as reflected in the accounting guidance letter.

On November 14, 2001, PNC filed its Form 10-Q for the third quarter of 2001 with the Commission. The Form 10-Q included the third quarter financial statements that E&Y had reviewed. In those financial statements, PNC excluded from its balance sheet the assets it had transferred to the SPEs in the two PAGIC transactions. The financial statements reflected that PNC had $361 million in nonperforming loan assets and $13 million in other nonperforming assets. These figures did not include a total of $207 million in nonperforming assets among the $592 million of loan assets that PNC had transferred to the SPEs in the first two PAGIC transactions. PNC's third quarter Form 10-Q did not provide any disclosure concerning the two PAGIC transactions into which PNC had entered.

4. PNC's Fourth Quarter 2001

Throughout October and November 2001, the National Office partner continued to assist in AIG's marketing efforts and on November 29, 2001, the National Office partner issued another SAS 50 letter for AIG's negotiations with yet another public company. Also at about the same time, the National Office partner conferred with another E&Y audit client regarding a potential C-GAITS transaction with AIG.

On October 23, 2001, the Federal Reserve sent a letter to PNC expressing concern about PNC's accounting for the assets transferred in PAGIC I. E&Y, including the National Office partner, reviewed and commented on PNC's proposed responses to the Federal Reserve, which defended PNC's accounting. During the same October-to-November period, the National Office partner, through E&Y's engagement team, advised PNC on the accounting treatment for a third PAGIC transaction, which closed on November 29, 2001. Again, E&Y provided PNC management with a written guidance letter stating that it was E&Y's view that nonconsolidation was the appropriate accounting treatment for PAGIC III. As before, E&Y incorporated virtually verbatim into the PNC guidance letter the accounting analysis and conclusions that the National Office partner had included in the SAS 50 letter. The National Office partner reviewed and approved the guidance letter before it was issued to PNC.

Also in November 2001, another of E&Y's banking audit clients discussed with the Federal Reserve the accounting for a C-GAITS transaction that it was contemplating. On or about December 4, 2001, the Federal Reserve informed E&Y's client of its view that the proposed accounting was not in conformity with GAAP. When consulted by AIG, the National Office partner helped AIG defend the proposed accounting for the transaction.

On January 11, 2002, the Federal Reserve directed PNC to consolidate the three PAGIC transactions in its bank holding company regulatory reports for 2001. Thereafter, on January 29, 2002, PNC announced that it would reverse the accounting for all three PAGIC transactions, restate its financial statements for the second and third quarters of 2001, and revise its previously announced fourth quarter and full-year 2001 financial results. The change in accounting and restatement resulted in a $155 million charge to PNC's earnings and a $0.53 per share drop (equivalent to 38%) in PNC's previously reported earnings per share for 2001.

For its work on the SAS 50 letters, the accounting guidance given to PNC, and the interim reviews and work related to the restatements of PNC's financial statements, E&Y billed AIG and PNC $1,196,700.

E. LEGAL ANALYSIS

1. Applicable Professional Standards

Standards relating to the independence of public accounting firms are contained in GAAS and Rule 2-01(b) of Regulation S-X. Throughout the relevant time, GAAS required that "[i]n all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors."[6] This requirement is necessary because of the importance in having the public maintain confidence in the independence of auditors.[7] Auditors, accordingly, are required not only to be independent in fact but also to avoid the appearance of a lack of independence.[8]

Rule 2-01(b) of Regulation S-X, in pertinent part, provides as follows:

> The Commission will not recognize an accountant as independent, with respect to an audit client, if the accountant is not, or a reasonable investor with knowledge of all relevant facts and circumstances would conclude that the accountant is not, capable of exercising objective and impartial judgment on all issues encompassed within the accountant's engagement. In determining whether an accountant is independent, the Commission will consider all relevant circumstances, including all relationships between the accountant and the audit client, and not just those relating to reports filed with the Commission.[9]

2. E&Y Violated Independence Standards

As discussed above, the National Office partner was intimately involved in the development of AIG's C-GAITS product and assisted in AIG's efforts to market that product. The National Office partner provided advice on the structure, prepared four SAS 50 letters that AIG used in marketing the product, participated in conference calls with potential purchasers of the product and, on at least one occasion, accompanied an AIG marketing team to assist in AIG's marketing of the C-GAITS product to a potential customer. The National Office partner charged AIG for his services. As a result of the activities of the National Office partner, E&Y was invested both financially and reputationally in the success of the C-GAITS product and therefore had a conflict of interest when it evaluated the accounting for that product for its audit client PNC.[10]

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6 Codification of Statements on Auditing Standards, *Statement on Auditing Standards No. 1, § 150.02* (Am. Inst. of Certified Pub. Accountants 1972).

7 *See id.* § 220.03.

8 *Id.*

9 17 CFR § 210.2-01(b).

10 In determining whether an accountant is independent, the Commission "looks in the first instance to whether a relationship or the provision of a service: creates a mutual or conflicting interest between the accountant and the audit client: [or] places the accountant in the position of auditing his or her own work…." 17 CFR § 210.2-01 prelim. note.

E&Y's engagement team relied upon the National Office partner's advice and analysis of the accounting for the PAGIC transactions, both when drafting and issuing the guidance letters to PNC and during E&Y's interim reviews of PNC's Form 10-Qs. E&Y's engagement team did not perform a meaningful analysis when issuing the accounting guidance letters to PNC and did not perform any separate analysis in the course of the interim reviews, but instead relied on the National Office partner's accounting analysis. Because of the role that the National Office partner had played in AIG's development and marketing of the C-GAITS product and because of the role the National Office partner also played in evaluating and advising PNC on the PAGIC transactions in connection with E&Y's audit work for PNC, a reasonable investor with knowledge of all relevant facts and circumstances would conclude that E&Y was not impartial and lacked the requisite independence in the performance of its functions as PNC's auditor.

The departures from GAAS and failure to comply with Rule 2-01 of Regulation S-X described above constitute improper professional conduct within the meaning of Rule 102(e)(1)(ii). Regarding accountants, the term "improper professional conduct" is defined by Rule 102(e)(1)(iv) to include a "single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which an accountant knows, or should know, that heightened scrutiny is warranted" or "repeated instances of unreasonable conduct, each resulting in a violation of applicable professional standards, that indicate a lack of competence to practice before the Commission."[11] E&Y's conduct in this matter represents improper professional conduct under either standard. At a minimum, as described above, E&Y engaged in multiple instances of unreasonable conduct resulting in independence violations. In addition, inasmuch as a reasonable investor would have concluded that E&Y, through the National Office partner, was operating on both sides of several transactions which led to auditor independence violations, E&Y engaged in highly unreasonable conduct under circumstances in which it knew or should have known warranted heightened scrutiny. As the Commission has stated, "Because of the importance of an accountant's independence to the integrity of the financial reporting system, the Commission has concluded that circumstances that raise questions about an accountant's independence *always* merit heightened scrutiny."[12]

3. E&Y Caused PNC to Violate Reporting Provisions

As a result of its violation of the independence standards, E&Y also caused PNC to violate reporting provisions of the federal securities laws. Section 13(a) of the Exchange Act requires issuers of registered securities to file periodic reports with the Commission containing information prescribed by Commission rules and regulations. Exchange Act Rule 13a-13 requires the filing of quarterly reports on Form 10-Q, and Exchange Act Rule 12b-20 requires that, in addition to the information required by Commission rules to be included in periodic reports, such further material information as may be necessary to make the required statements not misleading also must be included. Periodic reports must be complete and accurate. Rule 10-01(d) of Regulation S-X

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[11] 17 CFR § 201.102(e)(1)(iv).

[12] Amendment to Rule 102(e) of the Commission's Rules of Practice, Securities Act Release No. 7593, at II.C. (October 19, 1998) (emphasis added).

requires that interim financial statements included in quarterly reports must be reviewed by an independent public accountant prior to filing.[13] Because E&Y was not independent, PNC failed to comply with Rule 10-01(d) of Regulation S-X and consequently violated Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-13.

By its conduct described above, E&Y caused PNC's violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20 and 13a-13 thereunder.

F. REMEDIAL ACTIONS BY E&Y

In determining to accept the Offer, the Commission considered the remedial steps taken by E&Y. Since the conduct discussed in this Order, E&Y has significantly revised its independence policies and procedures. E&Y has also set forth new procedures that specifically address potential conflicts of interest that may arise when providing accounting advice to investment bankers and financial intermediaries.

G. FINDINGS

A. Based on the foregoing, the Commission finds that E&Y engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

B. Based on the foregoing, the Commission finds that E&Y was a cause of PNC's violations of Section 13(a) of the Exchange Act and Exchange Act Rules 12b-20 and13a-13.

IV.

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

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

A. E&Y hereby is censured; and

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[13] 17 CFR § 210.10-01(d).

B. E&Y shall, within ten days of the entry of this Order, pay disgorgement of $1,196,700 and interest of $390,470.42, totaling $1,587,170.42, to the victim restitution fund established pursuant to paragraph 7 of the Deferred Prosecution Agreement between PNC ICLC Corp. and the United States Department of Justice, Criminal Division, Fraud Section signed on June 2, 2003, together with a cover letter identifying Ernst & Young LLP as the Respondent in these proceedings, identifying the file number of these proceedings, and specifying that the payment is being made pursuant to this Order. E&Y shall simultaneously transmit a photocopy of the cover letter and the document by which payment is made to Thomas D. Silverstein, Esq., Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, D.C. 20549.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 242

[Release No. 34-55520; File No. S7-12-06]

RIN 3235-AJ57

Amendments to Regulation SHO

AGENCY: Securities and Exchange Commission.

ACTION: Notice of re-opening of comment period.

SUMMARY: The Securities and Exchange Commission is re-opening the comment period on the "Amendments to Regulation SHO" it proposed in Securities Exchange Act Release No. 54154 (July 14, 2006), 71 FR 41710 (July 21, 2006) (the "Proposal"). In view of the continuing public interest in the Proposal, as well as to reflect concerns raised by commenters, we believe that it is appropriate to re-open the comment period before we take action on the Proposal.

DATES: Comments should be received 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); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-12-06 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

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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 S7-12-06. 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 20549-1090. 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: James A. Brigagliano, Associate Director, Josephine J. Tao, Branch Chief, Joan M. Collopy, Special Counsel, Lillian S. Hagen, Special Counsel, Elizabeth A. Sandoe, Special Counsel, Victoria L. Crane, Special Counsel, Office of Trading Practices and Processing, Division of Market Regulation, at (202) 551-5720, at the Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: The Commission is requesting additional public comment on proposed amendments to Rule 203 of Regulation SHO [17 CFR 242.200 and 242.203] under the Exchange Act. In Release No. 54154 (July 14, 2006), 71 FR 41710 (July 21, 2006), the Commission proposed amendments to Regulation SHO under the Securities Exchange Act of 1934 (the "Exchange Act") intended to further reduce the number of persistent fails to deliver in certain equity securities by eliminating the grandfather provision and narrowing the options market maker exception.[1] The Commission is re-opening the comment period, which ended on September 19, 2006, to provide additional information with respect to the Proposal to the public.

Commenters have urged the Commission to provide additional data related to the Proposal before it determines whether additional rulemaking is necessary.[2] In formulating the Proposal, the Commission relied primarily on data collected by the National Association of Securities Dealers, Inc. ("NASD"). NASD collected this data through confidential queries and examinations of member firms. As a result, the Commission did not provide the data underlying the examinations and discussions because it was concerned that the data contained confidential, company-specific examination findings and discussions. However, in response to commenters' requests for data, the NASD submitted a comment letter on March 12, 2007 that provides the NASD's findings in summary form with confidential, company-specific information removed.[3]

Accordingly, the Commission is re-opening the comment period to highlight the fact that additional data has become available and to provide the public with an

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[1] The Commission also proposed amendments to update the market decline limitation referenced in Regulation SHO.

[2] See e.g., Comments of Keith F. Higgins, Chair, Committee on Federal Regulation of Securities, American Bar Association (September 27, 2006) (stating that "without the benefit of knowing the information relied upon by the Commission in analyzing the cause or causes of the current fails to deliver and the likelihood that the proposed changes will reduce those fails to deliver, commenters are deprived of the opportunity to opine on the significance of the examination results or the Commission's interpretation of such information"); comments of Alan Schwartz, Novato, California (September 19, 2006) (requesting "strong empirical data for the existence of problems. . ."); comments of Margaret Wiermanski, Chief Operations Officer, and Matthew Abraham, Compliance Officer, CTC LLC (September 28, 2006) (stating, "What is not clear in the current Proposing Amendments is any research that would evidence the anticipated levels of additional improvements in eliminating fails to deliver.")

[3] See File No. S7-12-06, Comments of the National Association of Securities Dealers, Inc. (March 12, 2007).

opportunity to comment on this data. In addition, in re-opening the comment period, the Commission also directs the public's attention to additional data that may be of interest to commenters seeking information on the reasons why fails may be persisting since the adoption of Regulation SHO:[4]

- Prior to the Commission's Proposal, the New York Stock Exchange LLC (the "NYSE") informed the Commission that it conducted a review of five securities with substantial aged fail positions from July 1, 2005 through September 23, 2005. The NYSE found that the aged fail positions in these five securities were attributable to one broker-dealer. This broker-dealer informed the NYSE that the fail positions were not being closed out because it was relying on the options market maker exception.
- Prior to the Commission's Proposal, the Commission's Office of Compliance and Inspections ("OCIE") conducted some examinations for Regulation SHO compliance and found that some broker-dealers were still carrying a significant amount of fails to deliver in securities that they were not closing out because they were relying on the grandfather provision. One broker-dealer indicated that it had not closed out several persistent fails in threshold securities because it was relying on the options market maker exception.

[4] See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004).

Therefore, the Commission is re-opening the comment period for Exchange Act Release No. 54154 from the date of this release through [insert date 30 days after publication in the Federal Register].

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: March 26, 2007

/ . . .

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55527 / March 26, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12601

In the Matter of **DEAN C. REDER,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AS TO DEAN C. REDER**

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") against Dean C. Reder ("Respondent" or "Reder").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

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III.

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

Respondent

1. Reder, age 38, is a resident of Orono, Minnesota. From the fall of 2000 to January 2003, Reder was the Controller of Stockwalk Group, Inc. ("Stockwalk") and supervised the accounting department. He was also Financial Operations Principal ("FINOP") for Stockwalk.com, Inc., Stockwalk's former subsidiary on-line brokerage. In February 2003, Reder became Chief Compliance Officer of Miller Johnson Steichen Kinnard, Inc. ("MJSK"), a position he continues to hold. From at least July 2001 through September 2001 (the "relevant time period"), Reder was a registered representative associated with broker-dealers registered with the Commission. He is also a certified public accountant, but his certificate was inactive during the relevant time period.

Other Relevant Entities and Persons

2. Stockwalk is a Minnesota corporation with its principal place of business in Minneapolis, Minnesota, originally incorporated in the 1990s. Its subsidiary, MJK Clearing, Inc. ("MJK") was originally incorporated as Miller Johnson and Kuehn, Inc. in 1980. At all relevant times, Stockwalk's common stock was registered under Section 12(g) of the Exchange Act and was traded on the NASDAQ under the ticker "STOK." The common stock has since been delisted. During the relevant time period, Stockwalk had three subsidiaries: MJK, Stockwalk.com, Inc., a registered online broker-dealer, and MJSK, a full-service broker-dealer.[2] In 2002, Stockwalk reorganized its debt under Chapter 11 of the Bankruptcy Code. The only subsidiary still operating under Stockwalk is MJSK.

3. From January 2001, MJK provided securities clearing functions for Stockwalk's three registered broker-dealers and sixty-five other correspondent brokerage firms. MJK became insolvent on September 25, 2001. MJK and its predecessor, Miller Johnson and Kuehn, Inc., had been registered with the Commission as a broker-dealer since 1981.

Summary

4. In July and August 2001, MJK improperly calculated its net capital by failing to reduce its net capital for stock borrow deficits relating to certain securities it borrowed from a counter-party broker-dealer, Native Nations Securities, Inc. ("Native Nations"). MJK's

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

[2] Clearing and transaction settlement services were originally provided by MJK Clearing Services, a division within Miller Johnson & Kuehn, Inc. On January 1, 2001, MJK Clearing, Inc. ("MJK") became a wholly-owned subsidiary of Stockwalk, while the brokerage components of Miller Johnson & Kuehn, Inc. were merged with the recently acquired R.J. Steichen and Co., and John G. Kinnard Co. brokerages, to create MJSK, then a wholly-owned subsidiary of MJK.

stock lending department had failed to collect marks to market owed to MJK by Native Nations when the value of securities MJK had borrowed from Native Nations declined. This resulted in significant stock borrow deficits, which MJK and Stockwalk failed to discover and account for in a timely manner. MJK's miscalculation of its net capital caused it to conduct business while not maintaining sufficient net capital in August 2001 and September 2001. Moreover, the Financial and Operational Combined Uniform Single ("FOCUS") Reports for July and August 2001 filed with the NASD reflected the inaccurate net capital computations. During that time, Stockwalk's accounting department was responsible for MJK's incorrect net capital calculations and inaccurate FOCUS Reports filed with the NASD. Reder participated in the preparation of MJK's FOCUS Reports and he reviewed the net capital computation. As a result of his conduct, Reder willfully aided and abetted and caused MJK's violations of the net capital requirements, its filing of incorrect FOCUS Reports, and its failure to file proper notice with the Commission of its net capital deficiencies, in accordance with Rule 17a-11, C.F.R. §240.17a-11. Upon its discovery of the net capital deficiency, MJK immediately contacted the NASD and staff of the Commission.

Improper Net Capital Computations and Failure to Comply with the Notice Requirements

5. On or about July 31, 2001 and August 31, 2001, the accounting department of Stockwalk failed to detect, calculate, and deduct charges related to MJK's stock borrow deficits with Native Nations when calculating MJK's monthly net capital. According to MJK's FOCUS Reports from July and August, MJK calculated and reported excess net capital of $14.7 million on July 31, 2001 and $14.8 million on August 31, 2001.

6. However, proper deduction of charges relating to MJK's stock borrow deficits reveals that MJK actually had excess net capital of $6.2 million on July 31, 2001, and a net capital deficiency of $6.1 million on August 31, 2001. On September 25, 2001, MJK contacted Commission staff to report a net capital deficiency, which prompted Commission examination staff to conduct an exam. In the course of this exam, staff determined that MJK had a net capital deficiency of $70.3 million. Thus, from at least August 31, 2001 through September 25, 2001, MJK conducted business without sufficient net capital.

7. Prior to MJK's miscalculation of its net capital, Stockwalk received a deficiency letter dated July 17, 2001 from the staff of the Commission regarding MJSK, another subsidiary of Stockwalk. The letter stated that, among other things, the accounting department had not been properly reducing MJSK's net worth for certain stock borrow deficits which became necessary after MJSK borrowed securities from MJK. The accounting department failed to take any remedial steps to ensure that the charges for stock borrow deficits were being appropriately made in MJK's calculations of net capital figures.

8. MJK's miscalculation of its net capital during the relevant time period led MJK to file inaccurate July 2001 and August 2001 FOCUS Reports with the NASD.

9. MJK also failed to provide proper notice to the Commission that it was out of compliance with its minimum net capital requirement on August 31, 2001.

Respondent's Omissions as FINOP

10. As a registered FINOP assisting in the preparation of MJK's FOCUS Reports, it was Reder's responsibility to review the computations in the reports to ensure their accuracy. The accounting department had the information necessary to calculate the charges for MJK's stock borrow deficits. In performing his duties, Reder reviewed MJK's FOCUS Reports and net capital computations for accuracy. However, Reder failed to review adequately the documentation that included MJK's stock borrow deficits and the need to deduct appropriate charges in calculating net capital. Proper review of MJK's net capital computations and the supporting documents would have revealed that MJK's net capital calculations and FOCUS Reports were inaccurate, and that notice of net capital deficiencies was required.

Violations

11. As a result of the conduct described above, Reder willfully aided and abetted and caused MJK's violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-1 promulgated thereunder, which prohibit a broker-dealer from effecting transactions in securities in contravention of Commission rules with respect to financial responsibility and requires a broker-dealer to maintain a minimum level of liquid net worth (net capital). Paragraph (c)(2)(iv)(B) of Rule 15c3-1 of the Exchange Act requires a broker-dealer to deduct from its net worth in computing net capital certain unsecured and partly secured receivables. As a result of the conduct described above, Reder willfully aided and abetted and caused MJK's failure to deduct charges related to its stock borrow deficits, thereby resulting in MJK's operation of a securities business while it was net capital deficient.

12. As a result of the conduct described above, Reder willfully aided and abetted and caused MJK's violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder, which require registered brokers or dealers that clear transactions or carry customer accounts, such as MJK, to file accurate monthly and quarterly FOCUS Reports that include net capital computations.

13. As a result of the conduct described above, Reder willfully aided and abetted and caused MJK's violations of Section 17(a)(1) of the Exchange Act and Rule 17a-11 thereunder, which require every broker or dealer whose net capital falls below the minimum required amount, to give notice that same day to the Commission.

IV.

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

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

A. Respondent Reder cease and desist from causing any violations and any future violations of Sections 15(c)(3) and 17(a) of the Exchange Act and Rules 15c3-1, 17a-5 and 17a-11 thereunder.

B. It is further ordered that Respondent shall, within thirty (30) days of the entry of this Order, pay a civil money penalty in the amount of $15,000 to the United States Treasury. Such payment shall be: (A) made by United States postal money order, certified check, bank cashier's check or bank money order; (B) made payable to the Securities and Exchange Commission; (C) hand-delivered or mailed to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Stop 0-3, Alexandria, VA 22312; and (D) submitted under cover letter that identifies Dean C. Reder as a Respondent in these proceedings, the file number of these proceedings, a copy of which cover letter and money order or check shall be sent to Tracy W. Lo, Securities and Exchange Commission, 175 West Jackson Boulevard, Suite 900, Chicago, Illinois 60604.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 200, 232, 240 and 249

[RELEASE NO. 34-55540; INTERNATIONAL SERIES RELEASE NO. 1301;

FILE NO. S7-12-05]

RIN 3235-AJ38

TERMINATION OF A FOREIGN PRIVATE ISSUER'S REGISTRATION OF A CLASS OF SECURITIES UNDER SECTION 12(g) AND DUTY TO FILE REPORTS UNDER SECTION 13(a) OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: We are adopting amendments to the rules that govern when a foreign private issuer may terminate the registration of a class of equity securities under section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act") and the corresponding duty to file reports required under section 13(a) of the Exchange Act, and when it may cease its reporting obligations regarding a class of equity or debt securities under section 15(d) of the Exchange Act. Under the current rules, a foreign private issuer may find it difficult to terminate its Exchange Act registration and reporting obligations despite the fact that there is relatively little interest in the issuer's U.S.-registered securities among United States investors. Moreover, currently a foreign private issuer can only suspend, and cannot terminate, a duty to report arising under section 15(d) of the Exchange Act. New Exchange Act Rule 12h-6 will permit a foreign private issuer of equity securities to terminate its reporting obligations under either section 13(a) or section 15(d) of the Exchange Act by meeting a quantitative benchmark designed to

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measure relative U.S. market interest for its equity securities that does not depend on a head count of the issuer's U.S. security holders. The new rule will permit a foreign private issuer to compare the average daily trading volume of its securities in the United States with its worldwide average daily trading volume, using a 5 percent benchmark. The accompanying rule amendments will also help provide U.S. investors with ready access through the Internet on an ongoing basis to material information about a foreign private issuer of equity securities that is required by its home country after it has exited the Exchange Act reporting system. The new rule will also permit a foreign private issuer of debt securities to terminate, rather than merely suspend, its section 15(d) reporting obligations.

DATES: **Effective Date**: [Insert date 60 days after publication in the Federal Register.]

FOR FURTHER INFORMATION CONTACT: Elliot Staffin, Special Counsel, at (202) 551-3450, in the Office of International Corporate Finance, Division of Corporation Finance, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-3628.

SUPPLEMENTARY INFORMATION: We are adopting amendments to Commission Rule 30-1,[1] Rule 101[2] of Regulation S-T,[3] and Rules 12g3-2, 12g-4 and 12h-3[4] under the

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[1] 17 CFR 200.30-1.

[2] 17 CFR 232.101.

[3] 17 CFR 232.10 et seq.

[4] 17 CFR 240.12g3-2, 240.12g-4 and 240.12h-3.

Exchange Act,[5] and adding new Rule 12h-6[6] and Form 15F[7] under the Exchange Act.

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[5] 15 U.S.C. 78a et seq.

[6] 17 CFR 240.12h-6.

[7] 17 CFR 249.324.

I. EXECUTIVE SUMMARY AND BACKGROUND

A. Introduction

In December 2005, the Commission issued proposed amendments to its current rules governing when a foreign private issuer[8] may exit the Exchange Act reporting regime.[9] Under the current rules, the primary determinant regarding whether a foreign private issuer may terminate its registration of a class of securities under section 12(g)[10] or suspend its reporting obligations under section 15(d)[11] is if its subject securities are held of record by less than 300 residents in the United States.[12] The Commission proposed to amend these rules out of concern that, due to the increased globalization of securities markets in recent decades as well as other trends, it has become difficult for a foreign private issuer to exit the Exchange Act reporting system even when there is relatively little U.S. investor interest in its U.S.-registered securities.[13]

[8] See the definition of foreign private issuer at Exchange Act Rule 3b-4(c) (17 CFR 240.3b-4(c)).

[9] Release No. 34-53020 (December 23, 2005), 70 FR 77688 (December 30, 2005) (Original Proposing Release).

[10] This statutory section applies to equity securities only. See Exchange Act Section 12(g)(1) [15 U.S.C. 78l (g)(1)].

[11] 15 U.S.C. 78o(d). The effectiveness of a registration statement under the Securities Act of 1933 ("Securities Act") triggers Section 15(d) reporting obligations. That section provides that an issuer cannot suspend its reporting obligations unless the subject class of securities is held of record by less than 300 persons at the beginning of a fiscal year other than the year in which the Securities Act registration statement became effective. Section 15(d) does not permit an issuer to terminate, but only to suspend, its reporting obligations under that section.

[12] Exchange Act Rules 12g-4(a)(2)(i) (17 CFR 240.12g-4(a)(2)(i)) and 12h-3(b)(2)(i) (17 CFR 240.12h-3(b)(2)(i)).

[13] See Original Proposing Release, 70 FR at 77689-77690.

We recognize that U.S. investors benefit from the investment opportunities provided by foreign private issuers registering their securities with the Commission and listing and publicly offering those securities in the United States. However, because of the burdens and uncertainties associated with terminating registration and reporting under the Exchange Act, the current exit process may serve as a disincentive to foreign private issuers accessing the U.S. public capital markets.[14] In order to remove this disincentive, we proposed to amend the current Exchange Act exit rules for foreign private issuers.

As originally proposed, new Exchange Act Rule 12h-6 would have permitted a foreign private issuer of equity securities to terminate its Exchange Act registration and reporting obligations if, among other conditions, it met one of a set of alternative quantitative benchmarks that, depending on whether the issuer was a well-known seasoned issuer ("WKSI"),[15] was based either on a combination of U.S. trading volume and U.S. public float criteria or just U.S. public float data.[16] However, numerous commenters stated that the originally proposed rules would still unduly restrict a

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[14] See Part I.C of the Original Proposing Release for a discussion of the concerns raised by foreign private issuers regarding the current Exchange Act exit regime.

[15] For purposes of proposed Rule 12h-6, a "well-known seasoned issuer" meant a well-known seasoned issuer as defined in Securities Act Rule 405 (17 CFR 230.405), which would have required the worldwide market value of an issuer's outstanding voting and non-voting common equity held by non-affiliates to be $700 million or more.

[16] Under the original rule proposal, a WKSI would have been eligible to terminate its Exchange Act reporting obligations regarding a class of equity securities if the U.S. average daily trading volume ("ADTV") of the subject class of securities had been no greater than 5 percent of the ADTV of that class of securities in its primary trading market during a recent 12 month period, and U.S. residents held no more than 10 percent of the issuer's worldwide public float as of a specified date. A WKSI with greater than 5 percent U.S. ADTV or a non-WKSI would have been eligible for termination of reporting regarding a class of equity securities if, regardless of U.S. trading volume, U.S. residents held no more than 5 percent of the issuer's worldwide public float as of a specified date. See Part II.B.2.d of Release No. 34-53020.

significant portion of U.S.-registered foreign private issuers from exiting the Exchange Act reporting regime, thus making it unlikely that the proposed rules would achieve their purpose of attracting more foreign companies to U.S. public capital markets.

In light of these criticisms, we reconsidered our approach and, in December 2006, we reproposed the amendments to the Exchange Act exit rules for foreign private issuers.[17] As an alternative to the record holder standard for equity securities issuers, we proposed a quantitative benchmark based solely on a comparison of the average daily trading volume of a foreign private issuer's equity securities in the United States with that in its primary trading market. We reasoned that a standard based on trading volume may in fact be superior to the originally proposed standard, which was based primarily on a comparison of an issuer's U.S. public float with its worldwide public float, because it is a more direct measure of the issuer's nexus with the U.S. market and because trading volume data is easier to obtain than public float or record holder data.[18] We concluded that, in applying an exit standard based on trading volume data for the U.S. and an issuer's primary trading market, issuers would face reduced costs when determining whether they can terminate their registration and reporting obligations under the Exchange Act, compared to the originally proposed standards that would have required an issuer to assess the U.S. residence of its security holders.[19]

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[17] Release No. 34-55005 (December 22, 2006), 72 FR 1384 (January 11, 2007) (Reproposing Release).

[18] We reproposed the rule amendments primarily because the Commission did not fully address this trading volume approach in the Original Proposing Release.

[19] See Parts II.A.1.a and IV of the Reproposing Release.

B. Principal Comments Regarding the Reproposed Rule Amendments

We received 30 comment letters in response to the reproposed rule amendments.[20] These letters represented the views of over 40 distinct entities, including business, financial and legal associations, foreign companies, financial advisory and accounting firms, law firms, and one foreign government. While the commenters generally strongly supported the trading volume-based approach and other aspects of the reproposed rules, many offered suggestions designed primarily to fine-tune those rules.

We received the most comments concerning the reproposed trading volume benchmark for equity securities issuers. Numerous commenters urged us to adopt a quantitative benchmark that would require an issuer to measure its U.S. ADTV as a percentage of its ADTV for the same class of securities on a worldwide basis, rather than against its ADTV in its primary trading market, as reproposed. Many commenters also requested that we permit an issuer to include off-market transactions when calculating its worldwide ADTV for a class of equity securities, rather than only when calculating its U.S. ADTV, as reproposed. Some commenters further urged us to permit an issuer to include trades conducted through alternative trading systems when determining whether it meets the proposed trading volume benchmark. Still others requested that we increase the percentage in the trading volume-based measure to a percentage greater than 5 percent, as reproposed, particularly if we did not move to a worldwide ADTV standard.

Commenters expressed concern or requested guidance regarding a number of other issues, including:

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[20] These comment letters, along with the letters received at the proposing stage, are available on the Commission's Internet Web site, located at http://www.sec.gov/ rules/proposed/s71205.shtml, and in the Commission's Public Reference Room in its Washington, DC headquarters.

- the appropriateness of the proposed provision that would prohibit reliance on the trading volume standard if an issuer has delisted its securities from a U.S. exchange during the preceding 12 months when its U.S. ADTV exceeded the 5 percent threshold;
- the appropriateness of the proposed provision that would prohibit reliance on the trading volume standard if an issuer has terminated a sponsored American Depositary Receipts (ADR) facility[21] during the preceding 12 months, regardless of whether the issuer met the trading volume benchmark at the time of termination;
- whether to include convertible debt and other equity-linked securities in the definition of equity security for purposes of the new exit rule;
- whether a special financial report filed pursuant to Exchange Act Rule 15d-2[22] would constitute an Exchange Act annual report for the purpose of the reproposed prior reporting condition;
- the appropriateness of the reproposed dormancy condition for equity securities registrants,[23] including whether it would prohibit an issuer from

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[21] An ADR is a negotiable instrument that represents an ownership interest in a specified number of securities, which the securities holder has deposited with a designated bank depositary. Use of an ADR facility makes it easier for a U.S. resident to collect dividends in U.S. dollars. Moreover, because the clearance and settlement process for ADRs generally is the same for securities of domestic companies that are traded in U.S. markets, a U.S. holder of an ADR is able to hold securities of a foreign company that trades, clears and settles within automated U.S. systems and within U.S. time periods.

[22] 17 CFR 240.15d-2.

[23] As reproposed, Rule 12h-6 would prohibit an equity securities registrant from selling its securities in the United States in a registered offering under the Securities Act, except for specified registered offerings, during the 12 months preceding the filing of its Form 15F.

conducting a registered offering in which an underwriter has agreed to a standby purchase commitment but only resells the purchased securities outside the United States;

- the appropriateness of the reproposed foreign listing condition for equity securities registrants,[24] including whether it should apply to an issuer relying on the alternative 300 holder provision of Rule 12h-6, and to an issuer that delists from its non-U.S. exchange in connection with being acquired;
- the role of a predecessor in determining a successor issuer's eligibility to terminate its Exchange Act reporting obligations under reproposed Rule 12h-6, including whether, under Exchange Act Rule 12g-3(g),[25] a successor issuer would have to file an Exchange Act annual report for the predecessor's most recently completed fiscal year before it could terminate its reporting obligations under Rule 12h-6;
- whether to permit a foreign company that filed a Form 15 previously to terminate or suspend its Exchange Act reporting obligations regarding a class of equity securities before the effectiveness of new Rule 12h-6 to terminate its reporting obligations under the new exit rule without having to recount its holders, as long as it meets that rule's trading volume benchmark;
- whether to increase the threshold number of record holders in the debt securities provision; and

[24] As reproposed, Rule 12h-6 would require an equity securities issuer to have maintained a listing on an exchange in its primary trading market.

[25] 17 CFR 240.12g-3(g).

- whether an issuer that has filed a Form 15F[26] solely to terminate its reporting obligations regarding debt securities must wait until the effectiveness of that termination before it can submit an application for the Rule 12g3-2(b) exemption regarding a class of equity securities.

C. Summary of the Adopted Rule Amendments

We have carefully considered commenters' concerns regarding the reproposed rules, and have addressed many of them in the rule amendments that we are adopting today. As adopted, new Exchange Act Rule 12h-6 and the accompanying rule amendments will:

- permit a foreign private issuer, regardless of size, to terminate its Exchange Act registration and reporting obligations regarding a class of equity securities, assuming it meets all the other conditions of Rule 12h-6, if, for a recent 12-month period, the U.S. ADTV of the subject class of securities has been no greater than 5 percent of its worldwide ADTV--rather than 5 percent of the ADTV in its primary trading market, as reproposed;
- permit an issuer to include off-market transactions, including transactions through alternative trading systems, when calculating its worldwide ADTV for a class of equity securities--as discussed in connection with calculating its U.S. ADTV, as reproposed--as long as the trading volume information regarding the off-market transactions is reasonably reliable and does not duplicate other trading volume information regarding the subject class of securities;

[26] Like current Rules 12g-4 and 12h-3, which require the filing of Form 15, reproposed Rule 12h-6 would require the filing of a form--Form 15F--by which an issuer would certify that it meets the conditions for ceasing its Exchange Act reporting obligations.

- require an issuer to wait 12 months before filing its Form 15F in reliance on the trading volume standard if the issuer has delisted its class of equity securities from a national securities exchange or automated inter-dealer quotation system in the United States,[27] or terminated a sponsored ADR facility and, at the time of delisting or termination, the U.S. ADTV of the subject class of securities exceeded 5 percent of its worldwide ADTV for the preceding 12 months;

- retain the 300-holder standard as an alternative to the trading volume standard for an equity securities issuer and as the quantitative standard for a debt securities issuer, as reproposed;

- exclude convertible debt and other equity-linked securities from the definition of equity security for the purpose of new Rule 12h-6's trading volume provision;

- require an equity securities registrant to have at least one year of Exchange Act reporting, be current in reporting obligations for that period, and have filed at least one Exchange Act annual report, as reproposed;

- permit an issuer to count a special financial report filed pursuant to Exchange Act Rule 15d-2 as an Exchange Act annual report for the purpose of the new rule's prior reporting condition;

[27] Neither the OTC Bulletin Board operated by Nasdaq nor the market operated by the Pink Sheets LLC are deemed to be automated inter-dealer quotation systems. See Release 33-6862 (April 23, 1999), n.22.

- prohibit an issuer of equity securities from selling securities in the United States in a registered offering under the Securities Act, except as specified, during the 12 months preceding the filing of its Form 15F (the "dormancy condition"), substantially as reproposed;
- require an issuer of equity securities to have maintained a listing of the subject class of securities for at least the 12 months preceding the filing of its Form 15F on one or more exchanges in a foreign jurisdiction that, either singly or together with the trading of the same class of the issuer's securities in another foreign jurisdiction, constitutes the primary trading market for those securities, substantially as reproposed;
- define primary trading market to mean that at least 55 percent of the trading in a foreign private issuer's class of securities that is the subject of Form 15F took place in, on or through the facilities of a securities market or markets in a single foreign jurisdiction or in no more than two foreign jurisdictions during a recent 12-month period, as long as the trading in at least one of the two foreign jurisdictions is larger than the trading in the United States for the same class of the issuer's securities;
- permit an equity securities issuer relying on the alternative 300-holder standard, or a debt securities issuer, to use a revised counting method that limits the inquiry regarding the amount of securities represented by accounts of customers resident in the United States to brokers, dealers, banks and other nominees located in the United States, the foreign private issuer's jurisdiction of incorporation, legal organization or establishment, and the one or two

jurisdictions comprising the issuer's primary trading market if different from the issuer's jurisdiction of incorporation, legal organization or establishment, as reproposed;

- permit an issuer of equity or debt securities to rely on the assistance of an independent information services provider when determining whether the issuer falls below the 300-holder standard, as reproposed;
- permit a successor issuer meeting specified conditions to terminate its Exchange Act reporting obligations under new Rule 12h-6, as reproposed;[28]
- permit a foreign private issuer that filed a Form 15 and suspended or terminated its Exchange Act reporting obligations under the current exit rules before the effective date of Rule 12h-6 to terminate its Exchange Act reporting obligations under new Exchange Act Rule 12h-6, as long as, if regarding a class of equity securities, the issuer meets Rule 12h-6's listing condition and either the trading volume or alternative-300 holder condition or, if regarding a class of debt securities, the issuer meets the rule's 300-holder condition for debt issuers;
- extend the Rule 12g3-2(b) exemption to a foreign private issuer of equity securities, including a successor issuer and prior Form 15 filer, immediately upon its termination of reporting under Rule 12h-6, and require the issuer to maintain that exemption by publishing in English specified material home

[28] See Part II.D.1 of this release for clarification regarding the limited role of the predecessor in determining a successor issuer's eligibility to terminate its Exchange Act reporting obligations under Rule 12h-6.

country documents required by Rule 12g3-2(b)[29] on its Internet Web site or through an electronic information delivery system generally available to the public in its primary trading market, as reproposed;

- permit a non-reporting company that has received or will receive the Rule 12g3-2(b) exemption, upon application to the Commission and not pursuant to Rule 12h-6, to publish its "ongoing" home country documents required under Rule 12g3-2(b) on its Internet Web site or through an electronic information delivery system rather than submit them in paper to the Commission; and
- permit an issuer that has filed a Form 15F to terminate its Exchange Act reporting obligations regarding a class of debt securities to establish the Rule 12g3-2(b) exemption for a class of equity securities upon the effectiveness of its termination of reporting under Rule 12h-6, by submitting an application for the Rule 12g3-2(b) exemption after filing its Form 15F.

We are also adopting, as reproposed, procedural conditions that will:

- require a foreign private issuer to file a Form 15F providing information with respect to whether the issuer meets the requirements for terminating its reporting obligations under Rule 12h-6;
- automatically suspend an issuer's Exchange Act reporting obligations upon the filing of its Form 15F and trigger a 90-day waiting period at the end of which, assuming the Commission has no objections, the suspension will become a termination of reporting; and

[29] See Exchange Act Rule 12g3-2(b)(1)(iii) (17 CFR 240.12g3-2(b)(1)(iii)).

- require a foreign private issuer to publish a notice, such as a press release, announcing its intention to terminate its Exchange Act reporting obligations under Rule 12h-6, before or at the time of filing its Form 15F.

We believe the rules that we are adopting today provide meaningful protection of U.S. investors by permitting the termination of Exchange Act registration and reporting only by those foreign registrants with relatively low U.S. market interest in their U.S.-registered securities. Compared to the current exit rules, Rule 12h-6 will establish a more clearly defined process with a more appropriate benchmark by which a foreign private issuer can terminate its Exchange Act reporting obligations. As a result, we believe foreign private issuers should be more willing initially to register their securities with the Commission, which will provide more investment choices for U.S. investors.

At the same time, we believe the conditions that determine a foreign private issuer's eligibility to terminate its Exchange Act registration and reporting regarding a class of equity securities under new Rule 12h-6 will serve to protect U.S. investors. For example, the prior reporting condition[30] is intended to provide investors with at least one complete year's worth of Exchange Act reports, including an annual report, upon which they can base their investment decisions about a particular foreign registrant before that registrant exits the Exchange Act reporting system. The dormancy condition is designed to deter a foreign private issuer's promotion of U.S. investor interest through recent registered capital-raising shortly before exiting our reporting system. The one year reporting and dormancy conditions are consistent with the statutory requirements under section 15(d).

[30] See p. 12 and Part II.A.2 of this release.

The foreign listing condition and U.S. trading volume benchmark support our view that, before a foreign private issuer may terminate its Exchange Act reporting obligations under Rule 12h-6, it must have been subject to an ongoing disclosure and financial reporting regime, and have a significant market following, in its primary trading market. We have set the U.S. trading volume benchmark at such a level that, although there may be some U.S. investor interest in the subject securities of an issuer meeting the benchmark, that interest would appear to be sufficiently diminished so that a foreign private issuer should not be required to continue its Exchange Act reporting if it determines that it is no longer desirable to continue as a U.S. registrant.

The condition restricting the ability of an issuer to rely on the trading volume standard under specified circumstances (U.S. delisting and termination of a sponsored ADR facility) should deter an issuer from excluding U.S. investors, particularly retail investors, from investing in their securities when U.S. market interest is still significant. The immediate availability of the exemption under Rule 12g3-2(b) will foster access by U.S. investors to ongoing home country information about an issuer after it terminates its Exchange Act registration and reporting under Rule 12h-6. Finally, the conditions relating to the filing of Form 15F and the publication of a press release or other notice will promote transparency in the exit process.

II. DISCUSSION

A. Conditions For Equity Securities Issuers

1. Quantitative Benchmarks

a. Trading Volume Benchmark

As adopted, new Exchange Act Rule 12h-6 will enable a foreign private issuer of equity securities, regardless of size, to qualify for termination of its Exchange Act reporting by meeting a quantitative benchmark provision that does not depend on the number of its U.S. record holders or the percentage of its securities held by those holders. Under new Rule 12h-6, an issuer will be able to terminate its Exchange Act registration and reporting obligations regarding a class of equity securities, assuming it meets the other conditions of Rule 12h-6, if the ADTV of the subject class of equity securities in the United States has been 5 percent or less of the ADTV of that class of securities on a worldwide basis during a recent 12-month period.[31] This trading volume benchmark is substantially similar to the reproposed standard, except that the adopted benchmark requires an issuer to measure its U.S. ADTV as a percentage of its worldwide ADTV rather than the ADTV in its primary trading market.

A threshold matter in this regulatory initiative has been what is the most appropriate benchmark for equity securities that would best serve the interests of investors and issuers, and most commenters addressed this issue. Most of the commenters agreed that a benchmark based solely on trading volume is superior to one based on a combination of U.S. public float and trading volume criteria or just U.S. public float data, as under the originally proposed Rule 12h-6, or one based on the number of record holders in the United States or on a worldwide basis, as under the current exit rules. Most commenters stressed that trading volume data is easier to obtain and confirm than is the data required for a U.S. public float or record holder determination.[32] As commenters have noted, it is difficult for a reporting foreign private

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[31] New Exchange Act Rule 12h-6(a)(4)(i) (17 CFR 240.12h-6(a)(4)(i)).

[32] See, for example, the letter, dated February 12, 2007, from Cleary Gottlieb, Steen & Hamilton LLP (Cleary Gottlieb).

issuer to determine accurately the specific country of residence of its investors.[33] Because a public float benchmark would require such a determination to varying degrees, most commenters agreed with our conclusion that the reproposed trading volume-based benchmark should result in reduced costs to issuers in determining whether they can terminate their Exchange Act reporting obligations.[34]

Some commenters supported the reproposed trading volume measure because it would provide a simple and clear measure of the degree of U.S. market interest in an issuer's equity securities.[35] Some commenters expressed the view that basing the new exit rule on a trading volume measure would help ensure that an issuer's termination of Exchange Act registration and reporting would not have a significant impact on the primary price-setting determinants of an issuer's equity securities, which would allow for U.S. investors to trade in that issuer's securities following its U.S. deregistration.[36]

Commenters expressed their belief that adoption of the reproposed trading volume standard would enable significantly more foreign private issuers to exit the Exchange Act reporting regime if they so desire.[37] Consequently, as one commenter indicated, by removing restrictions regarding the ability to exit U.S. securities markets, adoption of new Rule 12h-6 and the accompanying amendments will have a major impact on the

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[33] See the comment letters discussed in Part II.A.1.a of the Reproposing Release.

[34] See, for example, the letter, dated February 12, 2007, from the European Association for Listed Companies and other signatories (EALIC).

[35] See, for example, the letter, dated February 12, 2007, from Sullivan & Cromwell LLP (Sullivan & Cromwell) and the letter, dated January 2, 2007, from Galileo Global Advisors (Galileo).

[36] See, for example, the letter from Cleary Gottlieb.

[37] See, for example, the letter, dated February 12, 2007, from the European Commission.

perception that foreign companies have of those markets, making the U.S. capital markets "much more attractive and competitive on an international scale."[38]

For the above reasons, we are adopting a quantitative exit standard for equity securities registrants based solely on trading volume instead of one based on a combination of trading volume and public float criteria or just public float data. We also are adopting, as reproposed, one trading volume standard that will apply to all issuers of equity securities. Commenters generally supported having one benchmark applicable to any foreign private issuer, regardless of size.[39] Although we originally proposed a set of quantitative benchmarks that depended primarily on whether an issuer was a WKSI, we are adopting the same trading volume standard for a smaller issuer as for a larger issuer in order to provide increased flexibility and simplification to the Exchange Act deregistration regime, and for the other reasons discussed in the Reproposing Release.[40]

i. Calculation of the U.S. Trading Volume Benchmark as a Percentage of Worldwide Trading Volume Instead of Primary Trading Market Trading Volume

Numerous commenters requested that the Commission calculate U.S. trading volume as a percentage of worldwide trading volume rather than as a percentage of

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[38] See the letter from Cleary Gottlieb.

[39] See, most recently, the letter, dated February 23, 2007, from the American Business Association, Section of Business Law (ABA).

[40] For example, a trading volume standard that favored WKSIs could discourage smaller foreign companies from entering U.S. public capital markets, to the detriment of U.S. investors. Moreover, commenters at the proposing stage noted that the costs of continued Exchange Act reporting fall disproprotionately on smaller issuers. See Part II.A.1.a of the Reproposing Release.

ADTV in the issuer's primary trading market,[41] as reproposed.[42] The primary rationale for this request is that, with the increased globalization of securities markets, many issuers now trade on multiple non-U.S. markets. According to these commenters, since the goal of the reproposed trading volume benchmark is to determine the relative importance of the U.S. trading market for an issuer's securities, an issuer should be able to take into account all non-U.S. trading in its securities, and not just the trading that has occurred in the one or two jurisdictions comprising its primary trading market.[43]

Some commenters maintained that, while it is reasonable to base Rule 12h-6's foreign listing condition on the reproposed primary trading market definition, it is not so for the trading volume benchmark.[44] As discussed below, the purpose of the foreign listing condition is to help assure that there is a non-U.S. jurisdiction that principally regulates and oversees the issuance and trading of the issuer's securities and the issuer's disclosure obligations to investors.[45] Limiting the definition of primary trading market in this context to no more than two jurisdictions helps to further the purpose of the foreign

[41] As discussed in Part II.A.4 of this release, we define primary trading market to mean that at least 55 percent of the trading in a foreign private issuer's subject class of securities took place in, on or through the facilities of a securities market or markets in a single foreign jurisdiction or in no more than two foreign jurisdictions during a recent 12-month period. If an issuer aggregates the trading in two foreign jurisdictions, the trading market for the issuer's securities in at least one of the two foreign jurisdictions must be larger than the United States trading market for the same class of the issuer's securities. We proposed a substantially similar definition at the reproposing stage.

[42] See, for example, the letter, dated February 8, 2007, from BusinessEurope, the letters, dated February 12, 2007, from Davis Polk & Wardwell (Davis Polk), Linklaters, and Makinson Cowell, and the letters from Cleary Gottlieb, EALIC, and the EU. In contrast, only one commenter opposed using worldwide trading volume. See the letter from Galileo.

[43] See the letters from Cleary Gottlieb and EALIC.

[44] See the letter from Linklaters.

[45] See Part II.A.4 of this release.

listing condition. In contrast, the purpose of the trading volume benchmark is to measure the relative U.S. market interest in a foreign private issuer's equity securities. Accounting for as much of the issuer's trading as is reasonably possible would further the purpose of this rule.

We agree that, in light of the number of foreign registrants that have listings in more than two jurisdictions, and given the purpose of the trading volume benchmark, measuring an issuer's U.S. ADTV as a percentage of its worldwide ADTV would increase the likelihood of obtaining a more accurate measure of relative U.S. market interest for that issuer's equity securities. Therefore, we are adopting a trading volume benchmark for new Rule 12h-6 that will require an issuer to use as the denominator of its trading volume calculation its worldwide ADTV for the subject class of securities.[46]

ii. Inclusion of Off-Market Transactions in the Trading Volume Calculation

We reproposed to require an issuer to include both transactions occurring on a stock exchange and over-the-counter trades for the purpose of calculating U.S. ADTV for the numerator of the trading volume benchmark, but to include only on-exchange transactions for the purpose of calculating its ADTV for the denominator (its primary trading market, as reproposed). We did so based on our belief that trading volume information about over-the-counter trades was more readily available in the United States than in many foreign jurisdictions.

[46] Worldwide ADTV includes U.S. ADTV. Some commenters favored a trading measure based on the dollar value of shares traded rather than on the number of shares traded. See the letter, dated February 12, 2007, from Ziegler, Ziegler and Associates (Ziegler) and the letter from Galileo. We decline to adopt a trading value measure because we believe that it would add an unnecessary level of complexity and cost to the non-record holder determination.

Numerous commenters[47] urged the Commission to permit an issuer to include "off-market" transactions when determining whether it meets the 5 percent trading volume standard, rather than just transactions occurring on a stock exchange, as reproposed. These commenters maintained that it was inappropriate to require an issuer to include both on-exchange and off-exchange transactions when calculating its U.S. ADTV but not when calculating its worldwide trading volume. As noted by some of these commenters, members of Euronext markets are currently required to report off-market transactions.[48] Moreover, some commenters noted that an EU Directive,[49] scheduled for effectiveness in November 2007, will generally require the reporting of off-market transactions, which will make information regarding off-market transactions generally available in Europe the same way that such information is available through a transaction reporting plan in the United States.[50]

Some of these commenters urged the Commission to permit an issuer to include not only off-market transactions that currently occur through traditional over-the-counter means, but those that may occur through alternative trading systems.[51] According to these commenters, MiFID will encourage the development of such trading systems.[52] These commenters stated that, as long as trading information is credible and the sources

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[47] See the letters from BusinessEurope, Cleary Gottlieb, Davis Polk, EALIC, the EU, Makinson Cowell, and Sullivan & Cromwell, and the letters, dated February 12, 2007, from the International Bar Association and Skadden Arps Slate Meagher & Flom (Skadden Arps).

[48] See, for example, the letter from Cleary Gottlieb.

[49] Directive 2004/39/EC, also known as the Market in Financial Instruments Directive (MiFID).

[50] See the letters from Cleary Gottlieb, the EU, and BusinessEurope.

[51] See the letters from the EU and Davis Polk.

[52] See, for example, the EU letter.

reliable, an issuer should be able to include information about securities transactions regardless of the platform on which they occur.[53]

Some commenters requested that, if the Commission does not permit an issuer to include off-market transactions when determining its worldwide trading volume for the denominator of its trading volume calculation, it should also prohibit the inclusion of off-market transactions when determining its U.S. ADTV for the numerator of that calculation.[54] In contrast, one commenter, which favored a worldwide trading volume measure, expressly requested that the Commission prohibit the inclusion of off-market transactions for both the numerator and denominator because of the difficulty of obtaining over-the-counter trading information.[55]

These comments have persuaded us that, for at least some foreign private issuers, information regarding off-exchange transactions in non-U.S. jurisdictions will be readily obtainable. Therefore, under adopted Rule 12h-6, when making its trading volume determination, an issuer must include in its calculation of U.S. ADTV both on-exchange and off-exchange transactions, as reproposed. For both on-exchange and off-exchange transactions in the United States, we expect an issuer to be able to obtain relevant trading volume information as reported pursuant to an effective transaction reporting plan,[56]

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[53] See, for example, the letter from Davis Polk.

[54] See the letters from BusinessEurope and the EU.

[55] See the letter from Skadden Arps.

[56] Rule 601 of Regulation NMS (17 CFR 242.601) requires every national securities exchange to file a transaction reporting plan regarding transactions in listed equity and Nasdaq securities.

pursuant to NASD rules,[57] or reported by a national securities exchange otherwise than pursuant to an effective transaction reporting plan. In addition, an issuer may include in its calculation of worldwide ADTV off-market transactions, including transactions conducted through alternative trading systems, in addition to transactions occurring on an exchange, as long as an issuer has obtained the information concerning the off-market transactions from publicly available sources or third-party information service providers, upon which the issuer has reasonably relied in good faith, and as long as the off-market transaction information does not duplicate any other trading volume information obtained.

In response to our request for comments on whether issuers should be required to obtain trading volume data from particular sources, a number of commenters advocated that the final rules provide issuers with sufficient flexibility to use such data sources as they deem reliable and appropriate.[58] The adopted rules do not specify any particular data sources that issuers must use to determine either its U.S. or worldwide trading volume. In this respect, when obtaining information concerning either on-exchange or off-exchange transactions, issuers will have the latitude to use market data vendors or other commercial service providers and publicly available sources of market information that they reasonably believe to be reliable and that do not duplicate trading volume

[57] See, for example, NASD Manual Rule 6600 et seq. for rules regarding recording and reporting transactions in OTC Equity Securities. A member broker-dealer must report information concerning OTC trades not involving a listed security, including a Nasdaq security, under the NASD rules rather than pursuant to a transaction reporting plan since the latter only covers unlisted transactions involving listed (and Nasdaq) securities.

[58] See, for example, the letters from Cleary Gottlieb and EALIC.

information obtained from other sources, such as various exchanges or markets.[59] Issuers will be required to disclose their trading volume data sources on Form 15F, which will inform investors of the data sources used.[60]

iii. The 5 Percent Trading Volume Measure

Commenters expressed a variety of views on whether 5 percent U.S. ADTV was the appropriate threshold for the trading volume benchmark. Although some commenters requested that the Commission increase the percentage to 10 percent ADTV,[61] many others supported the 5 percent threshold.[62] Moreover, some of the commenters that requested an increase to 10 percent did so only if the Commission decided not to adopt a world-wide trading based benchmark.[63]

We believe that adoption of the "5 percent of worldwide trading volume" standard will permit foreign companies with relatively little U.S. market interest to deregister.[64] Moreover, by permitting an issuer to include both on-exchange and off-exchange transactions when calculating its worldwide ADTV, we have addressed the concerns of commenters who suggested the 5 percent threshold could be too low to achieve the rule's

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[59] See Instruction 3.c to Item 4 of Form 15F.

[60] See Item 4.F of Form 15F.

[61] See the letter, dated February 9, 2007, from SGL Carbon, the letter, dated February 12, 2007, from Fried Frank Harris Shriver & Jacobson (Fried Frank), and the letter from Skadden Arps. Another commenter requested an increase to 15 percent. See the letter from i-CABLE Communications Ltd. (i-CABLE).

[62] See the letters from Cleary Gottlieb, EALIC, Galileo, Sullivan & Cromwell, and the New York State Society of Certified Public Accountants (NYSSCPA).

[63] See the letters from the ABA, BusinessEurope, and Linklaters.

[64] See Part III, n. 191 of this release.

purpose of reducing the disincentive to U.S. registration that may be caused by the current exit regime.

iv. Definition of Equity Securities

We reproposed that, for purposes of new Rule 12h-6, an issuer would use the definition of equity security provided in Exchange Act Rule 3a11-1.[65] That provision includes equity-linked securities, such as convertible debt securities and warrants, within the definition of equity security. Several commenters[66] requested that the Commission exclude equity-linked securities from the definition of equity security on the grounds that trading volume information for equity-linked securities is difficult to obtain. One commenter suggested using instead the definition of equity security provided in the Securities Act cross-border rules, which explicitly excludes convertible debt and other equity-linked securities.[67]

We agree with those commenters that, because trading volume information concerning convertible debt and other equity-linked securities is more difficult to obtain than trading volume information for the underlying equity securities, an issuer should not have to include equity-linked securities when determining whether it meets the trading volume benchmark. The same reasoning applies to an issuer's determination concerning the foreign listing condition, which requires an issuer to meet the definition of primary trading market, which is a trading volume-based definition.[68] Therefore, we are adopting

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[65] 17 CFR 240.3a11-1.

[66] See the letters from BusinessEurope, the EU, EALIC and Cleary Gottlieb.

[67] See the letter from Cleary Gottlieb, which cites Securities Act Rule 800(b) (17 CFR 230.800(b)).

[68] See Part II.A.4 of this release.

a definition of equity security that is based on Rule 3a11-1, except that, for purposes of the trading volume and foreign listing provisions of Rule 12h-6, the definition explicitly excludes:

- any debt security that is convertible into an equity security, with or without consideration;
- any debt security that includes a warrant or right to subscribe to or purchase an equity security;
- any such warrant or right; or
- any put, call, straddle, or other option or privilege that gives the holder the option of buying or selling a security but does not require the holder to do so.[69]

v. One Year Ineligibility Period After Delisting

We are adopting, substantially as proposed, a condition to the use of Rule 12h-6's trading volume standard and corresponding eligibility to file Form 15F. This condition provides that if a foreign private issuer has had its equity securities delisted from a registered national securities exchange or automated inter-dealer quotation system within one year before filing the Form 15F, it must have satisfied the trading volume percentage as of the date of delisting, as measured over the 12 months preceding the date of delisting.[70] Under this condition:

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[69] New Exchange Act Rule 12h-6(f)(3) (17 CFR 240.12h-6(f)(3). These are the same categories of securities excluded from the definition of equity security under Securities Act Rule 800(b).

[70] New Exchange Act Rule 12h-6(b)(1) (17 CFR 240.12h-6(b(1)). We previously proposed to codify this delisting requirement, along with a similar requirement concerning termination of a sponsored ADR facility, as Notes to paragraph (a)(4) of reproposed Rule 12h-6. We have restructured final Rule 12h-6 to provide for these requirements in a separate paragraph and have changed the paragraph numbering of the adopted rule accordingly. As adopted, Rule 12h-6(b) does not apply to issuers terminating their reporting obligations under either Rule 12h-6(d) (the successor issuer provision) or Rule 12h-6(i) (the prior Form 15 filer provision).

- a listed foreign private issuer that satisfied the trading volume condition will be able to delist from its stock exchange and terminate its Exchange Act registration and reporting obligations concurrently; and
- a listed foreign private issuer that did not satisfy the trading volume condition will be able to delist but will not be eligible to file a Form 15F and terminate its Exchange Act registration and reporting obligations until one year after the date of delisting, assuming that, at that time, it meets the conditions of the rule.[71]

We are adopting this condition in order to prevent the new trading volume-based rule from creating an incentive for a foreign private issuer to delist its securities from a U.S. exchange for the purpose of decreasing its U.S. trading volume. As one commenter suggested early on, if we were to adopt a standard based solely on trading volume, a foreign private issuer that delisted its securities from a U.S. exchange before its trading volume fell below the applicable percentage should not be eligible to terminate its registration under such a standard.[72]

A few commenters requested that the Commission remove this delisting condition on the grounds that it imposed a restraint on the use of the new exit rule that was not necessary for the protection of U.S. investors.[73] We agree that companies should not be unnecessarily restricted in choosing the markets on which their securities are listed.

[71] For example, an issuer that failed to meet the trading volume standard at the date of delisting would have to meet the trading volume standard one year later when filing its Form 15F. If, notwithstanding its delisting, an active U.S. over-the-counter market in the company's securities continued, the company would not be eligible to use Rule 12h-6 and file a Form 15F in reliance on the trading volume benchmark.

[72] See the letter, dated February 9, 2004, from Cleary Gottlieb.

[73] See the letters from Galileo, Makinson Cowell and SGL Carbon.

Thus, we do not believe that delisting from a U.S. exchange should result in an automatic bar against a foreign private issuer from using the new exit rule. Nonetheless, we share the concern about possible negative impacts on U.S. investors stemming from a measure based solely on trading volume. Moreover, by requiring companies to remain registered and reporting under the Exchange Act for a period of time after delisting when, before delisting, the company had a relatively active U.S. market for its securities, U.S. investors will have access to information prepared in accordance with the Commission's financial reporting and disclosure requirements for a period of time during which, most likely, the U.S. market will be diminishing. Accordingly, we are adopting the delisting condition substantially as proposed.[74]

vi. One Year Ineligibility Period After Termination of Sponsored ADR Facility

As part of the rule reproposal, we proposed an additional condition to an issuer's use of Rule 12h-6 and eligibility to file Form 15F in reliance on the trading volume provision. That condition provided that a foreign private issuer must not have terminated any sponsored ADR facility within the 12 month period before filing its Form 15F. We proposed that condition in order to encourage foreign private issuers to maintain their ADR facilities, even after they delist from a U.S. market and terminate their Exchange Act reporting obligations.

After a foreign private issuer delists and deregisters, investors will benefit if its ADRs continue to be traded in the over-the-counter market in the United States. The

[74] Some commenters requested that we exempt from the delisting condition an issuer that has been involuntarily delisted. See, for example, the letter, dated February 22, 2007, from Cravath, Swaine & Moore (Cravath). We decline to do so since such an exemption could encourage an issuer not to comply with exchange standards in order to get delisted.

termination of ADR facilities has a detrimental impact on holders, imposing fees and other charges on investors and, when investors are cashed out, subjecting investors to unplanned tax consequences and limiting their investment choices.[75] In addition, the termination of ADR facilities will limit the ability of many U.S. investors to effect transactions in the securities of the subject foreign company.

Some commenters opposed the ADR facility termination condition on grounds similar to those raised against the delisting condition. However, these commenters also objected to the fact that, unlike the delisting condition, the proposed ADR facility condition applied regardless of whether, at the time of termination of its ADR facility, an issuer met the trading volume threshold measured for the previous 12 months.[76] One commenter stated that adoption of the reproposed condition could dissuade issuers from sponsoring ADR programs, to the detriment of U.S. investors.[77]

We continue to believe that, due to the importance of ADR facilities for U.S. investors, a sponsored ADR facility termination condition is appropriate. However, we agree with commenters that the importance of this concern significantly diminishes if, at the time of its termination of a sponsored ADR facility, an issuer's U.S. ADTV has already fallen below the trading volume threshold.

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[75] When an issuer terminates its ADR facility, the holders of ADRs generally have the option to make arrangements to hold the underlying securities directly. However, if holders are unable or unwilling to make these arrangements, or to pay the costs associated with these arrangements, the holders will have their investment cashed out, that is, the underlying securities will generally be sold into the home market and the net proceeds (after deducting fees and expenses of the selling broker and the depositary bank) remitted to the former ADR holders.

[76] See, for example, the letter, dated February 12, 2007, from the NewYork State Bar Association (N.Y. State Bar), and the letters from the ABA and Linklaters.

[77] See the letter from the N.Y. State Bar.

Therefore, we are adopting a condition providing that, if an issuer has terminated a sponsored ADR facility, and at the time of termination the average daily trading volume in the United States of the ADRs exceeded 5 percent of the average daily trading volume of the underlying class of securities on a worldwide basis for the preceding 12 months, the issuer must wait 12 months before it may file a Form 15F to terminate its Exchange Act reporting obligations in reliance on Rule 12h-6's trading volume provision.[78] We are also clarifying that, for purposes of Rule 12h-6's trading volume provision, an issuer must calculate the trading volume of its ADRs in terms of the number of securities represented by those ADRs.[79]

vii. Transition Period

In connection with our reproposal of Rule 12h-6, we solicited comment on whether the proposed delisting and ADR termination conditions should apply to a foreign private issuer that delisted its equity securities from a U.S. exchange or terminated a sponsored ADR facility before the effective date of the new exit rule. One commenter[80] requested that neither provision apply to an issuer that delisted or terminated a sponsored ADR facility before December 13, 2006, which is the date of the open meeting at which the Commission voted to repropose Rule 12h-6 and the accompanying rule amendments.

We agree that, in the interests of fairness, an issuer should not be precluded from relying on Rule 12h-6's trading volume provision because it delisted or terminated a

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[78] New Exchange Act Rule 12h-6(b)(2) (17 CFR 240.12h-6(b)(2)).

[79] Note to paragraph (a)(4) of Rule 12h-6. Typically the ratio defining the number of common or ordinary shares underlying each ADR is included as part of the deposit agreement or in an exhibit to that agreement.

[80] See the letter from the ABA.

sponsored ADR facility before the Commission had even proposed to make those acts meaningful to the application of Rule 12h-6. However, we believe that March 21, 2007 should be the dispositive date since, on that date, the Commission voted to adopt the delisting and ADR termination conditions, thus making definite its intent that those conditions apply to Rule 12h-6's trading volume provision.

Therefore, a foreign private issuer that, before March 21, 2007, delisted a class of equity securities from a national securities exchange or inter-dealer quotation system in the United States or terminated a sponsored ADR facility, may file a Form 15F in reliance on Rule 12h-6's trading volume provision even if, at the time of delisting or termination, its U.S. ADTV exceeded 5 percent of the ADTV of that class of securities on a worldwide basis for the preceding 12 months.

b. Alternative 300-Holder Condition

We are adopting, substantially as reproposed, an alternative to the trading volume benchmark provision, which will permit a foreign private issuer to terminate its Exchange Act reporting obligations regarding a class of equity securities if it has less than 300 record holders on a worldwide basis or who are U.S. residents as long as the issuer meets the rule's other conditions.[81] The purpose of this alternative 300-holder condition is to enable an issuer to terminate its Exchange Act reporting obligations if it cannot satisfy the new trading volume benchmark but does meet the current 300-holder standard. Otherwise, an issuer could find itself worse off under Rule 12h-6 than under the current exit rules.[82]

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[81] New Exchange Act Rule 12h-6(a)(4)(ii) (17 CFR 240.12h-6(a)(4)(ii)).

[82] We did not originally propose or repropose a similar 500 record holder condition, although one exists in the current rules for a small issuer with total assets that have not exceeded $10 million

The adopted alternative record holder condition is substantially the same as the proposed and reproposed condition. Although at the proposing stage, some commenters requested that the Commission significantly raise the 300-holder threshold in both the Exchange Act exit and entrance rules, and a few made a similar request at the reproposing stage,[83] we decline to adopt an increase to the 300-holder threshold for foreign private issuers either in the exit or entrance rules at this time. As we previously stated, the limited purpose for retaining the 300-holder provision in the new exit rule is to preclude disadvantaging those companies that could terminate their Exchange Act reporting obligations under the current exit rules but not under the new trading volume condition.[84] Moreover, since domestic registrants are subject to a substantially similar record holder standard, we believe any change would be more appropriately considered as part of a comprehensive evaluation of the record holder provisions in both the Exchange Act entrance and exit rules for both domestic and foreign registrants.[85] In addition, issuers relying on the alternative holder provision will be able to use the revised counting method that we are adopting today, which should make the U.S. holder determination easier for those issuers.[86]

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for its most recent three fiscal years. Based on current experience, most foreign private issuers have not relied on that provision due to the difficulty in meeting the asset test.

[83] See the letters from the ABA and the Organization for International Investment.

[84] See Part II.A.1.b of the Reproposing Release.

[85] In this regard, we note that the Advisory Committee on Smaller Public Companies has made recommendations relating to Exchange Act registration and termination of registration. See the Final Report of the Advisory Committee on Smaller Public Companies, dated April 23, 2006, which is available at http://www.sec.gov/ info/smallbus/acspc/acspc-finalreport.pdf.

[86] See Part II.C of this release.

2. Prior Exchange Act Reporting Condition

We are adopting, substantially as reproposed, a prior Exchange Act reporting condition that a foreign private issuer must meet before it can terminate its section 12(g) registration or its section 15(d) reporting obligations regarding a class of equity securities under Rule 12h-6.[87] This condition will require an issuer of equity securities to have had reporting obligations under section 13(a) or section 15(d) of the Exchange Act for at least the 12 months preceding the filing of Form 15F, to have filed or furnished all reports required for this period, and to have filed at least one annual report pursuant to section 13(a) of the Exchange Act. The purpose of this prior Exchange Act reporting condition is to provide investors in U.S. securities markets with a minimum period of time to make investment decisions regarding a foreign private issuer's securities based on the information provided in an Exchange Act annual report and the interim home country materials furnished in English under cover of Form 6-K.[88]

Originally proposed Rule 12h-6 would have required a foreign private issuer to have had Exchange Act reporting obligations for the two years preceding the filing of its Form 15F and to have filed at least two Exchange Act annual reports before it could terminate its Exchange Act reporting obligations regarding a class of equity securities. As previously noted, several commenters objected to this two year reporting condition primarily on the grounds that it would impose a stricter reporting requirement than is the

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[87] New Exchange Act Rule 12h-6(a)(1) (17 CFR 240.12h-6(a)(1)).

[88] Under cover of a Form 6-K (17 CFR 249.306), a foreign private issuer is required to furnish in English a copy of any document that it publishes or is required to publish under the laws of its home country or the requirements of its local exchange or that it has distributed to shareholders, and which is material to an investment decision.

case under the current exit rules.[89] In response to those commenters, when reproposing Rule 12h-6, we reduced the required prior reporting period to at least 12 months and proposed to require only one Exchange Act annual report.

We received only a few comments on the reproposed prior reporting condition for equity security issuers. One commenter supported the revisions made to the proposed prior reporting condition but urged the Commission to permit an issuer to terminate its Exchange Act reporting obligations regarding a class of equity securities even if it has not submitted all required Form 6-Ks.[90] That commenter pointed to the difficulties that a foreign private issuer may experience when determining whether a Form 6-K submission is required under foreign reporting and U.S. materiality requirements.

As adopted, Rule 12h-6 will require a foreign private issuer to have submitted all Form 6-Ks required during the 12 months preceding the filing of its Form 15F in order to be eligible to terminate its reporting obligations regarding a class of equity securities. This requirement will help ensure that a U.S. investor is able to access through EDGAR[91] and in English all material interim information about a foreign private issuer as required by its home country. We continue to believe that our rules should provide appropriate incentives for companies to stay current with their Exchange Act reporting obligations.

From a practical point of view, the 12-month prior reporting requirement should not be problematic since, based on current experience, most foreign companies that register securities with the Commission, including solely under Exchange Act

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[89] See Part II.A.2 of the Reproposing Release.

[90] See the letter from the ABA.

[91] EDGAR is the Commission's Electronic Data Gathering, Analysis and Retrieval System.

section 12(g), stay in the U.S. market for at least a year and file at least one Exchange Act annual report.[92] Moreover, the prior reporting condition will require that a foreign private issuer must be current in its reporting obligations, not that it must have timely filed all reports required during the 12 month period. In the event that an issuer determines that it should have filed a Form 6-K during this period, it can do so before it files its Form 15F.

Another commenter[93] requested that we permit an issuer to satisfy the prior Exchange Act annual report requirement by filing a special financial report required under Exchange Act Rule 15d-2.[94] We agree that it would be appropriate to have the special financial report satisfy the annual report filing requirement under new Rule 12h-6(a)(1). In this situation, an issuer will have recently sold securities under an effective Securities Act registration statement with non-financial information as current as the date of the prospectus, and the information in the special financial report will provide financial statements and other information as of and for the most recent fiscal year end, thus serving the same purpose as an Exchange Act annual report.

In addition, this approach is consistent with our recent implementation rules for the internal control over financial reporting requirements mandated by Section 404 of the

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[92] See, for example, the letter from Galileo.

[93] See the letter from Sullivan & Cromwell.

[94] 17 CFR 240.15d-2. This rule requires an issuer that filed a Securities Act registration statement, which did not contain audited financial statements for the last full fiscal year preceding the year in which the registration statement became effective, to file a special financial report with the Commission that includes audited financials for that last full fiscal year.

Sarbanes-Oxley Act of 2002.[95] Accordingly, we are clarifying that a special financial report, filed with the Commission pursuant to Rule 15d-2, constitutes an Exchange Act annual report for the purpose of complying with Rule 12h-6's prior reporting condition.

3. One Year Dormancy Condition

We are adopting, as reproposed, a one year dormancy condition with which a foreign private issuer must comply before it can terminate its Exchange Act registration and reporting obligations regarding a class of equity securities under Rule 12h-6.[96] New Rule 12h-6 will prohibit sales of a foreign private issuer's securities in the United States in a registered offering under the Securities Act during the 12 months preceding the filing of its Form 15F other than securities issued:

- to the issuer's employees;
- by selling security holders in non-underwritten offerings;
- upon the exercise of outstanding rights granted by the issuer if the rights are granted pro rata to all existing security holders of the class of the issuer's securities to which the rights attach;
- pursuant to a dividend or interest reinvestment plan; or
- upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer.

[95] 15 U.S.C. 7262. See Release No. 33-8760 (December 15, 2006), 71 FR 76580 (December 21, 2006).

[96] New Exchange Act Rule 12h-6(a)(2) (17 CFR 240.12h-6(a)(2)).

The primary purpose of the dormancy condition's prohibition of registered offerings is to preclude a foreign private issuer from exiting the Exchange Act reporting system shortly after it has engaged in U.S. public capital raising.

We received relatively few comments on the reproposed dormancy condition.[97] Most welcomed the revisions made to the originally proposed dormancy condition.[98] For example, the originally proposed rule would have prohibited sales of unregistered securities, with limited exceptions. We removed this prohibition when reproposing Rule 12h-6 after commenters convinced us that adoption of the originally proposed dormancy condition could well drive many private placement financings and other unregistered offerings by foreign companies offshore, to the detriment of U.S. investors and U.S. broker-dealers, since many companies might prefer to finance outside the United States under Regulation S in order to avoid triggering the dormancy condition. Consequently, as reproposed, the adopted rule will permit the unregistered sale of securities that are exempted under the Securities Act during the dormancy period. The permitted category of securities will include sales pursuant to section 4(2),[99] Regulation D,[100] Rule 144A,[101] Rules 801 and 802,[102] and exempt securities under

[97] See the letters from the ABA, Linklaters, the N.Y. State Bar, Sullivan & Cromwell, and Skadden Arps.

[98] See the letters from the ABA, Skadden Arps, and Sullivan & Cromwell.

[99] 15 U.S.C. 77d(2).

[100] 17 CFR 230.501 et seq.

[101] 17 CFR 230.144A.

[102] 17 CFR 230.801 and 230.802.

section 3, including section 3(a)(10) of the Securities Act.[103]

Some of the comments pertained to additional proposed exceptions to the dormancy condition. As originally proposed, Rule 12h-6 would have excepted from the dormancy condition's prohibition of sales of an issuer's registered securities in the United States only securities sold to an issuer's employees and those sold by selling security holders in non-underwritten offerings. When reproposing Rule 12h-6, we proposed three additional exceptions to the dormancy condition's prohibition of sales of an issuer's registered securities: the issuance of registered securities pursuant to pro rata rights offerings, dividend or interest reinvestment plans, and the conversion of outstanding convertible securities.[104] Like the earlier proposed exceptions, these transactions often occur for reasons unrelated to capital raising or for the benefit of the issuer, for example, to benefit current security holders or for the convenience of investors.

We also reproposed that these additional exceptions would not apply to securities issued pursuant to a standby underwritten offering or other similar arrangement in the United States. As we explained, this limitation is consistent with the Commission's previous treatment of these types of registered offerings.[105]

Two commenters requested that we clarify that an issuer would not trigger the dormancy condition if it conducted a registered offering involving, for example, a rights offering, in the United States, with a standby underwriting arrangement according to which the underwriter only resold the securities purchased in the offering outside the

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[103] 15 U.S.C. 77c and 77c(a)(10).

[104] See Part II.A.3 of the Reproposing Release.

[105] Instruction 2 to Item 8 of Form 20-F imposes a similar limitation.

United States pursuant to Regulation S.[106] We agree that this type of standby underwritten arrangement would not trigger the dormancy condition since it would not increase an issuer's involvement in public capital raising in the United States.

Also as reproposed, the adopted rule includes under the dormancy condition sales of an issuer's securities by its selling security holders in an underwritten registered offering because there is a greater likelihood of issuer involvement in a U.S. underwritten offering than in a non-underwritten offering of selling security holders.

New Exchange Act Rule 12h-6 will use the definition of "employee" under Form S-8[107] for the purpose of applying the dormancy condition under Rule 12h-6, as reproposed.[108] That definition includes any employee, director, general partner, certain trustees, certain insurance agents, and former employees as well as executors, administrators or beneficiaries of the estates of deceased employees, and a family member of an employee who has received shares through a gift or domestic relations order.[109] Otherwise, a narrow interpretation of the term "employee" could result in an issuer being disqualified from terminating its Exchange Act registration and reporting obligations under Rule 12h-6 because it engaged in a sale of securities during the dormancy period to an employee's family member or other relationship permitted under Form S-8 but not explicitly allowed under the new rule.

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[106] See the letters from Linklaters and the N.Y. State Bar.

[107] 17 CFR 239.16b. Form S-8 is the form used by an Exchange Act reporting company to register securities for issuance to its employees or those of its subsidiaries or parent under an employee benefit plan.

[108] New Exchange Act Rule 12h-6(f)(2) (17 CFR 240.12h-6(f)(2)).

[109] See General Instruction A.1 to Form S-8.

4. Foreign Listing Condition

We are adopting a foreign listing condition under Rule 12h-6, which will require that, with respect to equity securities, for at least the 12 months preceding the filing of its Form 15F, a foreign private issuer must have maintained a listing of the subject class of securities on one or more exchanges in a foreign jurisdiction that, either singly or together with the trading of the same class of the issuer' s securities in another foreign jurisdiction, constitutes the primary trading market for the issuer's subject class of securities.[110] The new rule defines "primary trading market" to mean that at least 55 percent of the trading in the foreign private issuer's subject class of securities took place in, on or through the facilities of a securities market or markets in no more than two foreign jurisdictions during a recent 12-month period.[111] That definition further provides that if an issuer aggregates the trading of its securities in two foreign jurisdictions for the purpose of Rule 12h-6's foreign listing condition, the trading for the issuer's securities in at least one of the two foreign jurisdictions must be larger than the trading in the United States for the same class of the issuer's securities.[112]

The purpose of this foreign listing condition is to help assure that there is a non-U.S. jurisdiction that principally regulates and oversees the issuance and trading of

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[110] New Exchange Act Rule 12h-6(a)(3) (17 CFR 240.12h-6(a)(3)).

[111] New Exchange Act Rule 12h-6(f)(5)(i) (17 CFR 240.12h-6(f)(5)(i)). Rule 12h-6 defines "recent 12-month period" to mean a 12-calendar month period that ended no more than 60 days before the filing date of the Form 15F. New Exchange Act Rule 12h-6(f)(6) (17 CFR 240.12h-6(f)(6)).

[112] New Exchange Act Rule 12h-6(f)(5)(ii) (17 CFR 240.12h-6(f)(5)(ii)). As proposed and as adopted, measurement under this condition is by reference to average daily trading volume (ADTV) as reported by the relevant market. Although the proposing and reproposing releases noted that there are differences concerning how various markets measure and report trading volume (for example, dealer markets versus auction markets), no commenter supported a trading volume standard that would take such differences into account.

the issuer's securities and the issuer's disclosure obligations to investors. This foreign listing condition increases the likelihood that the principal pricing determinants for a foreign private issuer's securities are located outside the United States, and makes more likely the availability of a set of non-U.S. securities disclosure documents to which a U.S. investor may turn for material information when making investment decisions about the issuer's securities following the termination of its disclosure obligations under Rule 12h-6. If the United States was the sole or principal market for the foreign private issuer's securities, then the Commission would have a greater regulatory interest in continuing to subject the foreign company to the Exchange Act reporting regime.

The adopted foreign listing condition is substantially the same as the reproposed condition, except that, at the request of commenters, we have modified the rule to reflect that an issuer may be listed on multiple exchanges within a single jurisdiction.[113] Thus, the new rule provides that an issuer may aggregate trading in the same class of its equity securities on all of its exchanges within a single foreign jurisdiction or in no more than two foreign jurisdictions for the purpose of the foreign listing condition, as long as the trading in one of the foreign jurisdictions is greater than the trading in the United States.[114]

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[113] See, for example, the letter from Cravath.

[114] For the purpose of the primary trading market determination, an issuer would measure the ADTV of on-exchange transactions in its securities aggregated over one or two foreign jurisdictions against its worldwide trading volume. The issuer could include in this measure off-exchange transactions in those jurisdictions comprising the numerator only if it includes those off-exchange transactions when calculating worldwide trading volume in the denominator. This denominator would be the same as the denominator used for the trading volume benchmark. Thus, this denominator would consist of U.S. ADTV, which must include both on-exchange and off-exchange transactions, and non-U.S. ADTV, which must include on-exchange transactions, but could also include off-exchange transactions. See Part II.A.1.a.ii of this release.

We received relatively few comments on the reproposed foreign listing condition.[115] Three commenters generally approved of the changes made to the originally proposed foreign listing condition.[116] These changes included shortening the proposed foreign listing requirement from two years to one year and permitting an issuer to aggregate its trading on an exchange in one foreign jurisdiction with that in a second foreign jurisdiction.[117] These commenters agreed that the reproposed foreign listing condition would increase the flexibility of the new rule for foreign private issuers while serving to protect investors.

New Rule 12h-6's foreign listing condition will apply to any issuer of equity securities, whether that issuer is relying on the trading volume benchmark or the alternative holder provision, as reproposed. Some commenters requested that the Commission not apply the foreign listing condition to an issuer that has delisted in its primary trading market as a result of being acquired. According to these commenters, that issuer would not be able to terminate its Exchange Act reporting obligations under the 300-holder provision because it could not meet the foreign listing requirement.[118]

The foreign listing condition is an important component of the new exit regime because it increases the likelihood that U.S. investors will have a set of material disclosure documents about an issuer to which they may turn following that issuer's exit from the Exchange Act reporting system. Therefore, we decline to create an exception

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[115] See the letters from the ABA, BusinessEurope, Cravath, Davis Polk, Linklaters, and Skadden Arps.

[116] See the letters from the ABA, Linklaters, and Skadden Arps.

[117] See Part II.A.4 of the Reproposing Release.

[118] See the letters from BusinessEurope and Davis Polk.

from this condition for any issuer at this time.[119] We note that, under most circumstances, a foreign private issuer that has been acquired may exit the Exchange Act reporting regime under the provisions of the current exit rules that permit any issuer, whether domestic or foreign, or listed or unlisted, to file a Form 15 if its securities are held by less than 300 holders of record.[120]

B. Debt Securities Provision

As adopted, Rule 12h-6 will enable a foreign private issuer to terminate its Exchange Act reporting obligations regarding a class of debt securities as long as the issuer has filed or furnished all reports required under Exchange Act section 13(a) or section 15(d), including at least one Exchange Act annual report, and has its class of debt securities held of record by less than 300 holders either on a worldwide basis or who are U.S. residents.[121] This provision reflects the minimum reporting requirement and current 300 holder standard under section 15(d) and Rule 12h-3. Moreover, it is the same as the reproposed debt securities provision.[122]

Some commenters requested that we revise the 300-holder standard for termination of a foreign private issuer's Exchange Act reporting obligations under

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[119] For this reason, we decline to adopt a general exception from the foreign listing condition for equity securities issuers proceeding under the alternative 300-holder provision.

[120] Exchange Act Rules 12g-4(a)(1)(i) and 12h-3(b)(1)(i) (17 CFR 240.12g-4(a)(1)(i) and 240.12h-3(b)(1)(i)).

[121] New Exchange Act Rule 12h-6(c) (17 CFR 240.12h-6(c)).

[122] As originally proposed and reproposed, the adopted exit rule for debt securities does not include a provision comparable to Rule 12h-3's 500 record holder provision because most foreign private issuers that are debt securities registrants would likely exceed the $10 million asset threshold that accompanies the 500 record holder standard. No commenter has ever requested that we incorporate the 500 record holder and $10 million asset standard into Rule 12h-6's debt securities provision, either at the proposing or reproposing stage.

Exchange Act Section 15(d) regarding a class of debt securities that had been offered and sold pursuant to an effective registration statement under the Securities Act.[123] In the view of most of these commenters, an increase to at least 1,000 holders would be appropriate in light of the changes in the global securities markets since the 300-holder standard was adopted by Congress in the 1960s.[124]

We are not revising the 300-holder standard as it applies to debt securities. While we agree that there have been substantial changes in the global capital markets, no commenter has presented us with data or other information that supports raising the threshold from that adopted by Congress. In addition, the problems associated with determining the ownership of equity securities do not appear to apply to debt securities, as to which there is generally a single U.S.-based transfer agent. Further, the same 300-holder threshold applies to U.S. companies, and unlike the situation for equity securities, no commenter has addressed why it would be appropriate to treat U.S. and foreign registrants differently with respect to the termination or suspension of reporting obligations under section 15(d) as applied to debt securities.[125]

C. Revised Counting Method

We are adopting, as reproposed, Rule 12h-6's revised counting method, which will enable an issuer of equity securities proceeding under the alternative 300-holder provision, or a debt securities issuer, to use a modified version of the "look through"

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[123] See the letters from Cleary Gottlieb, EALIC, Davis Polk, and the EU.

[124] Davis Polk favored an increase to at least 3,000.

[125] We note that foreign private issuers that avail themselves of Rule 12h-6 will be able to terminate their reporting obligations under section 15(d) while U.S. companies will only continue to be able to suspend their reporting obligations pursuant to Rule 12h-3 and section 15(d).

counting method under Rule 12g3-2(a) when determining the number of its U.S. resident security holders.[126] Instead of having to look through the accounts of brokers, banks and other nominees on a worldwide basis to determine the number of its U.S. resident holders, as is required under the current rules, a foreign private issuer could limit its inquiry to brokers, banks and other nominees located in the United States, the issuer's jurisdiction of incorporation, legal organization or establishment and, if different, the jurisidiction of its primary trading market.[127] This revised counting method is substantially similar to the counting method that the Commission adopted under the exemptive rules for cross-border rights offerings, exchange offers and business combinations,[128] as well as under the definition of foreign private issuer.[129]

Like the reproposed rule, the adopted counting method provision requires an issuer that aggregates the trading volume of its securities in two foreign jurisdictions for the purpose of meeting Rule 12h-6's foreign listing condition to look through nominee accounts in both foreign jurisdictions, which comprise its primary trading market, and in the United States as well as in its jurisdiction of incorporation or organization, if different from the two jurisdictions that comprise its primary trading market.[130] Also as reproposed, the adopted counting method provision permits an issuer to rely on the

[126] New Exchange Act Rule 12h-6(e) (17 CFR 240.12h-6(e)).

[127] New Exchange Act Rule 12h-6(e)(1) (17 CFR 240.12h-6(e)(1)).

[128] Securities Act Rules 800 et seq. (17 CFR 230.800 et seq.).

[129] 17 CFR 230.405 and 240.3b-4(c).

[130] New Exchange Act Rule 12h-6(e)(1)(ii) (17 CFR 240.12h-6(e)(1)(ii)).

assistance of an independent information services provider when calculating the number of its U.S. security holders.[131]

We are also adopting a presumption, included in both the originally proposed and reproposed counting method provisions, that we previously adopted under the cross-border rules and definition of foreign private issuer.[132] This presumption is that, if, after reasonable inquiry, an issuer is unable without unreasonable effort to obtain information about the amount of securities held by nominees for the accounts of customers resident in the United States, it may assume that the customers are the residents of the jurisdiction in which the nominee has its principal place of business.[133]

The reproposed rule provided that an issuer must count securities as owned by U.S. holders when publicly filed reports of beneficial ownership or information that is otherwise provided to it indicates that the securities are held by U.S. residents. One commenter requested that we clarify that an issuer is not required to take account of U.S. ownership information provided to it if the issuer determines that it is unreliable.[134] We have so clarified by revising the above provision to state that an issuer must count securities as owned by U.S. holders when publicly filed reports of beneficial ownership or other reliable information that is provided to it indicates that the securities are held by U.S. residents.[135]

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[131] New Exchange Act Rule 12h-6(e)(4) (17 CFR 240.12h-6(e)(4)).

[132] See Securities Act Rule 800(h)(4) (17 CFR 230.800(h)(4)) and Instruction B to Exchange Act Rule 3b-4(c)(1) (17 CFR 240.3b-4(c)(1)).

[133] New Exchange Act Rule 12h-6(e)(2) (17 CFR 240.12h-6(e)(2)).

[134] See the letter from Cravath.

[135] New Rule 12h-6(e)(3) (17 CFR 240.12h-6(e)(3)).

Some foreign jurisdictions have laws that provide an established and enforceable means for a public company to obtain information about its shareholders.[136] Like the reproposed rule, Rule 12h-6 does not provide that a foreign private issuer may rely solely on specified foreign statutory or code provisions when calculating the number of its U.S. resident equity or debt holders. We received only two comments in support of such a provision at the proposing stage, and none at the reproposing stage. However, as we noted in the reproposing release, as part of its inquiry regarding whether it meets any of the quantitative benchmarks under Rule 12h-6, an issuer may refer to shareholder information obtained pursuant to those foreign statutory or code provisions to the extent that this shareholder information is reasonably reliable and accurate and furthers the purpose of the inquiry.

D. Expanded Scope of Rule 12h-6

We are adopting, substantially as reproposed, an expansion of the scope of the originally proposed Rule 12h-6 in two respects. First, we are adopting a rule providing that an issuer that has succeeded to the Exchange Act reporting obligations of an acquired company may terminate those reporting obligations under Rule 12h-6 as long as it satisfies specified conditions. Second, we are extending the application of Rule 12h-6 to a foreign private issuer that previously filed a Form 15 and effected its termination of registration or suspension of reporting under the current exit rules before the effective date of Rule 12h-6, subject to conditions.

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[136] See, for example, section 212 of the United Kingdom Companies Act.

1. Application of Rule 12h-6 to Successor Issuers

As adopted, Exchange Act Rule 12h-6(d)[137] provides that, following a merger, consolidation, exchange of securities, acquisition of assets or otherwise, a foreign private issuer that has succeeded to the registration of a class of securities under Exchange Act section 12(g) pursuant to Rule 12g-3,[138] or to the reporting obligations of another issuer under Exchange Act section 15(d) pursuant to Rule 15d-5,[139] may file a Form 15F to terminate those reporting obligations if, regarding a class of equity securities, the successor issuer meets the conditions under Rule 12h-6(a), which applies to equity securities issuers.[140] Regarding a class of debt securities, the successor issuer must meet the conditions under Rule 12h-6(c), including the reporting condition.[141] New Rule 12h-6(d) then provides that, when determining whether it meets the prior reporting condition under either the equity or debt securities provision of the final rule, a successor issuer may take into account the reporting history of the issuer whose reporting obligations it has assumed pursuant to Rule 12g-3 or 15d-5.[142]

This successor issuer provision will enable a non-Exchange Act reporting foreign private issuer that acquires a reporting foreign private issuer in a transaction exempt

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[137] 17 CFR 240.12h-6(d).

[138] 17 CFR 240.12g-3.

[139] 17 CFR 240.15d-5.

[140] New Exchange Act Rule 12h-6(d)(1)(i) (17 CFR 240.12h-6(d)(1)(i)).

[141] New Exchange Act Rule 12h-6(d)(1)(ii) (17 CFR 240.12h-6(d)(1)(ii)).

[142] New Exchange Act Rule 12h-6(d)(2) (17 CFR 240.12h-6(d)(2)).

under the Securities Act, for example, under Rule 802 or section 3(a)(10), to qualify immediately for termination of its Exchange Act reporting obligations under Rule 12h-6, without having to file an Exchange Act annual report, as long as the successor issuer meets the rule's foreign listing, dormancy and quantitative benchmark conditions, and the acquired company's reporting history fulfills Rule 12h-6's prior reporting condition. Since the successor issuer will have assumed the acquired company's Exchange Act reporting obligations, we believe it is appropriate that the issuer succeed to the acquired company's reporting history for the purpose of Rule 12h-6.

The adopted successor issuer provision is substantially similar to the reproposed provision, except that the adopted rule clarifies that, in order to qualify for deregistration under the successor issuer provision, an issuer must meet all of the conditions pertaining to equity securities registrants, including the dormancy condition. We have made this clarification in order to underscore our position, stated at the reproposing stage, that if a previously non-Exchange Act reporting foreign private issuer acquires an Exchange Act reporting company by consummating an exchange offer, merger or other business combination registered under the Securities Act, most likely on a Form F-4 registration statement, the acquiror will have to fulfill Rule 12h-6's prior reporting condition without reference to the acquired company's reporting history. Since the acquiror will have triggered its own section 15(d) reporting obligations upon the effectiveness of its Securities Act registration statement, it will have to meet Rule 12h-6's full reporting condition like any other section 15(d) reporting company before it can terminate its reporting obligations under the new rule. In order to clarify that such a Securities Act registrant may not proceed under the successor issuer provision and immediately terminate its section 15(d) reporting obligations upon completion of the Form F-4 transaction, the adopted rule provides that an issuer must meet Rule 12h-6's equity securities conditions, which includes the dormancy condition.[143]

Most of the parties that commented on the reproposed successor issuer provision supported it.[144] However, one commenter sought clarification regarding the intended role that the predecessor company would play in satisfying Rule 12h-6's requirements.[145] More particularly, this commenter was concerned that Rule 12h-6 could be construed to require an issuer to take into account the listing and trading history of an acquired company. Such an interpretation could preclude an acquiror from terminating its Exchange Act reporting obligations immediately after succession if the acquired company was unlisted or had an active U.S. trading market.

Therefore, we are clarifying that Rule 12h-6(d) permits a successor issuer to consider an acquired company's history only when determining whether the successor meets Rule 12h-6's prior reporting condition. Following an acquisition, a successor issuer must look only to its own foreign listing history, and consider its own U.S. and worldwide trading volume, when determining whether it satisfies Rule 12h-6's foreign listing and trading volume conditions.

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[143] Because some commenters stated that the dormancy condition should not apply to a foreign private issuer that filed a Securities Act registration statement solely to effect an acquisition or business combination (see, for example, the letter from Sullivan & Cromwell), we believe it is necessary to state explicitly in Rule 12h-6 that the dormancy condition applies to a successor issuer.

[144] See, for example, the letters from Cleary Gottlieb and PricewaterhouseCoopers.

[145] See the letter from Latham & Watkins.

This commenter also sought clarification regarding whether, as a condition to deregistration under Rule 12h-6, a successor issuer would have an obligation under Exchange Act Rule 12g-3(g)[146] to file an Exchange Act annual report for the predecessor's last full fiscal year prior to succession. As with the filing of a Form 15 under the current exit rules, under Rule 12h-6(g),[147] the suspension of a foreign private issuer's duty to file reports under section 13(a) or 15(d) occurs immediately upon filing a Form 15F. This suspension extends to an annual report that would be required under Rule 12g-3(g). A successor issuer would only have to file an annual report on behalf of its predecessor under Rule 12g-3(g) if, at the time of filing its Form 15F, that annual report was past due. This is consistent with the current practice involving Form 15.

2. Application of Rule 12h-6 to Prior Form 15 Filers

As adopted, Rule 12h-6(i) will extend termination of Exchange Act reporting under the new exit rule to a foreign private issuer that, before the effective date of Rule 12h-6, already effected the suspension or termination of its Exchange Act reporting obligations after filing a Form 15.[148] A prior Form 15 filer will have to meet the following conditions in order to obtain the benefits of Rule 12h-6 with respect to a class of equity securities:

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[146] 17 CFR 240.12g-3(g). This provision requires a successor issuer to file an Exchange Act annual report for the last full fiscal year of the predecessor before the issuer's succession if the predecessor has not done so.

[147] 17 CFR 240.12h-6(g).

[148] New Exchange Act Rule 12h-6(i)(1) (17 CFR 240.12h-6(i)(1)). A former section 15(d) reporting company would benefit from proceeding under Rule 12h-6 by obtaining termination, rather than mere suspension, of its reporting obligations with respect to a class of equity or debt securities. As discussed below, a former section 12(g) company also would benefit from proceeding under Rule 12h-6 by being able to claim the Rule 12g3-2(b) exemption immediately upon the effectiveness of its Rule 12h-6 termination.

- the issuer must satisfy Rule 12h-6's foreign listing condition regarding the class of equity securities that was the subject of its Form 15;
- the issuer must satisfy either Rule 12h-6's trading volume or alternative holder provision; and
- the issuer must file a Form 15F.[149]

An equity securities issuer will not have to satisfy Rule 12h-6's prior reporting or dormancy provisions since it will already be a non-reporting entity.

A prior Form 15 filer will have to meet the following conditions in order to obtain the benefits of Rule 12h-6 with respect to a class of debt securities:

- the issuer must meet Rule 12h-6's record holder provision for debt securities; and
- the issuer must file a Form 15F.[150]

As reproposed, the prior Form 15 filer provision was substantially similar to the adopted rule, except that we proposed to establish, as a condition of eligibility, that an issuer not be required to register a class of securities under section 12(g) or be required to file reports under section 15(d).[151] While the parties that commented on the reproposed provision supported extending the benefits of Rule 12h-6 to a prior Form 15 filer, most also opposed requiring that filer to determine that it had not assumed or resumed

[149] Rule 12h-6(i)(2)(i) (17 CFR 240.12h-6(i)(2)(i)).

[150] Rule 12h-6(i)(2)(ii) (17 CFR 240.12h-6(i)(2)(ii)).

[151] See Part II.D.2 of the Reproposing Release.

Exchange Act reporting obligations.[152] Those commenters noted that, since under the reproposed rule, a former equity securities registrant could not have relied on the trading volume condition, that registrant would have had once more to undertake the costly task of counting its U.S. resident holders.

We agree that, as suggested by some of those commenters, a more equitable approach would be to place former equity securities registrants in as good a position as current registrants by permitting them to meet the trading volume benchmark as an alternative to the record holder standard.[153] The adopted rule takes this approach.

E. Public Notice Requirement

We are adopting, as reproposed, a public notice requirement as a condition to termination of reporting under Rule 12h-6, except for prior Form 15 filers.[154] Pursuant to this requirement, an issuer of equity or debt securities, including a successor issuer, will have to publish, either before or on the date that it files its Form 15F, a notice in the United States that discloses its intent to terminate its section 13(a) or 15(d) reporting obligations. The issuer must publish the notice, such as a press release, through a means reasonably designed to provide broad dissemination of the information to the public in the United States. The issuer also must submit a copy of the notice, either under cover of a Form 6-K before or at the time of filing of the Form 15F, or as an exhibit to the

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[152] See the letters from the ABA, BusinessEurope, Cleary Gottlieb, EALIC, the EU, the N.Y. State Bar, and Sullivan & Cromwell.

[153] See, for example, the letters from EALIC and Sullivan & Cromwell.

[154] New Exchange Act Rule 12h-6(h) (17 CFR 240.12h-6(h)).

Form 15F. The primary purpose of this notice provision is to alert U.S. investors who have purchased the issuer's securities about the issuer's intended exit from the Exchange Act registration and reporting system.

The notice requirement will not apply to a prior Form 15 filer that files a Form 15F to terminate its registration and reporting obligations under Rule 12h-6(i). Since a prior Form 15 filer will already have ceased its Exchange Act reporting obligations, investors would gain little from the publishing of such a notice.

One commenter requested that we clarify that an issuer may satisfy this notice provision by having the press release disseminated in the United States by one of the international wire services, such as those operated by U.S. and international financial publications.[155] We have so clarified by revising Form 15F to request that the issuer identify the means, such as publication in a particular newspaper or transmission by a particular wire service, used to disseminate the notice in the United States.[156]

F. Form 15F

Like our current exit rules, adopted Rule 12h-6 will require a foreign private issuer to file electronically on EDGAR a form certifying that it meets the requirements for ceasing its Exchange Act reporting obligations.[157] By signing and filing new Form 15F,[158] a foreign private issuer will be certifying that:

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[155] See the letter from Skadden Arps.

[156] See Item 7.B of Form 15F.

[157] New Exchange Act Rule 12h-6(a).

[158] 17 CFR 249.324.

- it meets all of the conditions for termination of Exchange Act reporting specified in Rule 12h-6; and
- there are no classes of securities other than those that are the subject of the Form 15F regarding which the issuer has Exchange Act reporting obligations.[159]

Unlike current Form 15, new Form 15F will require a foreign private issuer to provide disclosure regarding several items in order to provide investors with information regarding an issuer's decision to terminate its Exchange Act reporting obligations. The information will also assist Commission staff in assessing the use of Rule 12h-6. The Form 15F filing requirement and the specified items of information are substantially the same as those under reproposed Rule 12h-6, except that we have modified some items to conform to the changes we have made to the reproposed rule.

As with Form 15, and as originally proposed and reproposed, filing of new Form 15F will immediately suspend an issuer's Exchange Act reporting obligations regarding the subject class of securities and commence a 90-day waiting period. If, at the end of this 90-day period, the Commission has not objected to the filing, the suspension will automatically become a termination of registration and reporting. If the Commission denies the Form 15F or the issuer withdraws it, within 60 days of the date of the denial or withdrawal, the issuer will be required to file or submit all reports that would have been required had it not filed the Form 15F.[160]

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[159] Form 15F General Instruction B.

[160] New Exchange Act Rule 12h-6(g) (17 CFR 240.12h-6(g)).

After filing Form 15F, an issuer will have no continuing obligation to make inquiries or perform other work concerning the information contained in the Form 15F, including its assessment of trading volume or ownership of its securities. However, Form 15F will require an issuer to undertake to withdraw its Form 15F before the date of effectiveness if it has actual knowledge of information that causes it reasonably to believe that, at the date of filing the Form 15F:

- the average daily trading volume of its subject class of securities in the United States exceeded 5 percent of the average daily trading volume of that class of securities on a worldwide basis for the same recent 12-month period that the issuer used for purposes of Rule 12h-6(a)(4)(i);
- its subject class of securities was held of record by 300 or more United States residents or 300 or more persons worldwide, if proceeding under Rule 12h-6(a)(4)(ii) or Rule 12h-6(c); or
- it otherwise did not qualify for termination of its Exchange Act reporting obligations under Rule 12h-6.[161]

This undertaking is substantially the same as that required under the reproposed rule and form, except that, in the first prong of the reproposed rule's undertaking, we referred to trading volume "during a recent 12-month period." At the request of a commenter,[162] we have clarified that the undertaking applies to an issuer relying on the trading volume provision only when it learns that its trading volume exceeded the 5 percent threshold for

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[161] Form 15F Item 11.

[162] See the letter from Cleary Gottlieb.

the same recent 12-month period that the issuer used for purposes of Rule 12h-6's trading volume provision.

G. Amended Rules 12g-4 and 12h-3

Although similar to the current 300 record holder standard, Rule 12h-6's alternative record holder condition for equity securities and its debt securities provision will offer advantages compared to the current exit rules. As adopted, Rule 12h-6's revised counting method will limit the jurisdictions in which a foreign private issuer must search for records of its U.S. resident holders. Moreover, Rule 12h-6 will enable a foreign private issuer to terminate, rather than merely suspend, its section 15(d) reporting obligations regarding a class of equity or debt securities. In addition, under Rule 12h-6, a foreign private issuer will be able to claim the benefits of the Rule 12g3-2(b) exemption immediately upon the effectiveness of its termination of reporting regarding a class of equity securities under section 12(g) or 15(d). In each instance, once its termination of reporting becomes effective under Rule 12h-6, an issuer will no longer have to concern itself with whether the number of its U.S. resident or worldwide holders of the class of subject securities has risen above the statutory or regulatory threshold.

Given these advantages, we continue to believe that, following the adoption of Rule 12h-6, few, if any, foreign private issuers will elect to proceed under the provisions of Rule 12g-4 or Rule 12h-3 that allow a foreign private issuer to terminate its registration of a class of securities under section 12(g) or suspend the duty to file reports under section 15(d) if the class of securities is held by less than 300 U.S. residents or by 500 U.S. residents and the issuer has had total assets not exceeding $10 million on the last day of each of its most recent three fiscal years.[163] Accordingly, we are adopting the amendments to eliminate these provisions in Rules 12g-4 and 12h-3, as reproposed.

H. Amendment Regarding the Rule 12g3-2(b) Exemption

We are adopting, substantially as reproposed, an amendment to Exchange Act Rule 12g3-2[164] that will apply the exemption under Exchange Act Rule 12g3-2(b) immediately to an issuer of equity securities upon the effectiveness of its termination of reporting under Rule 12h-6.[165] As a condition to the immediate application of the Rule 12g3-2(b) exemption upon its termination of reporting under Rule 12h-6, an issuer must publish subsequently in English material home country documents required under Rule 12g3-2(b)(1)(iii) on its web site or through an electronic information delivery system generally available to the public in its primary trading market.[166]

The purpose of this condition is to provide U.S. investors with access to material information about an issuer of equity securities following its termination of reporting pursuant to Rule 12h-6.[167] In addition, an issuer will be able to maintain a sponsored

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[163] See Exchange Act Rules 12g-4(a)(2) and 12h-3(b)(2) (17 CFR 240.12g-4(a)(2) and 12h-3(b)(2)).

[164] New Exchange Act Rule 12g3-2(e)(1) (17 CFR 240.12g3-2(e)(1)).

[165] Currently, foreign private issuers that registered a class of securities under section 12 must wait at least 18 months following their termination of reporting before they would be eligible to apply for the Rule 12g3-2(b) exemption. In addition, foreign private issuers with an active or suspended reporting obligation under section 15(d) have thus far not been eligible to claim the Rule 12g3-2(b) exemption. See Rule 12g3-2(d)(1) (17 CFR 240.12g3-2(d)(1)), which currently excepts from the 18 month requirement only issuers that have filed Securities Act registration statements using the Multijurisdictional Disclosure Act (MJDS) forms.

[166] New Exchange Act Rule 12g3-2(e)(2) (17 CFR 240.12g3-2(e)(2)).

[167] Any post-termination trading of a foreign private issuer's securities in the United States would have to occur through over-the-counter markets such as that maintained by the Pink Sheets, LLC since, as of April, 1998, the NASD and the Commission have required a foreign private issuer to register a class of securities under Exchange Act section 12 before its securities could be traded

ADR facility with respect to its securities.[168] This condition also will facilitate resales of that issuer's securities to qualified institutional buyers under Rule 144A.[169] Moreover, having a foreign private issuer's key home country documents posted in English on its web site will assist U.S. investors who are interested in trading the issuer's securities in its primary securities market.[170]

The adopted extension of Rule 12g3-2(b) will apply both to a class of equity securities formerly registered under section 12(g) and one that formerly gave rise to section 15(d) reporting obligations, as reproposed. The Rule 12g3-2(b) exemption received under new Rule 12g3-2(e) will remain in effect for as long as the foreign private issuer satisfies the rule's electronic publication conditions or until the issuer registers a new class of securities under section 12 or incurs section 15(d) reporting obligations by filing a new Securities Act registration statement, which has become effective.[171]

1. Extension of the Rule 12g3-2(b) Exemption Under Rule 12g3-2(e)

As adopted, because Rule 12g3-2(e) applies to any issuer that has terminated its reporting under Rule 12h-6, the rule amendment will effectively extend the

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through the electronic over-the-counter bulletin board administered by Nasdaq. See, for example, NASD Notice to Members (January 1998).

[168] In order to establish an ADR facility, an issuer must register the ADRs on Form F-6 (17 CFR 239.36) under the Securities Act. The eligibility criteria for the use of Form F-6 include the requirement that the issuer have a reporting obligation under Exchange Act section 13(a) or have established the exemption under Rule 12g3-2(b). See General Instruction I.A.3 of Form F-6.

[169] See Securities Act Rule 144A(d)(4) (17 CFR 230.144A(d)(4)).

[170] Brokers currently are exempt from complying with certain information obligations under Exchange Act Rule 15c2-11 (17 CFR 240.15c2-11) when a foreign company has established and maintains the Rule 12g3-2(b) exemption. See Release No. 34-41110 (February 25,1999), 64 FR 11124 (March 8, 1999).

[171] See New Exchange Act Rule 12g3-2(e)(3) (17 CFR 240.12g3-2(e)(3)).

Rule 12g3-2(b) exemption to:

- a foreign private issuer immediately upon its termination of reporting regarding a class of equity securities pursuant to Rule 12h-6(a);
- a successor issuer immediately upon its termination of reporting regarding a class of equity securities pursuant to Rule 12h-6(d); and
- a prior Form 15 filer immediately upon its termination of reporting regarding a class of equity securities pursuant to Rule 12h-6(i).[172]

Currently Rule 12g3-2(d)(2) precludes extending the Rule 12g3-2(b) exemption to a foreign private issuer, other than a Canadian issuer using the MJDS forms, that has issued securities in a merger or other similar transaction to acquire a company that has registered a class of securities under section 12 or has a reporting obligation under section 15(d).[173] As amended, and as reproposed, Rule 12g3-2(d)(2) will effectively extend the Rule 12g3-2(b) exemption to a successor issuer that has terminated its Exchange Act reporting obligations under Rule 12h-6(d). Since we are permitting a successor issuer to rely on its predecessor's reporting history for the purpose of Rule 12h-6, we believe the issuer should also benefit from claiming the Rule 12g3-2(b) exemption immediately upon the effectiveness of its Form 15F.

Also as reproposed, we are extending the Rule 12g3-2(b) amendment immediately upon the termination of reporting pursuant to Rule 12h-6(i) to a foreign private issuer that, before the effective date of Rule 12h-6, terminated its registration or

[172] Most parties that commented on reproposed Rule 12g3-2(e) favored the extension of the Rule 12g3-2(b) exemption to the above categories of issuers. See, for example, the letter from the ABA.

[173] 17 CFR 240.12g3-2(d)(2).

suspended its reporting obligations regarding a class of equity securities after filing a Form 15. This is consistent with our expansion of the scope of Rule 12h-6 to encompass prior Form 15 filers. Without this change, a prior Form 15 filer would find itself subject to the 18 month waiting period that currently exists under Rule 12g3-2(d), although the issuer qualified for termination of reporting under Rule 12h-6(i).

We further are permitting a foreign private issuer that filed a Form 15F solely to terminate its reporting obligations regarding a class of debt securities to establish the Rule 12g3-2(b) exemption for a class of equity securities upon the effectiveness of its termination of reporting regarding the class of debt securities.[174] Since we are abolishing the 18 month "waiting period" for equity securities issuers that have terminated their Exchange Act reporting obligations pursuant to Rule 12h-6, it would serve no useful purpose to impose this waiting period on a debt securities issuer that determines that it will need the Rule 12g3-2(b) exemption for a class of equity securities following its termination of reporting under Rule 12h-6.

The reproposed version of Rule 12g3-2(e)(4) provided that a debt securities issuer could apply for the Rule 12g3-2(b) exemption at any time following the effectiveness of its termination of reporting regarding the class of debt securities. One commenter pointed out that this version, if adopted, would jeopardize the legality of a sponsored ADR facility maintained by a registered debt securities issuer regarding a class of equity securities.[175] A foreign private issuer that has registered only debt securities under the Securities Act may establish an ADR facility for its equity securities by filing and having

[174] New Exchange Act Rule 12g3-2(e)(4) (17 CFR 240.12g3-2(e)(4)).

[175] See the letter from MTR Corporation.

become effective a Form F-6 registration statement because it is an Exchange Act reporting company.[176] Such an issuer would lose the legal basis for its ADR facility if, before it could apply for the Rule 12g3-2(b) exemption, it had to wait until after the completion of the 90-day waiting period, when the termination of its Exchange Act reporting obligations under Rule 12h-6 would become effective.

As we have previously stated, we value the formation of ADR facilities, because they are beneficial to U.S. investors, and we encourage foreign issuers to continue to maintain their ADR facilities after terminating their Exchange Act reporting obligations. Therefore, we are clarifying that, under adopted Rule 12g3-2(e)(4), while a debt securities issuer may establish the Rule 12g3-2(b) exemption only upon the effectiveness of its termination of reporting regarding its class of debt securities under Rule 12h-6, it may apply for the Rule 12g3-2(b) exemption after it has filed its Form 15F and commenced the 90-day waiting period.[177] The issuer must include in that application the date that it filed its Form 15F as well as the address of its Internet Web site or that of the electronic information delivery system on which it will publish the material home country information required under Rule 12g3-2(b).

2. Electronic Publishing of Home Country Documents

Currently foreign companies claim the Rule 12g3-2(b) exemption by submitting to the Commission on an ongoing basis the material required by the rule. This material

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[176] See General Instruction I.A.3 of Form F-6.

[177] Commission staff will work with issuers to coordinate the establishment of the Rule 12g3-2(b) exemption on the same day as their termination of Exchange Act reporting.

may only be submitted in paper format.[178] Because paper submissions are more difficult to access, we are adopting Rule 12g3-2(e), which relies on electronic access to a foreign company's home country securities documents, although not through the Commission's electronic database.

As part of the condition requiring an issuer to publish its home country documents required under Rule 12g3-2(b)(1)(iii) on its Internet Web site or through an electronic information delivery system generally available to the public in its primary trading market, Rule 12g3-2(e) will require an issuer to publish English translations of the following documents:

- its annual report, including or accompanied by annual financial statements;
- interim reports that include financial statements;
- press releases; and
- all other communications and documents distributed directly to security holders of each class of securities to which the exemption relates.[179]

Rule 12g3-2(e) will further require a foreign private issuer of equity securities to disclose in the Form 15F the address of its Internet Web site or that of the electronic information delivery system in its primary trading market on which it will publish the

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[178] A foreign private issuer that has successfully filed an application for the Rule 12g3-2(b) exemption must currently furnish its home country documents in paper because the application is analogous to one submitted for an exemption under Exchange Act section 12(h). See Regulation S-T Rule 101(c)(16) (17 CFR 232.101(c)(16)). Although the Commission's EDGAR database contains an entry signifying the receipt of paper documents, materials received in paper are not accessible through the EDGAR system.

[179] Note 1 to Rule 12g3-2(e). Rule 12g3-2(b) requires an exempt issuer to submit substantially the same categories of home country documents as a reporting issuer must furnish to the Commission under cover of Form 6-K. Moreover, both Rule 12g3-2(b) and Form 6-K state that only material information need be furnished under the rule and form. See Rule 12g3-2(b)(3) (17 CFR 240.12g3-2(b)(3)) and General Instruction B to Form 6-K.

information required under Rule 12g3-2(b)(1)(iii).[180] The purpose of this requirement is to alert investors and the Commission regarding where investors and others may find the company's home country documents should a problem arise concerning the Internet location of those documents.

Currently non-reporting issuers that seek the Rule 12g3-2(b) exemption must submit their letter application for the exemption and their home country documents to the Commission in paper. The same primary reason for requiring an issuer to publish its home country documents electronically after it terminates its reporting obligations under Rule 12h-6 applies equally to current Rule 12g3-2(b) exempt companies and the non-reporting companies that eventually will apply for the exemption. In each case, the electronic posting of an issuer's home country documents will increase an investor's ability to access those documents.

Therefore, we are adopting, as proposed, an amendment to Rule 12g3-2 to permit a foreign private issuer that, upon application to the Commission and not after filing Form 15F, has obtained or will obtain the Rule 12g3-2(b) exemption to publish its home country documents that it is required to furnish on a continuous basis under Rule 12g3-2(b)(1)(iii) on its Internet Web site or through an electronic information delivery system generally available to the public in its primary trading market.[181] As a condition to this electronic posting, an issuer that wishes to use this procedure will have

[180] Note 3 to Rule 12g3-2(e). An issuer will not have to update the Form 15F to reflect a change in that address.

[181] New Exchange Act Rule 12g3-2(f) (17 CFR 240.12g3-2(f)). Parties that commented on the reproposed extension of Rule 12g3-2(b) supported this electronic publishing provision for issuers claiming the Rule 12g3-2(b) other than through Rule 12h-6. See, for example, the letters from the ABA and Skadden Arps.

to comply with the English translation requirements of reproposed Rule 12g3-2(e). It also will have to provide the Commission with the address of its Internet Web site or that of the electronic information delivery system in its primary trading market in its application for the Rule 12g3-2(b) exemption or in an amendment to that application.

Currently the Commission does not have an established means for a non-reporting company to submit electronically to the Commission its initial documents under Rule 12g3-2(b)(1)(i) and (ii).[182] Therefore, an applicant will have to continue to submit its letter application and the home country documents submitted in support of its initial application to the Commission in paper.[183]

At both the proposing and reproposing stages, some commenters suggested that the Commission impose a specific time limit, for example three years, governing how long an issuer must keep its home country documents on its Internet Web site.[184] We decline to adopt a specific time limit primarily because different types of home country documents may require different periods of electronic posting. While an issuer will be required to post electronically a home country document for a reasonable period of time, what constitutes a reasonable period will depend on the nature and purpose of the home country document. At a minimum, we suggest companies provide Web site access to their home country reports for at least a 12 month period.

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[182] 17 CFR 240.12g3-2(b)(1)(i) and (ii).

[183] As under current practice, the applicant should send these initial materials to the Commission's Office of International Corporate Finance in the Division of Corporation Finance.

[184] See Part II.H.2 of the Reproposing Release and, more recently, the letter from Sullivan & Cromwell.

We also suggest that, if an issuer publishes its home country documents required under Rule 12g3-2(b) on an electronic information delivery system or an Internet Web site that is not in English, the issuer provide a prominent link on its Internet Web site directing investors to those home country documents in English.

I. Concerns Regarding Securities Act Rule 701

Some commenters asked that we clarify the availability of Securities Act Rule 701[185] for a foreign private issuer that terminates its registration and reporting obligations under Rule 12h-6. By its terms, Rule 701 is available to any issuer that is not subject to the reporting requirements of Exchange Act section 13 or 15(d). Therefore, upon the effectiveness of termination of registration and reporting requirements under Rule 12h-6, a foreign private issuer would appear to satisfy this condition of Rule 701.

As we noted when originally proposing Rule 12h-6, before the filing of a Form 15F, a foreign private issuer would have to file a post-effective amendment to terminate the registration of its remaining unsold securities under any of its Securities Act registration statements.[186] This would include a Form S-8 registration statement relating to securities issuable under certain compensatory benefit plans. After the effectiveness of the Form 15F, a foreign private issuer would be able to rely on Rule 701 with respect to unsold securities that had previously been covered by the Form S-8 registration statement.

[185] 17 CFR 230.701. Rule 701 provides a Securities Act exemption for the offer and sale of securities to employees and others pursuant to certain compensatory benefit plans and contracts relating to compensation.

[186] See the Original Proposing Release at n. 45.

III. PAPERWORK REDUCTION ACT ANALYSIS

The final rule amendments contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[187] The titles of the affected collection of informations are Form 20-F (OMB Control No. 3235-0288), Form 40-F (OMB Control No. 3235-0381), Form 6-K (OMB Control No. 3235-0116), new Form 15F, and submissions under Exchange Act Rule 12g3-2 (OMB Control No. 3235-0119).[188] An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information such as Form 20-F or new Form 15F unless it displays a currently valid OMB control number. Compliance with the disclosure requirements of new Form 15F and new Rule 12h-6, which will affect the above collections of information, is mandatory.

Form 20-F sets forth the disclosure requirements for a foreign private issuer's annual report and registration statement under the Exchange Act as well as many of the disclosure requirements for a foreign private issuer's registration statements under the Securities Act. We adopted Form 20-F pursuant to the Exchange Act and the Securities Act in order to provide investors with information about foreign private issuers that have registered securities with the Commission.

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[187] 44 U.S.C. 3501 et seq.

[188] A limited number of foreign private issuers file annual reports on Form 10-K. In voluntarily electing to file periodic reports using domestic issuer forms, these issuers seem to have closely aligned themselves with the U.S. market. Accordingly, for the purpose of the Paperwork Reduction Act Analysis, these issuers do not appear likely to terminate their Exchange Act registration under new Rule 12h-6, and we have assumed that none of these companies will seek to use Rule 12h-6. Foreign private issuers that file periodic reports using domestic issuer forms will be eligible, nonetheless, to use Rule 12h-6.

Form 40-F sets forth the disclosure requirements regarding the annual report and registration statement under the Exchange Act for a Canadian issuer that is qualified to use the Multijurisdictional Disclosure System ("MJDS"). We adopted Form 40-F pursuant to the Exchange Act in order to permit qualified Canadian issuers to prepare their Exchange Act annual reports and registration statements based primarily in accordance with Canadian requirements.

Form 6-K is used by a foreign private issuer to report material information that it:

- makes or is required to make public under the laws of the jurisdiction of its incorporation, domicile or organization (its "home country");
- files or is required to file with its home country stock exchange that is made public by that exchange; or
- distributes or is required to distribute to its security holders.

A foreign private issuer may attach annual reports to security holders, statutory reports, press releases and other documents as exhibits or attachments to the Form 6-K. We adopted Form 6-K under the Exchange Act in order to keep investors informed on an ongoing basis about foreign private issuers that have registered securities with the Commission.

New Form 15F is the form that a foreign private issuer must file when terminating its Exchange Act reporting obligations under new Exchange Act Rule 12h-6. Form 15F requires a filer to disclose information that will help investors understand the foreign private issuer's decision to terminate its Exchange Act reporting obligations and assist Commission staff in assessing whether the Form 15F filer is eligible to terminate its Exchange Act reporting obligations pursuant to Rule 12h-6.

Exchange Act Rule 12g3-2 is an exemptive rule that, under paragraph (b) of that rule, provides an exemption from Exchange Act section 12(g) registration for a foreign private issuer that, in addition to satisfying other requirements, submits copies of its material home country documents to the Commission on an ongoing basis. We adopted paragraph (b) of Rule 12g3-2 in order to provide information for U.S. investors concerning foreign private issuers with limited securities trading in U.S. capital markets.

The hours and costs associated with preparing, filing and sending Forms 20-F, 40-F, 6-K and 15F, and making submissions under Exchange Act Rule 12g3-2(b) constitute reporting and cost burdens imposed by those collections of information. We based our estimates of the effects that the final rule amendments will have on those collections of information primarily on our review of the most recently completed PRA submissions for Forms 20-F, 40-F, and 6-K, and for submissions under Rule 12g3-2(b), on the particular requirements for those forms and submissions, and on relevant information, for example, concerning comparative trading volume for numerous filers of those forms.

Final Rule 12h-6 will permit a foreign private issuer to terminate permanently its Exchange Act reporting obligations, including the obligation to file an annual report on Form 20-F or 40-F and the obligation to submit Form 6-K reports, after filing a Form 15F. Final Rule 12h-6 and the accompanying rule amendments will also enable a foreign private issuer to claim the Rule 12g3-2(b) exemption immediately upon the effectiveness of its termination of reporting pursuant to the new exit rule, and to publish copies of its home country documents required by Rule 12g3-2(b) on its Internet Web site instead of submitting them in paper to the Commission. We have based the annual burden and cost estimates of the adopted rule amendments on Forms 20-F, 40-F, 6-K and 15F, and on the home country submissions required under Rule 12g3-2(b), on the following estimates and assumptions:

- a foreign private issuer incurs or will incur 25% of the annual burden required to produce each Form 20-F or 40-F report or Form 15F;
- outside firms, including legal counsel, accountants and other advisors, incur or will incur 75% of the burden required to produce each Form 20-F or 40-F report or Form 15F at an average cost of $400 per hour;
- a foreign private issuer incurs or will incur 75% of the annual burden required to produce each Form 6-K report and Rule 12g3-2(b) submission, not including English translation work, and 25% of the annual burden required to perform the English translation work for Form 6-K reports and Rule 12g3-2(b) submissions; and
- outside firms, including legal counsel, accountants and other advisors, incur or will incur 25% of the burden required to produce each Form 6-K report and Rule 12g3-2(b) submission, not including English translation work, at an average cost of $400 per hour, and 75% of the annual burden resulting from the English translation work for Form 6-K reports and Rule 12g3-2(b) submissions, at an average cost of $125 per hour.

As was the case with the originally proposed and reproposed rule amendments, the estimated effects of the adopted rule amendments reflect the initial phase-in period of the Exchange Act termination process under new Rule 12h-6 and Form 15F during the first year of availability. We expect that most of these estimated effects will occur on a one-time, rather than a recurring, basis. While we expect that some issuers will terminate their Exchange Act reporting under Rule 12h-6 and file Form 15F in subsequent years, we do not expect the resulting burdens and costs to be of the same magnitude as the burdens and costs currently expected during the first year. Moreover, we expect that over time, the number of foreign private issuers that are encouraged to enter the Exchange Act reporting system as a result of the rule amendments will increase so that, on an annual basis, the number of foreign companies entering the Exchange Act reporting regime will exceed the number exiting that regime.

We published a notice requesting comment on the collection of information requirements in the Original Proposing Release and submitted these requirements to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[189] OMB subsequently approved the proposed requirements without change. We received several comment letters regarding the proposed rule amendments, although none addressed their estimated effects on the collection of information requirements. We revised and reproposed Rule 12h-6 and the accompanying rule amendments in response to these comments. We also revised the estimated reporting and cost burdens for the reproposed rules.[190] Because we are adopting Rule 12h-6 and the accompanying rule amendments substantially as reproposed, the estimated reporting and cost burdens for the adopted rules remain the same as the estimated reporting and cost burdens for the reproposed rules, as discussed below.

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[189] 44 U.S.C. 3507(d) and 5 CFR 1320.11.

[190] See Part III of the Reproposing Release.

A. Form 20-F

During the first year of effectiveness of reproposed Rule 12h-6, we estimate that as many as 25% of Form 20-F filers could terminate their Exchange Act reporting obligations under the new rule.[191] However, we continue to believe that Rule 12h-6 will encourage some foreign companies to enter the Exchange Act registration and reporting regime for the first time. Consequently, during the first effective year of Rule 12h-6, the number of Form 20-F annual reports filed could increase by 5%, leading to a net decrease of 20% for Form 20-Fs filed over this same period. This net decrease would cause:

- the number of Form 20-Fs filed to decrease to 880;[192]
- the total number of burden hours required to produce Form 20-F[193] to decrease to 2,314,400 total hours;[194]
- the total number of burden hours required by foreign private issuers to produce Form 20-F to decrease to 578,600 total hours;[195] and

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[191] As noted at the reproposing stage, a review by the Commission's Office of Economic Analysis of trading volume data on a sample of foreign Exchange Act reporting companies that filed Form 20-F during 2004 suggested that approximately 30% of filers would meet the U.S. trading volume threshold of the reproposed rule. See Part III, n. 137 of the Reproposing Release. A more recent review of the Office of Economic Analysis of trading volume data on foreign Exchange Act reporting companies with common equity trading during 2005 indicates that an estimated 29% of filers would meet the U.S. trading volume threshold of the adopted rule. That percentage may vary by region.

[192] 1,100 Form 20-Fs filed annually (prior to this rulemaking) x .20 = 220; 1,100 - 220 = 880 Form 20-Fs filed annually.

[193] As in the Reproposing Release, we estimate that a foreign private issuer requires on average 2,630 hours to produce each Form 20-F.

[194] 880 Form 20-Fs filed annually x 2,630 hours per Form 20-F = 2,314,400 hours.

[195] 880 Form 20-Fs x 2,630 hours per Form 20-F x .25 = 578,600 hours. Thus, we estimate that, during the first year of effectiveness of Rule 12h-6, foreign private issuers could incur a reduction of 144,650 hours in the number of burden hours required to produce Form 20-F. 220 Form 20-Fs x 2,630 hrs x .25 = 144,650 hours. Using an estimated hourly rate of $175 for in-house work,

- the cost incurred by outside firms[196] to produce Form 20-F to total $694,320,000.[197]

B. Form 40-F

During the first year of effectiveness of Rule 12h-6, we estimate that as many as 10% of Form 40-F filers could terminate their Exchange Act reporting obligations under the new rule.[198] However, the reproposed rule could encourage some foreign companies to enter the Exchange Act registration and reporting regime for the first time, including some that would be eligible to use the MJDS forms, including the Form 40-F annual report. Consequently, over this same period, the number of Form 40-F annual reports filed could increase by approximately 3%, resulting in a net decrease of 7% for Form 40-Fs filed over this same period.[199] This net decrease would cause:

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foreign private issuers could incur Form 20-F cost savings of $25,313,750 during Rule 12h-6's first year of effectiveness. 144,650 hrs. x $175/hr. = $25,313,750.

[196] We estimate cost savings of $173,580,000 regarding outside firms' production of Form 20-Fs during Rule 12h-6's first year of effectiveness. 220 Form 20-Fs x 2,630 hrs. x .75 x $400/hr. = $173,580,000. Thus, during the first year of its effectiveness, Rule 12h-6 could result in total estimated Form 20-F cost savings of $198,893,750. $25,313,750 + $173,580,000 = $198,893,750.

[197] 880 Form 20-Fs x 2,630 hours x .75 x $400/hour = $694,320,000. The $108,487,500 increase reflects the increase in the estimated outside firm hourly rate from $300 to $400.

[198] We do not expect the expanded scope of reproposed Rule 12h-6 to have as great an effect on MJDS filers as other foreign reporting companies since, typically, the U.S. trading volume relating to those shares is significant. Moreover, because of their close proximity to U.S. capital markets, we believe MJDS filers are less likely to seek to terminate their Exchange Act reporting obligations than other foreign private issuers. Accordingly, based on current experience, we expect no more than 10% of Form 40-F filers will terminate their Exchange Act reporting obligations under Rule 12h-6.

[199] This is the same percentage previously estimated under the originally proposed rule amendments.

- the number of Form 40-Fs filed to total 125;[200]
- the number of burden hours required to produce Form 40-F[201] to total 53,375 total hours;[202]
- the number of burden hours required by foreign private issuers to produce Form 40-F to total 13,344 hours;[203] and
- the cost incurred by outside firms to produce Form 40-F to total $16,012,500.[204]

C. Form 6-K

During the first year of effectiveness of Rule 12h-6, we estimate that as many as 23% of foreign private issuers that furnish Form 6-K reports could terminate their Exchange Act reporting obligations under the new rule.[205] However, the adopted rule

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[200] 134 Form 40-Fs filed annually (prior to this rulemaking) x .07 = 9; 134 - 9 = 125 Form 40-Fs filed annually.

[201] As in the Reproposing Release, we estimate that it takes 427 hours on average to produce a Form 40-F report.

[202] 125 Form 40-Fs filed annually x 427 hours per Form 40-F = 53,375 hours.

[203] 125 Form 40-Fs filed annually x 427 hours per Form 40-F x .25 = 13,344 hours. Thus, we estimate that, during the first year of effectiveness of Rule 12h-6, foreign private issuers could incur a reduction of 961 hours in the number of burden hours required to produce Form 40-F. 9 Form 40-Fs x 427 hrs. x .25 x = 961 hrs. This could result in estimated Form 40-F cost savings for foreign private issuers of $168,175. 961 hrs. x $175/hr. = $168,175.

[204] 125 Form 40-Fs filed annually x 427 hours per Form 40-F x .75 x $400/hour = $16,012,500. This estimate corresponds to estimated cost savings of $1,152,900 in connection with outside firms' production of Form 40-F during reproposed Rule 12h-6's first year of effectiveness. 9 x 427 hrs. x .75 x $400/hr. = $1,152,900. Thus, during the first year of its effectiveness, Rule 12h-6 could result in estimated total Form 40-F cost savings of $168,175 + $1,152,900 = $1,321,075.

[205] This estimate is based on the estimated number of Form 20-F and Form 40-F filers that are expected to terminate their Exchange Act reporting obligations under 2h-6. 1,100 Form 20-Fs x .25 = 275; 134 Form 40-Fs x .10 = 13; 288 = .23 x 1,234.

could encourage some foreign companies to enter the Exchange Act registration and reporting regime for the first time, including those that will furnish Form 6-K reports. Consequently, over this same period, the number of Form 6-K reports furnished could increase by as much as 5%,[206] resulting in a net decrease of 18% for Form 6-Ks furnished over this same period. This net decrease would cause:

- the number of Form 6-K reports furnished to decrease to 12,022;[207]
- the total number of burden hours required to produce the Form 6-Ks[208] to decrease to 104,591 total hours;[209]
- the total number of burden hours required by foreign private issuers[210] to produce Form 6-K to decrease to 65,369 hours;[211] and

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[206] This estimate is based on the estimated number of foreign private issuers that are expected to enter the Exchange Act reporting regime and file Form 20-Fs or Form 40-Fs as a result of this rulemaking during the first year of effectiveness. 1,100 Form 20-Fs x .05 = 55; 134 Form 40-Fs x .03 = 4; 59 = .05 x 1,234.

[207] 14,661 Form 6-K reports x .18 = 2,639; 14,661-2,639 = 12,022 Form 6-K reports.

[208] In the Original and Reproposing Releases, we estimated that, prior to this rulemaking, it took a total of 127,197 annual burden hours to produce the 14,661 Form 6-Ks, or approximately 8.7 hours per Form 6-K (for work performed by foreign private issuers and outside firms). We continue to use this 8.7 hour estimate for the final rule amendments.

[209] 12,022 Form 6-K reports x 8.7 hours = 104,591 hours.

[210] We estimate that, during the first year of effectiveness of Rule 12h-6, foreign private issuers could incur a reduction of 14,349 hours in the number of burden hours required to produce Form 6-K. 2,639 Form 6-Ks x 8.7 hours = 22,959 hours; 22,959 hours x .25 = 5,740 hours of English translation work; 5,740 hours x .25 = 1,435 hours of English translation work for foreign private issuers; 22,959 x .75 = 17,219 hours of non-English translation work; 17,219 x .75 = 12,914 hours of non-English translation work for foreign private issuers; 1,435 + 12,914 = 14,349 hours. This could result in estimated Form 6-K cost savings of $2,511,075 for foreign private issuers during the first year of Rule 12h-6's effectiveness. 14,349 hrs. x $175/hr. = $2,511,075.

[211] 104,591 hours x .25 = 26,148 hours for English translation work; 104,591 hours - 26,148 hours = 78,443 hours for non-English translation work; 78,443 hours x .75 = 58,832 hours for non-English translation work performed by foreign private issuers; 26,148 hours x .25 = 6,537 hours of English translation work performed by foreign private issuers; 58,832 hours + 6,537 hours =

- the cost incurred by outside firms[212] to produce Form 6-K to total $10,295,775.[213]

D. **Form 15F**

During the first year of effectiveness of Rule 12h-6, we estimate that as many as 351 foreign private issuers[214] could file a Form 15F to terminate their Exchange Act reporting obligations, which would cause:

- the number of burden hours required to produce Form 15F[215] to total 10,530 hours;[216]

65,369 total hours for Form 6-K work performed by foreign private issuers, or 5.4 hours for foreign private issuer work per Form 6-K.

[212] We estimate cost savings of $2,260,025 in connection with outside firms' production of Form 6-K during Rule 12h-6's first year of effectiveness. 5,740 hrs. x .75 x $125/hour = $538,125 for English translation work; 17,219 x .25 x $400/hour = $1,721,900 for non-English translation work. $538,125 + $1,721,900 = $2,260,025 in Form 6-K cost savings for outside firms. Thus, Rule 12h-6 could result in total estimated Form 6-K cost savings of $4,771,100. $2,511,075 + $2,260,025 = $4,771,100.

[213] 78,443 hours x .25 = 19,611 hours x $400/hour = $7,844,400 for non-translation work; 26,148 hours x .75 = 19,611 hours x $125/hour = $2,451,375 for English translation work; $7,844,400 + $2,451,375 = $10,295,775 for total work performed by outside firms. The $2,078,475 increase reflects the increase in the estimated outside firm hourly rate from $300 to $400.and the increase in the estimated outside firm rate for English translation work from $75 to $125/hour based on current information provided by financial printer representatives.

[214] We derived this estimate from the number of Form 20-F filers (275) and Form 40-F filers (13) estimated to elect to terminate their Exchange Act reporting obligations under Rule 12h-6 during the first year of the rule's effectiveness. We then added to this sum (288) the number of prior Form 15 filers (63) estimated to file a Form 15F during the first year of Rule 12h-6's effectiveness in order to make their Form 15 termination or suspension of reporting obligations permanent. The latter number is based on the approximate number of foreign private issuers that filed a Form 15 from 2003 through the present.

[215] In the Original and Reproposing Releases, we estimated that the production of each Form 15F would require 30 hours. We continue to use this estimate for the final rule amendments.

[216] 351 Form 15Fs x 30 = 10,530 hours.

- foreign private issuers to incur a total of 2,633 hours to produce Form 15F;[217] and
- outside firms to incur a total cost of $3,159,200[218] to produce Form 15F.[219]

E. Rule 12g3-2(b) Submissions

We estimate that 685 foreign private issuers currently have obtained the Rule 12g3-2(b) exemption.[220] In addition, we estimate that each Rule 12g3-2(b) exempt issuer currently makes 12 Rule 12g3-2(b) submissions per year for a total of 8,220 Rule 12g3-2(b) submissions. We further estimate that it takes a total of 32,880 annual burden hours, or 4 annual burden hours per submission (for work performed by foreign private issuers and outside firms), to produce the 8,220 Rule 12g3-2(b) submissions.[221]

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[217] 10,530 hours x .25 = 2,633 hours. This could result in estimated Form 15F costs for foreign private issuers of $460,775 during Rule 12h-6's first year of effectiveness. 2,633 hrs. x $175 = $460,775.

[218] 10,530 hours x .75 = 7,898 hours; 7,898 hours x $400/hour = $3,159,200. The $3,159,200 increase reflects the increase in the number of estimated Form 15F filers and the increase in the estimated outside firm hourly rate from $300 to $400.

[219] Thus, Rule 12h-6 could result in total estimated Form 15F costs of $3,619,975 during its first year of effectiveness. $460,775 + $3,159,200 = $3,619,975.

[220] This estimate is based on Commission staff's most recent annual review of the number of current Rule 12g3-2(b) exempt companies, which will be available soon on our Internet Web site at http://www.sec.gov/divisions/corpfin.shtml.

[221] These estimates are the same as the estimates presented in the Reproposing Release. As we stated in that release, the estimates represent an adjustment of 31,080 hours from the 1,800 total hours previously reported for Rule 12g3-2(b) submissions. They reflect a re-evaluation of the number of foreign private issuers that currently claim the Rule 12g3-2(b) exemption, the number of Rule 12g3-2(b) submissions made by them, and the number of burden hours required for their production, in addition to assessing the effects on Rule 12g3-2(b) submissions expected to result from adoption of the final rule amendments. We believe these estimates more accurately reflect the current burden hours required for the collections of information submitted under Rule 12g3-2(b).

During the first year of effectiveness of reproposed Rule 12h-6, we estimate that as many as 351 foreign private issuers could claim the Rule 12g3-2(b) exemption immediately upon the effectiveness of their termination of reporting under new Rule 12h-6.[222] This increase in the number of Rule 12g3-2(b) exempt issuers would cause:

- the number of issuers claiming the Rule 12g3-2(b) exemption to total 1,036;
- the number of Rule 12g3-2(b) submissions made annually to total 12,432;
- the number of annual burden hours required to produce these Rule 12g3-2(b) submissions to total 49,728 hours;
- foreign private issuers to incur a total of 31,080 annual burden hours to produce these Rule 12g3-2(b) submissions, or 2.5 annual burden hours per submission;[223] and
- outside firms to incur a total cost of $4,909,275[224] to produce the

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[222] This amount includes the estimated 288 Form 20-F and 40-F filers expected to terminate their Exchange Act reporting obligations under Rule 12h-6 as well as the estimated 63 prior Form 15 filers expected to file a Form 15F to make their prior termination or suspension of reporting under Rule 12h-6.

[223] Because the home country document submission requirement under Rule 12g3-2(b) is similar to the home country document submission requirement under Form 6-K, we have used the same assumptions regarding the English and non-English translation work required under Rule 12g3-2(b) that we adopted for Form 6-K submissions. Accordingly: 49,728 hours x .25 = 12,432 total annual burden hours for English translation work; 49,728 - 12,432 = 37,296 total annual burden hours required for non-English translation work; 37,296 hours x .75 = 27,972 total annual burden hours incurred by foreign private issuers for non-English translation work; 12,432 hours x .25 = 3,108 total annual hours incurred by foreign private issuers for English translation work; 27,972 + 3,108 = 31,080 total annual burden hours incurred by foreign private issuers for Rule 12g3-2(b) submissions, or 2.5 annual burden hours per submission. Of the 31,080 hours, 10,530 hours would result from adoption of the new rules and 20,550 hours represents an adjustment from the previous PRA estimates for Rule 12g3-2 submissions.

[224] 49,728 hours x .25 = 12,432 hours for English translation work; 12,432 hours x .75 = 9,324 hours; 9,324 hours x $125 = $1,165,500 for English translation work; 49,728 hours - 12,432 hours = 37,296 hours for non-English translation work; 37,296 hours x .25 = 9,324 hours; 9,324

Rule 12g3- 2(b) submissions.[225]

IV. COST-BENEFIT ANALYSIS

A. Expected Benefits

New Exchange Act Rule 12h-6 and the accompanying rule amendments will benefit U.S. investors to the extent that they remove a possible disincentive for foreign companies that are not currently Exchange Act reporting companies to register their equity and debt securities with the Commission. In response to foreign companies' concerns about Exchange Act reporting and other obligations, these rules will expand the criteria by which a foreign company may terminate those obligations. In so doing, the adopted rule amendments should over time remove an impediment to foreign company access and participation in U.S. public capital markets while still providing U.S. investors with the protections afforded by our Exchange Act reporting regime.

The adopted rule amendments should remove a disincentive for foreign firms to enter our Exchange Act reporting regime by lowering the cost of exiting from that regime. Investors are expected to benefit from the amendments by being able to purchase

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hours x \$400 = \$3,729,600 for non-English translation work; \$1,165,500 + \$3,729,600 = \$4,895,100 for total work performed by outside firms. Of that total amount, \$1,658,475 would result from adoption of the new rules and \$3,236,625 constitutes an adjustment from the previous PRA estimates for Rule 12g3-2 submissions.

[225] We further estimate that new Rule 12h-6 and the accompanying rule amendments could result in total estimated Rule 12g3-2(b) costs of \$3,501,225 during the first year of their effectiveness. 351 issuers x 12 submissions/issuer x 2.5 hrs./submission = 10,530 hours; 10,530 hours x \$175/hr. = \$1,842,750 in Rule 12g3-2(b) submission costs for foreign private issuers. For outside firm costs: 351 issuers x 12 submissions/issuer x 4 hrs./submission = 16,848 hours; 16,848 x .25 = 4,212 hours of English translation work; 4,212 x .75 x \$125 = \$394,875 of English translation costs for outside firms. 16,848 hours x .75 = 12,636 hours of non-English translation work; 12,636 x .25 x \$400 = \$1,263,600 of non-English translation costs for outside firms. \$394,875 + \$1,263,600 = \$1,658,475 in total Rule 12g3-2(b) submission costs for outside firms. \$1,842,750 + \$1,658,475 = \$3,501,225 in total estimated Rule 12g3-2(b) costs.

shares in foreign firms that have been registered with the Commission and that, therefore, provide a high level of investor protection. In addition, U.S. investors may incur lower transaction costs when trading a foreign company's shares on a U.S. exchange relative to a foreign exchange.

To remove a disincentive for foreign companies to enter U.S. public capital markets, the adopted rule amendments will benefit U.S. investors by enabling a foreign Exchange Act reporting company to lower its costs of compliance in connection with Exchange Act deregistration. This reduction in the cost of compliance will directly benefit both foreign companies and their investors, including those resident in the United States.

The final rule amendments will result in foreign private issuers incurring lower costs of Exchange Act compliance in four possible ways. First, rather than require a foreign private issuer to determine the number of its U.S.holders, as is the case under the current exit rules, new Rule 12h-6 will enable a foreign private issuer to rely solely on trading volume data regarding its securities in the United States and on a worldwide basis when determining whether it may terminate its Exchange Act reporting obligations. Because trading volume data is more easily obtainable than information regarding its U.S. shareholders, the new rule should lower the costs of Exchange Act termination for foreign private issuers.

Second, new Rule 12h-6 will allow a foreign firm to terminate its Exchange Act reporting obligations regarding a class of equity securities and immediately obtain the Rule 12g3-2(b) exemption. Accordingly, such a terminating foreign private issuer would be able to avoid the costs associated with continued annual verification that its number of holders of record remains below 300.

Third, new Rule 12h-6 will permit an issuer to rely on the assistance of an independent information services provider when determining whether it falls below the 300-holder standard. The option to hire an independent information services provider may be a more efficient and cost-effective mechanism to make that determination. Moreover, a foreign company may save costs when assessing its eligibility to terminate its registration and reporting under the 300-holder provision of Rule 12h-6, since the rule will limit the number of jurisdictions in which a foreign private issuer must search for the amount of securities represented by accounts of customers resident in the United States held by brokers, dealers, banks and other nominees. The current rules require a foreign private issuer to conduct a worldwide search for such U.S. customer accounts.

Fourth, once having terminated its reporting obligations under new Rule 12h-6, a foreign company will no longer be required to incur costs associated with producing an Exchange Act annual report or interim Form 6-K reports.[226] Based on estimates and assumptions used for the purpose of the Paperwork Reduction Act, these estimated cost savings could total approximately $200,000,000 for the first year of Rule 12h-6's effectiveness.[227]

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[226] We recognize that, as a result of terminating their Exchange Act reporting obligations under Rule 12h-6, foreign firms may accrue other cost savings that are not specifically quantified in this section. One such example is an investment in an internal control system in order to comply with the Sarbanes-Oxley Act.

[227] As discussed in Part III of this release, for the first year of Rule 12h-6's effectiveness, estimated cost savings in connection with Forms 20-F, 40-F and 6-K could amount to, respectively, $198,893,750, $1,321,075, and $4,771,100, for a total of $204,985,925. These cost savings could be less to the extent that more foreign private issuers register with the Commission over time as a result of the adoption of Rule 12h-6.

B. Expected Costs

Investors could incur costs from the adopted rule amendments to the extent that currently registered foreign companies respond to the rule changes by terminating their Exchange Act registration and reporting obligations with respect to their equity and debt securities. If Exchange Act disclosure requirements provide more information or protection to U.S. or other investors than is provided in an issuer's primary trading market, then all investors, both U.S. and foreign, may suffer the costs of losing that information and protection upon Exchange Act termination.[228] If this is the case, the announcement that a foreign firm is terminating its Exchange Act reporting may result in a loss of share value and the incurrence by investors of higher costs from trading in the firm's equity and debt securities.

There are costs associated with the filing of new Form 15F, which is a requirement for a foreign private issuer that terminates its Exchange Act registration and reporting under Rule 12h-6.[229] A foreign private issuer will also incur costs in connection with having to post on its Internet Web site in English its material home country documents required to maintain the Rule 12g3-2(b) exemption that it will have received upon the effectiveness of its termination of reporting under new Rule 12h-6.[230]

[228] Conversely, in countries that have similar regulatory regimes and levels of investor protection, the impact of U.S. deregistration may be mitigated.

[229] As discussed in Part III of this release, based on estimates and assumptions adopted for the purpose of the Paperwork Reduction Act, these costs could total $3,619,975 during the first year of the new form's use.

[230] As discussed in Part III of this release, based on estimates and assumptions adopted for the Paperwork Reduction Act, these resulting Rule 12g3-2(b) costs could amount to $3,501,225.

We expect that new Rule 12h-6 will enable some foreign registrants to avoid other recent U.S. regulation, such as the Sarbanes-Oxley Act. Investors will lose the benefits afforded by the Sarbanes-Oxley Act to the extent a current foreign registrant is not fully subject to that Act.

Some U.S. investors might seek to trade in the equity securities of a foreign company following its termination of Exchange Act reporting under Rule 12h-6. U.S. investors seeking to trade the former reporting company's securities in the U.S. may be forced to trade in over-the-counter markets such as the one administered by Pink Sheets, LLC, which could result in higher transaction costs than if the foreign company had continued to have a class of securities registered with the Commission.

U.S. investors seeking to trade the former reporting company's securities in its primary trading market also could incur additional costs. For example, U.S. investors who held the securities in the form of ADRs could incur costs associated with the depositary's conversion of the ADRs into ordinary shares.[231] Moreover, some U.S. investors could incur costs associated with finding and contracting with a new broker-dealer who is able to trade in the foreign reporting company's primary trading market. U.S. investors may face additional costs due to the cost of currency conversion and higher transaction costs trading the securities in a foreign market.

[231] A foreign company may terminate its ADR facility whether or not it is an Exchange Act registrant, and adopted Rule 12h-6 does not require the termination of ADR facilities. In fact, by granting foreign private issuers the Rule 12g3-2(b) exemption immediately upon their termination of reporting with regard to a class of equity securities, Rule 12h-6 will enable foreign private issuers to retain their ADR facilities as unlisted facilities following their termination of reporting under Rule 12h-6. As adopted, Rule 12h-6 will require an issuer that has terminated a sponsored ADR facility to wait a year before it may file a Form 15F in reliance on the trading volume provision of Rule 12h-6 if, on the date of termination, the issuer does not meet the trading volume benchmark.

Some investors who wish to make investment decisions regarding former Exchange Act reporting foreign companies also may incur costs to the extent that the information provided by such companies pursuant to any home country regulations is different from that which currently is required under the Exchange Act. Such investors could incur costs associated with hiring an attorney or investment adviser, to the extent that they have not already done so, to explain the material differences, if any, between a foreign company's home country reporting requirements, as reflected in its home country annual report posted on its Internet Web site, and Exchange Act reporting requirements.

V. CONSIDERATION OF IMPACT ON THE ECONOMY, BURDEN ON COMPETITION AND PROMOTION OF EFFICIENCY, COMPETITION AND CAPITAL FORMATION ANALYSIS

When adopting rules under the Exchange Act, Section 23(a)(2) of the Exchange Act[232] requires us to consider the impact that any new rule will have on competition. Section 23(a)(2) also prohibits us from adopting any rule that will impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. Furthermore, when engaging in rulemaking that requires us to consider or determine whether an action is necessary or appropriate in the public interest, Section 3(f) of the Exchange Act[233] requires the Commission to consider whether the action will promote efficiency, competition and capital formation.

In the Reproposing Release, we considered reproposed Rule 12h-6 and the accompanying reproposed rule amendments in light of the standards set forth in the

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[232] 15 U.S.C. 78w(a)(2).

[233] 15 U.S.C. 78c(f).

above statutory sections. We solicited comment on whether, if adopted, reproposed Rule 12h-6 and the other reproposed rule amendments would result in any anti-competitive effects or promote efficiency, competition and capital formation. We further encouraged commenters to provide empirical data or other facts to support their views on any anti-competitive effects or any burdens on efficiency, competition or capital formation that might result from adoption of reproposed Rule 12h-6 and the other reproposed rule amendments.

We did not receive any comments or any empirical data in this regard concerning reproposed Rule 12h-6 and the accompanying rule amendments. Accordingly, since the adopted rules are substantially similar to the reproposed rules, we continue to believe the new rules will provide a foreign reporting company with a more efficient option of exiting the Exchange Act reporting system when U.S. investor interest has become relatively scarce. In so doing, new Rule 12h-6 and the other rule amendments should encourage foreign private issuers to register their equity and debt securities with the Commission by reassuring foreign private issuers that, should interest in the U.S. market for their securities decline sufficiently, they may exit the Exchange Act reporting system with little difficulty.

By providing increased flexibility for foreign private issuers regarding our Exchange Act reporting system, the adopted rules should encourage foreign companies to participate in U.S. capital markets as Exchange Act reporting companies to the benefit of investors. In so doing, the adopted rules should foster increased competition between domestic and foreign firms for investors in U.S. capital markets.

Moreover, by requiring a foreign private issuer that has terminated its Exchange Act reporting under Rule 12h-6 to publish its home country documents required under Exchange Act Rule 12g3-2(b) in English on its Internet Web site or through an electronic information delivery system that is generally available to the public in its primary trading market, the adopted rules will help ensure that U.S. investors continue to have ready access to material information in English about the foreign private issuer.[234] Thus, new Rule 12h-6 and the accompanying rule amendments should foster increased efficiency in the trading of the issuer's securities for U.S. investors following the issuer's termination of Exchange Act reporting.

VI. REGULATORY FLEXIBILITY ACT CERTIFICATION

Under Section 605(b) of the Regulatory Flexibility Act,[235] we certified that, when adopted, reproposed Rule 12h-6 and the accompanying reproposed rule amendments would not have a significant economic impact on a substantial number of small entities. We included this certification in Part VI of the Reproposing Release. While we encouraged written comments regarding this certification, no commenters responded to this request.

VII. STATUTORY BASIS AND TEXT OF RULE AMENDMENTS

We are adopting the amendments to Rule 30-1 of Part 200, Rule 101 of Regulation S-T, and Exchange Act Rules 12g3-2, 12g-4 and 12h-3, new Exchange Act

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[234] Similarly, by expanding the scope of the originally proposed Rule 12h-6 to permit prior Form 15 filers to terminate their Exchange Act reporting obligations under the new exit rule and claim the Rule 12g3-2(b) exemption immediately upon such termination, the adopted rules will help promote the availability of material home country information in English about those issuers for U.S. investors.

[235] 5 U.S.C. 605(b).

Rule 12h-6 and new Exchange Act Form 15F under the authority in sections 6, 7, 10 and 19 of the Securities Act[236] and sections 3(b), 12, 13, 23 and 36 of the Exchange Act.[237]

List of Subjects

17 CFR Part 200

Administrative practice and procedure, Authority delegations (Government agencies).

17 CFR Parts 232, 240 and 249

Reporting and recordkeeping requirements, Securities.

TEXT OF RULE AMENDMENTS

For the reasons set out in the preamble, we are amending Title 17, Chapter II of the Code of Federal Regulations as follows.

PART 200 - ORGANIZATION; CONDUCT AND ETHICS; AND INFORMATION AND REQUESTS

1. The general authority citation for Part 200 is revised to read as follows:

Authority: 15 U.S.C. 77o, 77s, 77sss, 78d, 78d-1, 78d-2, 78w, 78ll(d), 78mm, 80a-37, 80b-11, and 7202, unless otherwise noted.

* * * * *

2. Amend §200.30-1 by adding paragraph (e)(17) to read as follows:

§200.30-1 Delegation of authority to Director of Division of Corporation Finance.

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[236] 15 U.S.C. 77f, 77g, 77j, and 77s.

[237] 15 U.S.C. 78c, 78l, 78m, 78w, and 78mm.

(e) * * *

(17) At the request of a foreign private issuer, pursuant to Rule 12h-6 (§240.12h-6 of this chapter), to accelerate the termination of the registration of a class of securities under section 12(g) of the Act (15 U.S.C. 78l(g)) or the duty to file reports under section 13(a) of the Act (15 U.S.C. 78m(a)) or section 15(d) of the Act (15 U.S.C. 78o(d)).

* * * * *

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

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

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

* * * * *

4. Amend §232.101 by:

a. Removing the word "and" at the end of paragraph (a)(1)(x);

b. Removing the period and adding "; and" at the end of paragraph (a)(1)(xi); and

c. Adding paragraph (a)(1)(xii).

The addition reads as follows:

§232.101 Mandated electronic submissions and exceptions.

(a) * * *

(1) * * *

(xii) Forms 15 and 15F (§249.323 and §249.324 of this chapter).

* * * * *

PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

5. The general 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.

* * * * *

6. Amend §240.12g3-2 by revising paragraphs (d)(1) and (d)(2) and adding paragraphs (e) and (f) to read as follows:

§240.12g3-2 Exemptions for American depositary receipts and certain foreign securities.

* * * * *

(d) * * *

(1) Securities of a foreign private issuer that has or has had during the prior eighteen months any securities registered under section 12 of the Act or a reporting obligation (suspended or active) under section 15(d) of the Act (other than arising solely by virtue of the use of Form F-7, F-8, F-9, F-10 or F-80), except as provided by paragraph (e) of this section;

(2) Securities of a foreign private issuer issued in a transaction (other than a transaction registered on Form F-8, F-9, F-10 or F-80) to acquire by merger, consolidation, exchange of securities or acquisition of assets, another issuer that had securities registered under section 12 of the Act or a reporting obligation (suspended or

active) under section 15(d) of the Act, except as provided by paragraph (e) of this section; and

* * * * *

(e)(1) A foreign private issuer that has filed a Form 15F (§249.324 of this chapter) pursuant to §240.12h-6 shall receive the exemption provided by paragraph (b) of this section for a class of equity securities immediately upon the effectiveness of the termination of registration of that class of securities under section 12(g) of the Act (15 U.S.C. 78l(g)) or the termination of the duty to file reports regarding that class of securities under section 15(d) of the Act (15 U.S.C. 78o(d)), or both.

(2) Notwithstanding any provision of §240.12g3-2(b), in order to satisfy the conditions of the §240.12g3-2(b) exemption received under this paragraph, the issuer shall publish in English the information required under paragraph (b)(1)(iii) of this section on its Internet Web site or through an electronic information delivery system generally available to the public in its primary trading market, rather than furnish that information to the Commission.

(3) The §240.12g3-2(b) exemption received under this paragraph will remain in effect for as long as the foreign private issuer satisfies the electronic publication condition of paragraph (e)(2) of this section or until the issuer registers a class of securities under section 12 of the Act or incurs reporting obligations under section 15(d) of the Act.

(4) Notwithstanding the time period specified in §240.12g3-2(d)(1), a foreign private issuer that filed a Form 15F solely with respect to a class of debt securities under section 15(d) of the Act (15 U.S.C. 78o(d)) may establish the exemption provided by

paragraph (b) of this section for a class of equity securities upon the effectiveness of its termination of reporting regarding the class of debt securities.

Notes to Paragraph (e): 1. In order to maintain the §240.12g3-2(b) exemption obtained under this paragraph, at a minimum, a foreign private issuer shall electronically publish English translations of the following documents required to be furnished under paragraph (b)(1)(iii) of this section if in a foreign language:

a. Its annual report, including or accompanied by annual financial statements;

b. Interim reports that include financial statements;

c. Press releases; and

d. All other communications and documents distributed directly to security holders of each class of securities to which the exemption relates.

2. As used in paragraph (e)(2) of this section, primary trading market has the same meaning as under §240.12h-6(f).

3. A foreign private issuer that files a Form 15F regarding a class of equity securities shall disclose in the Form 15F the address of its Internet Web site or that of the electronic information delivery system in its primary trading market on which it will publish the information required under paragraph (b)(1)(iii) of this section. An issuer need not update the Form 15F to reflect a change in that address.

4. A foreign private issuer that has filed a Form 15F solely with respect to a class of debt securities may establish the exemption under §240.12g3-2(b) regarding a class of equity securities by submitting an application to the Commission after filing its Form 15F. The issuer must provide in that application the date that it filed its Form 15F as well as the address of its Internet Web site or that of the electronic information

delivery system in its primary trading market on which it will publish the information required under paragraph (b)(1)(iii) of this section.

(f)(1) A foreign private issuer that, upon application to the Commission and not after filing a Form 15F, has obtained or will obtain the exemption under §240.12g3-2(b), may publish the information required under paragraph (b)(1)(iii) of this section on its Internet Web site or through an electronic information delivery system generally available to the public in its primary trading market, rather than furnish that information to the Commission, as long as it complies with the English translation requirements provided in paragraph (e) of this section.

(2) Before a foreign private issuer may publish information electronically pursuant to this paragraph, it must provide the Commission with the address of its Internet Web site or that of the electronic information delivery system in its primary trading market in its application for the exemption under §240.12g3-2(b) or in an amendment to that application.

7. Amend §240.12g-4 by:

a. Removing the authority citations following the section; and

b. Revising paragraph (a) to read as follows:

§240.12g-4 Certifications of termination of registration under section 12(g).

(a) Termination of registration of a class of securities under section 12(g) of the Act (15 U.S.C. 78l(g)) shall take effect 90 days, or such shorter period as the Commission may determine, after the issuer certifies to the Commission on Form 15 (17 CFR 249.323) that the class of securities is held of record by:

(1) Less than 300 persons; or

(2) Less than 500 persons, where the total assets of the issuer have not exceeded $10 million on the last day of each of the issuer's most recent three fiscal years.

* * * * *

8. Amend §240.12h-3 by:

a. Removing the authority citations following the section;

b. Adding the word "and" at the end of paragraph (b)(1)(ii);

c. Removing paragraph (b)(2), including the undesignated paragraph;

d. Redesignating paragraph (b)(3) as (b)(2);

e. Revising the cite "paragraphs (b)(1)(ii) and (2)(ii)" to read "paragraph (b)(1)(ii)" in paragraph (c); and

f. Revising the phrase "criteria (i) and (ii) in either paragraph (b)(1) or (2)" to read "either criteria (i) or (ii) of paragraph (b)(1)" in paragraph (d).

9. Add §240.12h-6 to read as follows:

§240.12h-6 Certification by a foreign private issuer regarding the termination of registration of a class of securities under section 12(g) or the duty to file reports under section 13(a) or section 15(d).

(a) A foreign private issuer may terminate the registration of a class of securities under section 12(g) of the Act (15 U.S.C. 78l(g)), or terminate the obligation under section 15(d) of the Act (15 U.S.C. 78o(d)) to file or furnish reports required by section 13(a) of the Act (15 U.S.C. 78m(a)) with respect to a class of equity securities, or both, after certifying to the Commission on Form 15F (17 CFR 249.324) that:

(1) The foreign private issuer has had reporting obligations under section 13(a) or section 15(d) of the Act for at least the 12 months preceding the filing of the Form 15F,

has filed or furnished all reports required for this period, and has filed at least one annual report pursuant to section 13(a) of the Act;

(2) The foreign private issuer's securities have not been sold in the United States in a registered offering under the Securities Act of 1933 (15 U.S.C. 77a et seq.) during the 12 months preceding the filing of the Form 15F, other than securities issued:

(i) To the issuer's employees;

(ii) By selling security holders in non-underwritten offerings;

(iii) Upon the exercise of outstanding rights granted by the issuer if the rights are granted pro rata to all existing security holders of the class of the issuer's securities to which the rights attach;

(iv) Pursuant to a dividend or interest reinvestment plan; or

(v) Upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer;

Note to Paragraph (a)(2): The exceptions in paragraphs (a)(2)(iii)-(v) do not apply to securities issued pursuant to a standby underwritten offering or other similar arrangement in the United States;

(3) The foreign private issuer has maintained a listing of the subject class of securities for at least the 12 months preceding the filing of the Form 15F on one or more exchanges in a foreign jurisdiction that, either singly or together with the trading of the same class of the issuer' s securities in another foreign jurisdiction, constitutes the primary trading market for those securities; and

(4)(i) The average daily trading volume of the subject class of securities in the United States for a recent 12-month period has been no greater than 5 percent of the average daily trading volume of that class of securities on a worldwide basis for the same period; or

(ii) On a date within 120 days before the filing date of the Form 15F, a foreign private issuer's subject class of equity securities is either held of record by:

(A) Less than 300 persons on a worldwide basis; or

(B) Less than 300 persons resident in the United States.

Note to Paragraph (a)(4): If an issuer's equity securities trade in the form of American Depositary Receipts in the United States, for purposes of paragraph (a)(4)(i), it must calculate the trading volume of its American Depositary Receipts in terms of the number of securities represented by those American Depositary Receipts.

(b) A foreign private issuer must wait at least 12 months before it may file a Form 15F to terminate its section 13(a) or 15(d) reporting obligations in reliance on paragraph (a)(4)(i) of this section if:

(1) The issuer has delisted a class of equity securities from a national securities exchange or inter-dealer quotation system in the United States, and at the time of delisting, the average daily trading volume of that class of securities in the United States exceeded 5 percent of the average daily trading volume of that class of securities on a worldwide basis for the preceding 12 months; or

(2) The issuer has terminated a sponsored American Depositary Receipts facility, and at the time of termination the average daily trading volume in the United States of the American Depositary Receipts exceeded 5 percent of the average daily trading volume of the underlying class of securities on a worldwide basis for the preceding 12 months.

(c) A foreign private issuer may terminate its duty to file or furnish reports pursuant to section 13(a) or section 15(d) of the Act with respect to a class of debt securities after certifying to the Commission on Form 15F that:

(1) The foreign private issuer has filed or furnished all reports required by section 13(a) or section 15(d) of the Act, including at least one annual report pursuant to section 13(a) of the Act; and

(2) On a date within 120 days before the filing date of the Form 15F, the class of debt securities is either held of record by:

(i) Less than 300 persons on a worldwide basis; or

(ii) Less than 300 persons resident in the United States.

(d)(1) Following a merger, consolidation, exchange of securities, acquisition of assets or otherwise, a foreign private issuer that has succeeded to the registration of a class of securities under section 12(g) of the Act of another issuer pursuant to §240.12g-3, or to the reporting obligations of another issuer under section 15(d) of the Act pursuant to §240.15d-5, may file a Form 15F to terminate that registration or those reporting obligations if:

(i) Regarding a class of equity securities, the successor issuer meets the conditions under paragraph (a) of this section; or

(ii) Regarding a class of debt securities, the successor issuer meets the conditions under paragraph (c) of this section.

(2) When determining whether it meets the prior reporting requirement under paragraph (a)(1) or paragraph (c)(1) of this section, a successor issuer may take into

account the reporting history of the issuer whose reporting obligations it has assumed pursuant to §240.12g-3 or §240.15d-5.

(e) Counting method. When determining under this section the number of United States residents holding a foreign private issuer's equity or debt securities:

(1)(i) Use the method for calculating record ownership §240.12g3-2(a), except that you may limit your inquiry regarding the amount of securities represented by accounts of customers resident in the United States to brokers, dealers, banks and other nominees located in:

(A) The United States;

(B) The foreign private issuer's jurisdiction of incorporation, legal organization or establishment; and

(C) The foreign private issuer's primary trading market, if different from the issuer's jurisdiction of incorporation, legal organization or establishment.

(ii) If you aggregate the trading volume of the issuer's securities in two foreign jurisdictions for the purpose of complying with paragraph (a)(3) of this section, you must include both of those foreign jurisdictions when conducting your inquiry under paragraph (e)(1)(i) of this section.

(2) If, after reasonable inquiry, you are unable without unreasonable effort to obtain information about the amount of securities represented by accounts of customers resident in the United States, for purposes of this section, you may assume that the customers are the residents of the jurisdiction in which the nominee has its principal place of business.

(3) You must count securities as owned by United States holders when publicly filed reports of beneficial ownership or other reliable information that is provided to you indicates that the securities are held by United States residents.

(4) When calculating under this section the number of your United States resident security holders, you may rely in good faith on the assistance of an independent information services provider that in the regular course of its business assists issuers in determining the number of, and collecting other information concerning, their security holders.

(f) Definitions. For the purpose of this section:

(1) Debt security means any security other than an equity security as defined under §240.3a11-1, including:

(i) Non-participatory preferred stock, which is defined as non-convertible capital stock, the holders of which are entitled to a preference in payment of dividends and in distribution of assets on liquidation, dissolution, or winding up of the issuer, but are not entitled to participate in residual earnings or assets of the issuer; and

(ii) Notwithstanding §240.3a11-1, any debt security described in paragraph (f)(3)(i) and (ii) of this section;

(2) Employee has the same meaning as the definition of employee provided in Form S-8 (§239.16b).

(3) Equity security means the same as under §240.3a11-1, but, for purposes of paragraphs (a)(3) and (a)(4)(i) of this section, does not include:

(i) Any debt security that is convertible into an equity security, with or without consideration;

(ii) Any debt security that includes a warrant or right to subscribe to or purchase an equity security;

(iii) Any such warrant or right; or

(iv) Any put, call, straddle, or other option or privilege that gives the holder the option of buying or selling a security but does not require the holder to do so.

(4) Foreign private issuer has the same meaning as under §240.3b-4.

(5) Primary trading market means that:

(i) At least 55 percent of the trading in a foreign private issuer's class of securities that is the subject of Form 15F took place in, on or through the facilities of a securities market or markets in a single foreign jurisdiction or in no more than two foreign jurisdictions during a recent 12-month period; and

(ii) If a foreign private issuer aggregates the trading of its subject class of securities in two foreign jurisdictions for the purpose of paragraph (a)(3) of this section, the trading for the issuer's securities in at least one of the two foreign jurisdictions must be larger than the trading in the United States for the same class of the issuer's securities.

(6) Recent 12-month period means a 12-calendar-month period that ended no more than 60 days before the filing date of the Form 15F.

(g)(1) Suspension of a foreign private issuer's duty to file reports under section 13(a) or section 15(d) of the Act shall occur immediately upon filing the Form 15F with the Commission if filing pursuant to paragraph (a), (c) or (d) of this section. If there are no objections from the Commission, 90 days, or such shorter period as the Commission may determine, after the issuer has filed its Form 15F, the effectiveness of any of the following shall occur:

(i) The termination of registration of a class of securities under section 12(g); and

(ii) The termination of a foreign private issuer's duty to file reports under section 13(a) or section 15(d) of the Act.

(2) If the Form 15F is subsequently withdrawn or denied, the issuer shall, within 60 days after the date of the withdrawal or denial, file with or submit to the Commission all reports that would have been required had the issuer not filed the Form 15F.

(h) As a condition to termination of registration or reporting under paragraph (a), (c) or (d) of this section, a foreign private issuer must, either before or on the date that it files its Form 15F, publish a notice in the United States that discloses its intent to terminate its registration of a class of securities under section 12(g) of the Act, or its reporting obligations under section 13(a) or section 15(d) of the Act, or both. The issuer must publish the notice through a means reasonably designed to provide broad dissemination of the information to the public in the United States. The issuer must also submit a copy of the notice to the Commission, either under cover of a Form 6-K (17 CFR 249.306) before or at the time of filing of the Form 15F, or as an exhibit to the Form 15F.

(i)(1) A foreign private issuer that, before the effective date of this section, terminated the registration of a class of securities under section 12(g) of the Act or suspended its reporting obligations regarding a class of equity or debt securities under section 15(d) of the Act may file a Form 15F in order to:

(i) Terminate under this section the registration of a class of equity securities that was the subject of a Form 15 (§249.323 of this chapter) filed by the issuer pursuant to §240.12g-4; or

(ii) Terminate its reporting obligations under section 15(d) of the Act, which had been suspended by the terms of that section or by the issuer's filing of a Form 15 pursuant to §240.12h-3, regarding a class of equity or debt securities.

(2) In order to be eligible to file a Form 15F under this paragraph:

(i) If a foreign private issuer terminated the registration of a class of securities pursuant to §240.12g-4 or suspended its reporting obligations pursuant to §240.12h-3 or section 15(d) of the Act regarding a class of equity securities, the issuer must meet the requirements under paragraph (a)(3) and paragraph (a)(4)(i) or (a)(4)(ii) of this section; or

(ii) If a foreign private issuer suspended its reporting obligations pursuant to §240.12h-3 or section 15(d) of the Act regarding a class of debt securities, the issuer must meet the requirements under paragraph (c)(2) of this section.

(3)(i) If the Commission does not object, 90 days after the filing of a Form 15F under this paragraph, or such shorter period as the Commission may determine, the effectiveness of any of the following shall occur:

(A) The termination under this section of the registration of a class of equity securities, which was the subject of a Form 15 filed pursuant to §240.12g-4, and the duty to file reports required by section 13(a) of the Act regarding that class of securities; or

(B) The termination of a foreign private issuer's reporting obligations under section 15(d) of the Act, which had previously been suspended by the terms of that section or by the issuer's filing of a Form 15 pursuant to §240.12h-3, regarding a class of equity or debt securities.

(ii) If the Form 15F is subsequently withdrawn or denied, the foreign private issuer shall, within 60 days after the date of the withdrawal or denial, file with or submit to the Commission all reports that would have been required had the issuer not filed the Form 15F.

PART 249 - FORMS, SECURITIES EXCHANGE ACT OF 1934

10. 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.

* * * * *

11. Add §249.324 to read as follows:

§249.324 Form 15F, certification by a foreign private issuer regarding the termination of registration of a class of securities under section 12(g) or the duty to file reports under section 13(a) or section 15(d).

This form shall be filed by a foreign private issuer to disclose and certify the information on the basis of which it meets the requirements specified in Rule 12h-6 (§240.12h-6 of this chapter) to terminate the registration of a class of securities under section 12(g) of the Act (15 U.S.C. 78l(g)) or the duty to file reports under section 13(a) of the Act (15 U.S.C. 78m(a)) or section 15(d) of the Act (15 U.S.C. 78(o)(d)). In each instance, unless the Commission objects, termination occurs 90 days, or such shorter time as the Commission may direct, after the filing of Form 15F.

12. Add Form 15F (referenced in §249.324) to read as follows:

(Note: The text of Form 15F will not appear in the Code of Federal Regulations.)

OMB APPROVAL
OMB Number: 3235-0621
Expires:
Estimated average burden hours per response. . .30.0

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 15F

CERTIFICATION OF A FOREIGN PRIVATE ISSUER'S TERMINATION OF REGISTRATION OF A CLASS OF SECURITIES UNDER SECTION 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934 OR ITS TERMINATION OF THE DUTY TO FILE REPORTS UNDER SECTION 13(a) OR SECTION 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File Number ______________

____
(Exact name of registrant as specified in its charter)

____
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

____
(Title of each class of securities covered by this Form)

Place an X in the appropriate box(es) to indicate the provision(s) relied upon to terminate the duty to file reports under the Securities Exchange Act of 1934:

Rule 12h-6(a) ☐ (for equity securities)	Rule 12h-6(d) ☐ (for successor registrants)
Rule 12h-6(c) ☐ (for debt securities)	Rule 12h-6(i) ☐ (for prior Form 15 filers)

GENERAL INSTRUCTIONS

A. Who May Use Form 15F and When

1. A foreign private issuer may file Form 15F, pursuant to Rule 12h-6(a) (17 CFR 240.12h-6(a)) under the Securities Exchange Act of 1934 ("Exchange Act"),

when seeking to terminate:

- the registration of a class of securities under section 12(g) of the Exchange Act and the corresponding duty to file or furnish reports required by section 13(a) of the Exchange Act; or

- the obligation under section 15(d) of the Exchange Act to file or furnish reports required by section 13(a) of the Act regarding a class of equity securities; or

- both.

2. A foreign private issuer may file Form 15F, pursuant to Rule 12h-6(c) (17 CFR 240.12h-6(c)), when seeking to terminate its reporting obligations under section 13(a) or section 15(d) of the Exchange Act regarding a class of debt securities.

3. A foreign private issuer may file Form 15F, pursuant to Rule 12h-6(d) (17 CFR 240.12h-6(d)), when seeking to terminate the registration of a class of securities under section 12(g), or reporting obligations under section 13(a) or section 15(d) of the Exchange Act, to which it has succeeded pursuant to Rule 12g-3 (17 CFR 240.12g-3) or Rule 15d-5 (17 CFR 240.15d-5).

4. A foreign private issuer may file Form 15F, pursuant to Rule 12h-6(i) (17 CFR 240.12h-6(i)), if, before the effective date of Rule 12h-6, it terminated the registration of a class of securities under section 12(g) of the Act, or suspended its reporting obligations regarding a class of equity or debt securities under section 15(d) of the Act, in order to:

- terminate under Rule 12h-6 the registration of a class of equity securities that was the subject of a Form 15 (§249.323 of this chapter) filed by the issuer pursuant to §240.12g-4; or
- terminate its reporting obligations under section 15(d) of the Act, which had been suspended by the terms of that section or by the issuer's filing of a Form 15 pursuant to §240.12h-3, regarding a class of equity or debt securities.

B. Certification Effected by Filing Form 15F

By completing and signing this Form, the issuer certifies that:

- it meets all of the conditions for termination of Exchange Act reporting specified in Rule 12h-6 (17 CFR 240.12h-6); and
- there are no classes of securities other than those that are the subject of this Form 15F regarding which the issuer has Exchange Act reporting obligations.

C. Effective Date

For an issuer filing Form 15F under Rule 12h-6(a), (c) or (d), the duty to file any reports required under section 13(a) or 15(d) of the Exchange Act will be suspended immediately upon filing the Form 15F. If there are no objections from the Commission, 90 days, or within a shorter period as the Commission may determine, after the issuer has filed its Form 15F, there shall take effect:

- the termination of registration of a class of securities under section 12(g) of the Act;
- the termination of the issuer's duty to file or submit reports under section 13(a) or section 15(d) of the Act; or
- both.

For an issuer that has already terminated its registration of a class of equity securities pursuant to Rule 12g-4 or suspended its reporting obligations under section 15(d) or Rule 12h-3, the effectiveness of its termination of section 12(g) registration under Rule 12h-6 and the corresponding duty to file reports required by section 13(a) of the Act, or the termination of its previously suspended reporting obligations under section 15(d) of the Act, shall also occur 90 days after the issuer has filed its Form 15F under Rule 12h-6(i), or within a shorter period as the Commission may determine, if there are no objections from the Commission.

D. Other Filing Requirements

You must file Form 15F and related materials, including correspondence, in electronic format via our Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system in accordance with the EDGAR rules set forth in Regulation S-T (17 CFR Part 232). The Form 15F and related materials must be in the English language as required by Regulation S-T Rule 306 (17 CFR 232.306). You must provide the signature required for Form 15F in accordance with Regulation S-T Rule 302 (17 CFR 232.302). If you have technical questions about EDGAR, call the EDGAR Filer Support Office at (202) 551-8900. If you have questions about the EDGAR rules, call the Office of EDGAR and Information Analysis at (202) 551-3610.

If the Form 15F is subsequently withdrawn or denied, you must, within 60 days after the date of the withdrawal or denial, file with or submit to the Commission all reports that would have been required had you not filed the Form 15F. See Rule 12h-6(g)(2) (17 CFR 240.12h-6(g)(2)) and Rule 12h-6(i)(3)(ii) (17 CFR 240.12h-6(i)(3)(ii)).

E. Rule 12g3-2(b) Exemption

Regardless of the particular Rule 12h-6 provision under which it is proceeding, a foreign private issuer that has filed a Form 15F regarding a class of equity securities shall receive the exemption under Rule 12g3-2(b) (17 CFR 240.12g3-2(b)) for the subject class of equity securities immediately upon the effective date of its termination of registration and reporting under Rule 12h-6. Refer to Rule 12g3-2(e) (17 CFR 240.12g3-2(e)) for the conditions that a foreign private issuer must meet in order to maintain the Rule 12g3-2(b) exemption following its termination of Exchange Act registration and reporting.

PART I

The purpose of this part is to provide information to investors and to assist the Commission in assessing whether you meet the requirements for terminating your Exchange Act reporting under Rule 12h-6. If, pursuant to Rule 12h-6, there is an item that does not apply to you, mark that item as inapplicable.

Item 1. Exchange Act Reporting History

A. State when you first incurred the duty to file reports under section 13(a) or section 15(d) of the Exchange Act.

B. State whether you have filed or submitted all reports required under Exchange Act section 13(a) or section 15(d) and corresponding Commission rules for the 12 months preceding the filing of this form, and whether you have filed at least one annual report under section 13(a).

Instruction to Item 1.

If you are a successor issuer that has filed this Form 15F pursuant to Rule 12h-6(d), and are relying on the reporting history of the issuer to which you have succeeded under Rule 12g-3 (17 CFR 12g-3) or Rule 15d-5 (17 CFR 240.15d-5), identify that issuer and provide the information required by this section for that issuer.

Item 2. Recent United States Market Activity

State when your securities were last sold in the United States in a registered offering under the Securities Act of 1933 (15 U.S.C. 77a et seq.) ("Securities Act").

Instructions to Item 2.

1. Do not include registered offerings involving the issuance of securities:

   a. to your employees, as that term is defined in Form S-8 (17 CFR 239.16b);

   b. by selling security holders in non-underwritten offerings;

   c. upon the exercise of outstanding rights granted by the issuer if the rights are granted pro rata to all existing security holders of the class of the issuer's securities to which the rights attach;

   d. pursuant to a dividend or interest reinvestment plan; or

   e. upon the conversion of outstanding convertible securities or upon the exercise of outstanding transferable warrants issued by the issuer.

However, you must include registered offerings described in paragraphs (c) through (e) of this instruction if undertaken pursuant to a standby underwritten offering or other similar arrangement in the United States.

2. If you have registered equity securities on a shelf or other Securities Act registration statement under which securities remain unsold, disclose the last sale of securities under that registration statement. If no sale has occurred during the preceding

12 months, disclose whether you have filed a post-effective amendment to terminate the registration of unsold securities under that registration statement.

Item 3. Foreign Listing and Primary Trading Market

A. Identify the exchange or exchanges outside the United States, and the foreign jurisdiction in which the exchange or exchanges are located, on which you have maintained a listing of the class of securities that is the subject of this Form, and which, either singly or together with the trading of the same class of the issuer' s securities in another foreign jurisdiction, constitutes the primary trading market for those securities.

B. Provide the date of initial listing on the foreign exchange or exchanges identified in response to Item 3.A. In addition, disclose whether you have maintained a listing of the subject class of securities on one or more of those foreign exchanges for at least the 12 months preceding the filing of this Form.

C. Disclose the percentage of trading in the subject class of securities that occurred in the identified jurisdiction or jurisdictions of your foreign listing as of a recent 12-month period.

Instructions to Item 3.

1. When responding to this item, refer to the definition of "primary trading market" in Rule 12h-6(f) (17 CFR 240.12h-6(f)). In accordance with that definition, if your primary trading market consists of two foreign jurisdictions, provide the information required by this section for both foreign jurisdictions. In addition, disclose whether the trading market for your securities in at least one of those two foreign jurisdictions is larger than the trading market for your securities in the United States as of the same recent 12-month period. Disclose the first and last days of that recent 12-month period.

2. For the purpose of the primary trading market determination, you must measure the average daily trading volume of on-exchange transactions in the subject securities aggregated over one or two foreign jurisdictions against your worldwide trading volume. You may include in this measure off-exchange transactions in those jurisdictions comprising the numerator only if you include those off-exchange transactions when calculating worldwide trading volume in the denominator. This denominator should be the same as the denominator used for the trading volume benchmark under Rule 12h-6(a)(4)(i) (17 CFR 240.12h-6(a)(4)(i)) and Item 4 of this Form.

Item 4. Comparative Trading Volume Data

If relying on Rule 12h-6(a)(4)(i), provide the following information:

A. Identify the first and last days of the recent 12-month period used to meet the requirements of that rule provision.

B. For the same recent 12-month period, disclose the average daily trading volume of the class of securities that is the subject of this Form both in the United States and on a worldwide basis.

C. For the same recent 12-month period, disclose the average daily trading volume of the subject class of securities in the United States as a percentage of the average daily trading volume for that class of securities on a worldwide basis.

D. Disclose whether you have delisted the subject class of securities from a national securities exchange or inter-dealer quotation system in the United States. If so, provide the date of delisting, and, as of that date, disclose the average daily trading volume of the subject class of securities in the United States as a percentage of the average daily trading volume for that class of securities on a worldwide basis for the preceding 12-month period.

E. Disclose whether you have terminated a sponsored American depositary receipt (ADR) facility regarding the subject class of securities. If so, provide the date of the ADR facility termination, and, as of that date, disclose the average daily trading volume of the subject class of securities in the United States as a percentage of the average daily trading volume for that class of securities on a worldwide basis for the preceding 12-month period.

F. Identify the sources of the trading volume information used for determining whether you meet the requirements of Rule 12h-6. If you used more than one source, disclose the reasons why you used each source.

Instructions to Item 4.

1. "Recent 12-month period" means a 12-calendar-month period that ended no more than 60 days before the filing date of this form, as defined under Rule 12h-6(f). You may disclose the comparative trading volume data in response to this item in tabular format and attached as an exhibit to this Form.

2. An issuer is ineligible to rely on paragraph (a)(4)(i) of Rule 12h-6 if, as of the date of delisting or termination of an ADR facility, the average daily trading volume of the subject class of securities in the United States exceeded 5 percent of the average daily trading volume of that class of securities on a worldwide basis, as measured over the preceding 12 months, and 12 months has not elapsed from the date of delisting or termination of the ADR facility. See Rule 12h-6(b) (17 CFR 240.12h-6(b)).

3. For purposes of paragraph (a)(4)(i) of Rule 12h-6:

a. when determining your U.S. average daily trading volume, you must include all transactions, whether on-exchange or off-exchange;

b. when determining your worldwide average daily trading volume, in addition to on-exchange transactions, which you must include, you may include off-exchange transactions; and

c. the sources of your trading volume information may include publicly available sources, market data vendors or other commercial information service providers upon which you have reasonably relied in good faith, and as long as the information does not duplicate any other trading volume information obtained from exchanges or other sources.

Item 5. Alternative Record Holder Information

If relying on Rule 12h-6(a)(4)(ii) (17 CFR 240.12h-6(a)(4)(ii)):

Disclose the number of record holders of the subject class of equity securities on a worldwide basis or who are United States residents at a date within 120 days before filing this Form. Disclose the date used for the purpose of Item 5.

Item 6. Debt Securities

If relying on Rule 12h-6(c) (17 CFR 240.12h-6(c)):

Disclose the number of record holders of your debt securities either on a worldwide basis or who are United States residents at a date within 120 days before the date of filing of this Form. Disclose the date used for the purpose of Item 6.

Instructions to Items 5 and 6.

1. When determining the number of record holders of your equity or debt securities who are United States residents, refer to Rule 12h-6(e) (17 CFR 240.12h-6(e))

for the appropriate counting method.

2. If you have relied upon the assistance of an independent information services provider to determine the number of your United States equity or debt securities holders, identify this party in your response.

Item 7. Notice Requirement

If filing Form 15F pursuant to Rule 12h-6(a), (c) or (d):

A. Disclose the date of publication of the notice, required by Rule 12h-6(h) (17 CFR 240.12h-6(h)), disclosing your intent to terminate your duty to file reports under section 13(a) or 15(d) of the Exchange Act or both.

B. Identify the means, such as publication in a particular newspaper or transmission by a particular wire service, used to disseminate the notice in the United States.

Instruction to Item 7.

If you have submitted a copy of the notice under cover of a Form 6-K (17 CFR 249.306), disclose the submission date of the Form 6-K. If not, attach a copy of the notice as an exhibit to this Form. See Rule 12h-6(h).

Item 8. Prior Form 15 Filers

If relying on Rule 12h-6(i):

A. Disclose whether, before the effective date of Rule 12h-6, you filed a Form 15 (17 CFR 249.323) to terminate the registration of a class of equity securities pursuant to Rule 12g-4 (17 CFR 240.12g-4) or to suspend your reporting obligations under section 15(d) of the Act regarding a class of equity or debt securities pursuant to Rule 12h-3 (17 CFR 240.12h-3). If so, disclose the date that you filed the Form 15. If you suspended your reporting obligations by the terms of section 15(d), disclose the effective date of that suspension as well as the date that you filed a Form 15 to notify the Commission of that suspension pursuant to Rule 15d-6 (17 CFR 240.15d-6).

B. If you terminated the registration of a class of securities pursuant to Rule 12g-4 or suspended your reporting obligations pursuant to Rule 12h-3 or by the terms of section 15(d) of the Act regarding a class of equity securities, provide the disclosure required by Item 3 of this Form, "Primary Trading Market." Further provide the disclosure required by Item 4 of this Form, "Comparative Trading Volume Data," or the disclosure required by Item 5 of the Form, "Alternative Record Holder Information."

C. If you suspended your reporting obligations pursuant to Rule 12h-3 or by the terms of section 15(d) of the Act regarding a class of debt securities, provide the disclosure required by Item 6 of this Form, "Debt Securities."

PART II

Item 9. Rule 12g3-2(b) Exemption

Disclose the address of your Internet Web site or of the electronic information delivery system in your primary trading market on which you will publish the information required under Rule 12g3-2(b)(1)(iii) (17 CFR 240.12g3-2(b)(1)(iii)).

Instruction to Item 9.

Refer to Note 1 to Rule 12g3-2(e) for instructions regarding providing English translations of documents published pursuant to Rule 12g3-2(b)(1)(iii)

(17 CFR 240.12g3-2(b)(1)(iii).

PART III

Item 10. Exhibits

List the exhibits attached to this Form.

Instruction to Item 10.

In addition to exhibits specifically mentioned on this Form, you may attach as an exhibit any document providing information that is material to your eligibility to terminate your reporting obligations under Exchange Act Rule 12h-6. You should refer to any relevant exhibit when responding to the items on this Form.

Item 11. Undertakings

Furnish the following undertaking:

The undersigned issuer hereby undertakes to withdraw this Form 15F if, at any time before the effectiveness of its termination of reporting under Rule 12h-6, it has actual knowledge of information that causes it reasonably to believe that, at the time of filing the Form 15F:

(1) The average daily trading volume of its subject class of securities in the United States exceeded 5 percent of the average daily trading volume of that class of securities on a worldwide basis for the same recent 12-month period that the issuer used for purposes of Rule 12h-6(a)(4)(i);

(2) Its subject class of securities was held of record by 300 or more United States residents or 300 or more persons worldwide, if proceeding under Rule 12h-6(a)(4)(ii) or Rule 12h-6(c); or

(3) It otherwise did not qualify for termination of its Exchange Act reporting obligations under Rule 12h-6.

Instruction to Item 11.

After filing this Form, an issuer has no continuing obligation to make inquiries or perform other work concerning the information contained in this Form, including its assessment of trading volume or ownership of its securities in the United States.

Signature

Pursuant to the requirements of the Securities Exchange Act of 1934, [name of registrant as specified in charter] has duly authorized the undersigned person to sign on its behalf this certification on Form 15F. In so doing, [name of registrant as specified in charter] certifies that, as represented on this Form, it has complied with all of the conditions set forth in Rule 12h-6 for terminating its registration under section 12(g) of the Exchange Act, or its duty to file reports under section 13(a) or section 15(d) of the Exchange Act, or both.

By the Commission.

Nancy M. Morris

Nancy M. Morris
Secretary

Dated: March 27, 2007

UNITED STATES OF AMERICA
BEFORE THE
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55551 / March 28, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2585 / March 28, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12602

In the Matter of EDWARD S. PLINER, 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 Edward S. Pliner ("Pliner" or "Respondent") pursuant to Rule 102(e)(3) of the Commission's Rules of Practice.[1]

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 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.

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[1] Rule 102(e)(3)(i) provides, in relevant part, that:

> The Commission, with due regard to the public interest and without preliminary hearing, may, by order, . . . 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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III.

On the basis of this Order and Respondent's Offer, the Commission finds that:[2]

1. Pliner, age 49, has been a Certified Public Accountant licensed in Massachusetts at all relevant times. During 1997 through February 2000, Pliner served as the lead engagement partner on the audits of the financial statements for Raytheon Company ("Raytheon" or the "company"). From approximately April 2000 until December 2002, Pliner served as Raytheon's Controller and then became the company's CFO.

2. Raytheon is a Delaware corporation, headquartered in Waltham, Massachusetts. The company is an industry leader in defense, government electronics, space technology, and business and special mission aircraft. Between 1997 and 2001, Raytheon reported between $13 billion and $20 billion in net sales revenue annually and employed between 75,000 to 120,000 individuals. During this time period and continuing through today, Raytheon's securities have been registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934 and are listed on the New York, Chicago, and Pacific Exchanges.

3. On March 15, 2007, the Commission filed a complaint against Respondent in Securities and Exchange Commission v. Edward S. Pliner, Civil Action No. 07-cv-00495 (GK), in the United States District Court for the District of Columbia. Respondent neither admits nor denies the allegations in that complaint. On March 26, 2007, a final judgment was entered by consent against Pliner, permanently enjoining him from committing violations of Sections 17(a)(2) and (3) of the Securities Act of 1933 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, 13a-13, and 13b2-1 promulgated thereunder. The final judgment ordered Pliner to pay $325,000 in disgorgement of certain past bonus amounts, $90,042 in prejudgment interest thereon, and a $150,000 civil money penalty.

4. The Commission's complaint alleges among other things that, between 1997 and 2001, Raytheon and certain members of its senior management made false and misleading disclosures and used improper accounting practices that operated as a fraud by masking the declining results and deteriorating business of Raytheon Aircraft Company ("RAC") and inaccurately reporting the company's operating results on both a segmented and consolidated basis. According to the SEC's complaint, certain of these disclosures and accounting practices were undertaken by or with the knowledge of Pliner and others.

5. The Commission's complaint also alleges that, as Raytheon's lead auditor, Pliner was aware of certain bill-and-hold and commuter aircraft accounting practices at RAC, which he knew or should have known were improper. Yet, he signed unqualified audit opinions for the 1997 and 1998 audits, which represented that the company's financial statements "present fairly, in all material respect, the financial position of Raytheon Company and Subsidiaries

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

Consolidated… and the results of their operations…in conformity with generally accepted accounting principles."

6. The Commission's complaint further alleges that, as Raytheon's Controller, Pliner continued to be aware of and involved in certain on- and off-balance sheet commuter accounting, which he knew or should have known did not accurately reflect the negative impact of declining commuter values in Raytheon's financial statements. According to the Commission's complaint, Pliner further did not make or ensure the timely, accurate, and full disclosure of material trends and uncertainties related to Raytheon's commuter aircraft business in the company's SEC filings during 2000 and 2001, and he also did not ensure that the company maintained an adequate system of internal accounting controls related to these assets.

7. According to the Commission's complaint, RAC's operating results would have been reduced by at least $67 million (41 percent) at year-end 2000 had Pliner and others in senior Raytheon and RAC management timely and appropriately recognized losses inherent in a planned "soft landing" of the commuter aircraft line. According to the Commission's complaint, at this time, these and other senior executives further expected commuter losses of $240 million given the cash sales prices that had been approved in the "soft landing," and a charge of $67 million to $240 million would have reduced Raytheon's 2000 profit before taxes by at least 8 to 27 percent.

8. The Commission's complaint alleges that Pliner and others caused Raytheon to improperly take this charge in the third quarter of 2001, when the company wrote down its on-balance sheet commuter assets and increased reserves for its off-balance sheet commuter receivables by a total of $693 million after the terrorist attacks of September 11th. According to the Commission's complaint, given the charge that the company should have taken at year-end 2000, Raytheon's third quarter 2001 commuter loss provision was materially overstated by at least 10 to 53 percent.

IV.

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

Accordingly, IT IS HEREBY ORDERED, effective immediately, that:

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

B. After three (3) years from the date of this Order, Pliner 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 Pliner'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) Pliner, 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) Pliner, 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; and

(c) Pliner 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) Pliner acknowledges his responsibility, as long as he 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 Pliner to resume appearing or practicing before the Commission as an accountant provided that his accountant status is current and he has resolved any disciplinary issues with the applicable board of accountancy. However, if the resolution of any disciplinary action by a board of accountancy 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 Pliner'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

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55554 / March 29, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2587 / March 29, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12603

In the Matter of **AMBER SCHATZ, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative proceedings be, and hereby are, instituted against Amber Schatz, CPA ("Respondent" or "Schatz") pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[1]

II.

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

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[1] Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

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III.

On the basis of this Order and Respondent's Offer, the Commission finds[2] that:

A. SUMMARY

While employed by the auditing firm PricewaterhouseCoopers ("PwC"), Texas-licensed CPA Amber Schatz served as a senior associate on PwC's audit teams that conducted the independent audits of the 1998 and 1999 financial statements of Patterson-UTI, Inc. ("Patterson-UTI"). During the 1999 audit, Schatz received a $40,500 personal loan from Patterson-UTI's chief financial officer ("CFO") at the time. As a result of receiving the loan, which Schatz concealed from PwC, Schatz engaged in improper professional conduct by failing to maintain strict independence from the audit client as required under generally accepted auditing standards ("GAAS").

B. RESPONDENT

Amber Schatz, a Texas-licensed CPA, was employed by PwC from 1996 through 2002. Schatz participated in PwC's audits of the 1998 and 1999 financial statements of Patterson-UTI, a public company based in Snyder, Texas. Currently, she is not employed.

C. FACTS

1. Schatz was a member of the PwC team that audited Patterson-UTI's financial statements for the fiscal years 1998 and 1999. During the 1999 audit, she served as a PwC senior associate, conducting audit work at Patterson-UTI's offices. As a senior associate, her duties included, among other things, working with other PwC staff in planning the audit process, reviewing certain audit work papers of subordinate associates, and participating in the testing of Patterson-UTI's accounting controls.

2. During the 1999 audit, Jonathan D. Nelson, Patterson-UTI's CFO at the time, gave Schatz a $40,500 personal check dated December 16, 1999. The check reflected the notation "loan" in the memo block. Schatz did not execute a formal note, but ultimately paid off the loan in April 2005 after completing 59 monthly installments of $850 each, which included annual interest of 9%. Nelson resigned from Patterson-UTI in October 2005.[3]

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

[3] On November 16, 2005, the United States District Court for the Northern District of Texas, Lubbock Division, entered orders freezing Nelson's assets and granting other relief in a Commission lawsuit against him. The Commission alleged that he embezzled more than $69 million from Patterson-UTI and defrauded investors by, among other things, falsifying Patterson-UTI's financial statements and Commission filings over five years. *SEC v. Jonathan D. Nelson (Defendant), XIT Land & Energy, Inc., Chisum Travel Center, Ltd., Z8 Properties, Ltd., Three Stars Aviation, LLC, and Chisum Coach, Ltd. (Defendants Solely for Purposes of Equitable Relief),* Case No. 5-05CV0266-C. (N.D. Tex., Lubbock Division, filed November 16, 2005). On October 10, 2006, Nelson was sentenced to 25 years in prison by the same court in a related criminal case brought by the United States Attorney for the Northern District of Texas. Neither case named Schatz or alleged misconduct against her.

3. On May 15, 2000, Schatz signed an independence-certification letter to PwC that falsely stated that she had not received any loans from any Patterson-UTI officers during the 1999 audit work.

4. At the time of the events described above, the applicable Commission auditor-independence rule, Regulation S-X, Section 210.2-01, stated, in pertinent part:

> b. The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent . . . .
>
> c. In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationships existing in connection with the filing of reports with the Commission.[4]

5. GAAS requires auditors to maintain strict independence from their audit clients. Rule 101 of the Code of Professional Conduct of the American Institute of Certified Public Accountants ("AICPA"), states, in pertinent part, that a "member in public practice shall be independent in the performance of professional services." Interpretation 101-1 of AICPA Rule 101 provides, among other things, that independence shall be considered impaired if, during the period of the professional engagement, a member "had any loan to or from the client [or] any officer or director of the client."

6. Rule 102(e)(1)(ii) of the Commission's Rules of Practice provides, in pertinent part, that the Commission may deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter to have engaged in improper professional conduct.

D. FINDINGS

Based on the foregoing, the Commission finds that Schatz engaged in improper professional conduct within the meaning of Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

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[4] The current Regulation S-X, Rule 2-01(c)(1)(ii), explicitly prohibits loans or debtor/creditor relationships between auditors and audit clients. This rule became effective May 7, 2001, however, after the events that form the basis of this Order.

IV.

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

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

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

B. After one year from the date of this order, Respondent may request that the Commission consider her 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 her practice before the Commission will be reviewed either by the independent audit committee of the public company for which he/she works or in some other acceptable manner, as long as she 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 she 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 she 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 her 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 her state CPA license is current and that she 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

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 55556 / March 29, 2007

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 2588 / March 29, 2007

ADMINISTRATIVE PROCEEDING
File No. 3-12604

In the Matter of **ATLAS AIR WORLDWIDE HOLDINGS, INC.,** **Respondent.**	**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**

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 Atlas Air Worldwide Holdings, Inc. ("Atlas" or "Respondent").

II.

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

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and-Desist Proceedings, Making Findings, and Imposing a Cease-and-Desist Order Pursuant to Section 21C of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

RESPONDENT

1. **Atlas** is a Delaware corporation engaged in the business of providing air cargo and related services to commercial airlines and others. Since 2000, Atlas's principal executive offices have been located in Purchase, New York. Atlas's common stock has been publicly traded on the Nasdaq Global Select Market since May 31, 2006, and has been registered with the Commission pursuant to Section 12(b) of the Exchange Act since July 31, 2006. Atlas's common stock was previously registered with the Commission pursuant to Section 12(b) of the Exchange Act and was traded on the New York Stock Exchange until September 9, 2003, when the Exchange suspended trading in the stock. Atlas's stock was delisted from the Exchange, and was also deregistered under Section 12(b), as of November 28, 2003 due to Atlas's failure to file current audited financial statements and related factors. From November 28, 2003 through July 31, 2006, Atlas's common stock was, however, registered with the Commission under Section 12(g) of the Exchange Act. On January 30, 2004, Atlas filed a petition under Chapter 11 of the Bankruptcy Code. For the fiscal year ended December 31, 2003, Atlas reported a net loss of $100.9 million on revenue of $1.38 billion. On July 27, 2004, Atlas's then outstanding common stock was cancelled and new common stock was issued to Atlas's general unsecured creditors pursuant to the reorganization plan. From September 9, 2003 through May 30, 2006, Atlas stock traded in the over-the-counter market and was quoted in the Pink Sheets.

FACTS

2. As described below, Atlas violated the financial reporting, recordkeeping and internal control provisions of Section 13 of the Exchange Act and related Rules due to its failure to report accurately its financial results, maintain requisite accounting records and implement adequate internal accounting controls.[1] The relevant facts are as follows:

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[1] Section 13(a) of the Exchange Act requires issuers whose securities are registered with the Commission under the Exchange Act to file periodic reports with the Commission containing such information as the Commission prescribes by rule, and the information contained in such reports is required to be materially accurate. Exchange Act Rule 13a-1 requires registrants to file annual reports on Form 10-K, and Rule 13a-13 requires issuers to file quarterly reports on Form 10-Q. Rule 12b-20 provides that these reports must contain, in addition to disclosures expressly required by the pertinent statutes and rules, such other information as is necessary to ensure that the statements made in the report are not, under the circumstances, materially misleading. Section 13(b)(2)(A) requires registrants to make and keep books, records and accounts which, in reasonable detail, accurately and fairly reflect transactions and dispositions of assets. Section 13(b)(2)(B) requires registrants to devise and maintain a system of internal accounting controls

Overview

a. On October 16, 2002, Atlas issued a press release disclosing that there were material inaccuracies in some of the financial results it had previously reported and that, as a result, (i) a restatement of certain prior financial statements was required; and (ii) its financial statements for the fiscal years ended December 31, 2000 ("FY 2000") and 2001 ("FY 2001") would be re-audited. Atlas's financial statements for FY 2000 and FY 2001 and certain interim periods were materially inaccurate because Atlas, among other things, understated the expenses it incurred during those periods for aircraft maintenance, excess and obsolete inventory, and doubtful accounts receivable and overstated the value of its aircraft fleet.

b. On December 12, 2003, Atlas filed a current report on Form 8-K in which Atlas disclosed that as a result of the adjustments needed to correct previously reported financial statements, Atlas's retained earnings as of December 31, 2001 decreased from the $185.1 million it had previously reported to an accumulated deficit of $180.2 million. Atlas further disclosed that adjustments were also required to correct financial results that Atlas had previously reported for the quarters ended March 31, 2002 and June 30, 2002. Atlas was unable, however, to issue restated financial statements for FY 2001 and FY 2000 or any other prior period, because Atlas lacked the accounting records needed to re-audit those periods and to determine the specific prior period or periods in which adjustments were needed.

c. Atlas's failure to report accurately its financial results for FY 2000, FY 2001 and the first two quarters of 2002 and its inability to restate its financial results in those periods had three principal causes. First, numerous accounting records that Atlas was required to maintain were never created or were discarded. Second, Atlas did not devise and implement an adequate system of internal accounting controls. Third, Atlas did not account for an impairment of the value of its aircraft fleet and expenses associated with aircraft maintenance, excess and obsolete inventory and uncollectible accounts receivable in accordance with GAAP. As a result, the annual and quarterly reports that Atlas filed during this period were materially false and misleading.[2]

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sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles ("GAAP") and to maintain accountability for assets. No showing of scienter is required to prove violations of Sections 13(a) and 13(b)(2) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

[2] The periodic reports at issue were filed before the effective date of the certification requirements imposed on principal executive and financial officers of public companies by the Sarbanes-Oxley Act. Those provisions took effect on August 29, 2002 and require the officers to personally certify, among other things, that each periodic report filed thereafter is accurate in all material respects and that the officers have established adequate internal controls, evaluated the effectiveness of those controls during the relevant period and disclosed in the report and to the board of directors their conclusions about the effectiveness of, and any significant deficiencies in, the design and operation of the controls.

Impairment Of Aircraft Assets

d. In its Form 10-Q for the second quarter of FY 2001, Atlas stated that as a result of the global economic slowdown, it had removed six aircraft from its operating fleet and designated them for sale. Atlas recorded a charge of $54.1 million that quarter to account for the impairment in the value of those six aircraft. In the fourth quarter of FY 2001, Atlas recorded an additional $44.9 million impairment charge on those same aircraft, purportedly due to a further decline in global economic conditions and the adverse impact of the events of September 11, 2001 on the air cargo industry. Nevertheless, Atlas did not properly consider at that time, in accordance with GAAP, whether the rest of the aircraft and related equipment in its fleet were also impaired. According to the Form 8-K it filed on December 12, 2003, Atlas lacked sufficient documentation at the time it filed the Form 8-K to determine whether management had given any consideration to whether the entire fleet was impaired as of December 31, 2001. As disclosed in the Form 8-K, the information that was available at the time that Atlas filed its Form 10-K for FY 2001 demonstrated that the value of Atlas's entire fleet of aircraft was, in fact, impaired as of December 31, 2001. By failing to recognize the impairment in the value of its entire fleet, Atlas understated its impairment loss as of December 31, 2001 by at least $281.4 million.

Aircraft Maintenance Expenses

e. Atlas understated its aircraft maintenance expenses during the relevant period for two principal reasons. First, Atlas improperly capitalized and deferred certain repair costs that should have been recognized as expenses in the period in which they were incurred. Second, Atlas improperly calculated the expense incurred under so-called "power by the hour" agreements for long-term engine maintenance services. Specifically, Atlas employed a modified accrual accounting method to recognize its engine maintenance expenses that did not conform to GAAP and that did not properly take into account costs which increased in the later years of the maintenance contracts as the aircraft aged. In addition, the maintenance expense reserves that Atlas established under its modified accrual method were improperly reduced, as Atlas used some of those reserves to record expenses unrelated to aircraft maintenance. Moreover, Atlas failed to maintain records supporting its accounting for aircraft maintenance expenses. For example, Atlas did not maintain supporting documentation for scores of general ledger entries to engine maintenance reserve accounts that offset expenses unrelated to maintenance. Atlas also lacked procedures to prevent or even detect posting errors of this type, as accounting department staff were permitted to post journal entries without any supporting documentation and without first obtaining or recording management's authorization. As a result of these deficiencies, Atlas understated its maintenance expenses as of December 31, 2001 by a cumulative amount of at least $115.4 million.[3]

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[3] The amounts of this misstatement and those presented below in sub-paragraphs 2.f and 2.g are cumulative and reflect the aggregate impact on multiple prior reporting periods because, as noted above, Atlas's serious internal control and recordkeeping deficiencies render it unable to quantify the impact of these errors on specific annual and quarterly reporting periods. The cumulative amounts thus reflect the total estimated impact of these errors throughout 2000, 2001 and any prior affected periods.

Excess And Obsolete Inventory

f. Atlas's inventory was overvalued during the relevant period because Atlas did not properly account for the cost and reduced value of excess and obsolete inventory until the latter part of 2002. Atlas failed to maintain documents accurately reflecting the acquisition, age, average cost and usage of its inventory and lacked adequate systems and procedures for tracking and valuing inventory. For example, the purchase price was recorded haphazardly, if at all, and records documenting the cost, such as invoices, were often missing. Atlas's recordkeeping and internal control deficiencies prevented Atlas from determining when inventory became excess or obsolete. Atlas's inventory consisted largely of spare parts for its aircraft. Under GAAP, the cost of these spare parts, while they are in active use, may be depreciated gradually over the expected useful life of the aircraft for which they were acquired. When spare parts become obsolete, such as when the FAA prohibits their further use, GAAP requires that the cost of the parts must be fully expensed at that time and their value written down to scrap. Atlas failed to do so. When spare parts remain on the shelf for a certain time without being used (*e.g.* 18 months), they are then considered to be excess rather than active inventory and, under GAAP, must be written down to the lower of their cost or market value. Atlas failed to do so. In fact, Atlas had no procedure at all for determining when parts would be regarded as excess inventory for accounting purposes until the latter part of 2002. Due to the foregoing, Atlas did not properly record the expenses associated with excess or obsolete parts and the reported value of Atlas's inventory was therefore inflated. As of December 31, 2001, Atlas overstated the value of its inventory by at least $34.4 million.

Allowance For Doubtful Accounts

g. Atlas understated its bad debt expense during the relevant period because it did not maintain accurate records of its doubtful accounts receivable or implement procedures for tracking and estimating the collectibility of its accounts receivable. Specifically, Atlas failed to put in place a procedure to estimate what percentage of its accounts receivable would not be paid and to establish an appropriate allowance for those accounts. Contrary to GAAP, Atlas carried on its books many accounts receivable at the full amount of the debt owed, without any offsetting reserve, even though the accounts had been outstanding for substantial periods of time and were uncollectible. As a result, Atlas understated its allowance for doubtful accounts as of December 31, 2001 by at least $17.7 million.

Other Internal Control And Recordkeeping Deficiencies

h. In addition to the specific instances described above, there were broader, more systemic deficiencies in Atlas's internal controls and recordkeeping practices. The lack of key accounting records and controls made it impossible to determine, among other things, why certain journal entries were posted to the general ledger or even the identity of the person or persons responsible for making or directing such entries. Employees from outside the accounting department were permitted to make accounting entries without approval from senior management or the accounting department. Journal entry forms, where they existed, often contained nothing more than vague descriptions of the reasons for the entries and were not accompanied by any additional documentation to support the entries. Atlas also lacked proper procedures for the retention and preservation of the accounting documents that were created. In fact, Atlas did not establish a document retention policy until 2003. Some of Atlas's accounting records may have been lost when the company moved its accounting department from Colorado to New York in 2001, and Atlas failed to put in place adequate procedures to track the records during the move and to ensure that they all arrived and could be located in New York.

3. By reason of the foregoing, Atlas violated Sections 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 13a-1, Rule 13a-13 and 12b-20 thereunder.

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

IV.

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

Accordingly, it is hereby ORDERED that Respondent Atlas cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1, 13a-13 thereunder.

By the Commission.

Nancy M. Morris
Secretary

J. Lynn Taylor

By: J. Lynn Taylor
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 55562 / March 30, 2007

Admin. Proc. File No. 3-11909

In the Matter of

PHLO CORPORATION,
JAMES B. HOVIS, and ANNE P. HOVIS

OPINION OF THE COMMISSION

TRANSFER AGENT PROCEEDING

CEASE-AND-DESIST PROCEEDING

SECTION 12(J) PROCEEDING

Grounds for Remedial Action

Failure to Comply with Transfer Agent Turnaround Rule

Failure to Make Records Available for Examination

Failure to Make Timely Periodic Filings

Corporation that issued publicly traded securities and that served as its own transfer agent refused to cancel shares and issue new ones within three business days despite obligation as transfer agent to do so and failed to make records available for examination by Commission staff. Executive vice president of corporation willfully aided and abetted and was a cause of these violations.

Corporation additionally failed to make timely filings of quarterly and annual reports; president and chief executive officer of corporation was a cause of these violations.

Held, it is in the public interest to revoke registration of corporation as transfer agent, to bar executive vice president from associating with any registered transfer agent, to impose cease-and-desist orders, and to impose civil money penalties on executive vice president.

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APPEARANCES:

Anne P. Hovis, pro se and for Phlo Corporation.

Anthony W. Djinis and Peter E. McLeod, of Pickard and Djinis LLP, for James B. Hovis.

Robert K. Levenson and Scott A. Masel, for the Division of Enforcement.

Appeal filed: March 14, 2006
Last brief received: June 5, 2006
Oral argument: January 31, 2007

I.

Phlo Corporation ("Phlo" or the "Company"), a beverage manufacturer and an issuer of publicly traded securities that also acted as transfer agent for its own securities, its president and chief executive officer James B. Hovis ("J. Hovis"), and its executive vice president, secretary, and general counsel Anne P. Hovis ("A. Hovis"; together, "Respondents") appeal from the decision of an administrative law judge. The law judge found that Phlo willfully violated provisions requiring transfer agents to turnaround at least ninety percent of all routine items received in a month within three business days and willfully failed to make records available for examination by Commission staff. The law judge concluded that A. Hovis willfully aided and abetted and was a cause of Phlo's failure to complete transfers in a timely manner and failure to make records available for examination.

The law judge further found that Phlo failed to make timely filings of annual and quarterly reports with the Commission between March 2003 and November 2005. The law judge found that J. Hovis willfully aided and abetted and was a cause of Phlo's violations of the periodic reporting requirements.

The law judge assessed civil money penalties of $100,000 against Phlo, $25,000 against J. Hovis, and $50,000 against A. Hovis, revoked Phlo's registration as a transfer agent, barred A. Hovis from associating with any transfer agent, and imposed cease-and-desist orders as to all Respondents. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

A. Phlo Asserts that It Is Withdrawing Its Certificates from the Depository Trust Company

Processing transactions in securities involves the efforts of various entities, including transfer agents and clearing agencies. A transfer agent is a person who engages, on behalf of an issuer of securities, in (among other things) receiving certificates, cancelling them and issuing new certificates, or transferring record ownership of securities by bookkeeping entry (without physical issuance of securities). 1/ Transfer is accomplished when, in accordance with the presentor's instructions, the transfer agent does everything necessary to cancel the certificate presented for transfer and to issue a new certificate. 2/ Transfer agents are required to register with an appropriate regulatory agency, keep their registration information accurate, maintain certain records, effect transfers promptly, and make records available for examination by the appropriate authority. 3/

The Depository Trust Company ("DTC") is a limited trust company registered with the Commission as a clearing agency and self-regulatory organization. As a clearing agency, DTC is involved in "clearing" trades, i.e., confirming with the parties involved that a trade was executed, and that it was executed in accordance with the directions of the buyer and the seller. 4/ DTC also acts as a depository, holding securities for its participants (broker-dealers and banks) and maintaining ownership records of the securities on its own books. 5/ DTC registers the securities deposited with it in the name of a nominee, Cede & Co., which becomes the registered owner of the securities, while the participants and their customers retain beneficial ownership. 6/ Through its involvement in centralizing and automating securities settlement and reducing the physical movement of publicly traded securities, DTC has served a critical function in the efforts to facilitate the development of a national system for the prompt and accurate clearance and settlement of transactions in securities. 7/

1/ Exchange Act Section 3(a)(25), 15 U.S.C. § 78c(a)(25). See also Exchange Act Rule 17Ad-1(d), 17 C.F.R. § 240.17Ad-1(d) (defining "transfer").

2/ Exchange Act Rule 17Ad-1(d).

3/ Exchange Act Sections 17(a)-(b), 17A(c), 15 U.S.C. §§ 78q(a)-(b), 78q-1(c), and Exchange Act Rules 17Ac2-1, 17Ad-6, 17Ad-7, 17 C.F.R. §§ 240.17Ac2-1, 240.17Ad-6, 240.17Ad-7.

4/ See generally Louis Loss & Joel Seligman, Securities Regulation § 7-E-2 (3d ed. 2002 & supp. 2006). DTC is also involved in "settling" securities transactions, i.e., exchanging securities and payment. Id.

5/ See Order Granting Approval of a Proposed Rule Change Concerning Requests for Withdrawal of Certificates by Issuers, Securities Exchange Act Rel. No. 49798 (June 4, 2003), 80 SEC Docket 1309, 1313 (discussing DTC procedures).

6/ Id.

7/ Id.

Phlo registered with the Commission as a transfer agent in June 2002. American Stock Transfer & Trust Company previously acted as Phlo's transfer agent, but on December 12, 2002, Phlo gave DTC written notice that it would serve as its own transfer agent. 8/ In the same December 12 letter that provided this notice to DTC, A. Hovis asserted that DTC was no longer authorized to act as a trustee or "in any other capacity whatsoever for Phlo Corporation or its securities."

Around June 2003, A. Hovis told DTC that Phlo wanted to withdraw from DTC the securities that it had issued and settle investors' transactions using certificates rather than book entries. 9/ Susan Geigel, DTC's Director of Legal and Regulatory Compliance, told A. Hovis that, in DTC's view, only DTC participants (i.e., broker-dealers or banks) had the legal authority to withdraw securities from DTC, and that Phlo, as an issuer rather than a participant, could not withdraw its securities. However, in a letter dated June 5, 2003, A. Hovis again stated that Phlo was "discontinuing DTC's services as a clearing and settlement agency. Phlo will use a certificate-only clearing mode from this point forward." 10/

By letter dated June 17, 2003, Geigel reiterated that only participants, not issuers, could request withdrawal of securities. The letter enclosed a Commission order dated June 4, 2003 ("Order"), which stated that both DTC's existing rules and the proposed DTC rule that was the subject of the Order obligated and allowed DTC to take instructions only from its participants. 11/ The Order continued: "Since DTC participants and their customers, not issuers, have ownership interest in the securities, DTC participants and their customers have the authority to determine whether to deposit securities with DTC or not. . . . It would not be consistent with

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8/ Phlo has served as transfer agent only for its own securities, and not for any other issuer.

9/ The subject arose during a telephone conversation regarding DTC's uncertainty about Phlo's mailing address. Although in its initial registration form Phlo identified its principal transfer agent offices to be on K Street NW, Washington, D.C., Phlo informed the Commission in August 2002 that it would instead conduct its transfer agent activities principally from Budd Lake, New Jersey. DTC sent several packages to Phlo at the Budd Lake address; they were returned as undeliverable. By correspondence dated May 8 and June 5, 2003, Phlo asked DTC to send requests for transfers of stock certificates to an address in Jacksonville, Florida. Phlo continued, however, to use the Budd Lake address on letterhead stationery as late as August 15, 2003.

10/ The letter further asserted that "[f]rom this date forward, Phlo will honor certificates representing its common stock registered in the name of Cede & Co. only for the purpose of transferring shares represented by such certificates into the names of the actual beneficial holders of the securities."

11/ Order, 80 SEC Docket at 1313.

DTC rules to allow issuers to withdraw securities which they have not deposited at DTC or [in which they] have no ownership interest." 12/

B. Phlo Repeatedly Fails to Act on Transfer Instructions From DTC

When DTC sends a registered transfer agent certificates that are to be cancelled and reissued (whether in the nominee name of a registered clearing agency or in the name of other persons or entities), it provides the instructions on a shipment control list ("SCL"). Each line of instructions on an SCL is defined as a separate "item." 13/

Exchange Act Rule 17Ad-2 (the "turnaround rule") generally requires that registered transfer agents turnaround (or complete), within three business days of receipt, at least ninety percent of all routine items received for transfer during a month. 14/ Exchange Act Rule 17Ad-1(e) states that the "turnaround of an item is complete when transfer is accomplished." 15/ Routine items not turned around within three business days of receipt must be turned around "promptly." 16/ A transfer agent must determine whether an item is routine when the item is reviewed upon receipt, and an otherwise routine item does not become non-routine because of internal delays in turnaround. 17/

12/ Id., 80 SEC Docket at 1314 (footnote omitted). The Order also noted that "actions by some issuers of publicly traded securities to require transfer only by certificate and to restrict ownership of the securities by a depository or financial intermediary could result [in] many of the inefficiencies sought to be avoided when Congress promulgated section 17A of the [Exchange] Act." Consistent with a Congressional directive to end the physical movement of securities certificates in connection with settlement, the Commission encouraged the use of alternatives to holding securities in certificated form "in an effort to improve efficiencies and decrease risks associated with processing securities certificates." Id. (footnotes omitted).

13/ Exchange Act Rule 17Ad-1(a)(1)(ii), 17 C.F.R. § 240.17Ad-1(a)(1)(ii).

14/ Exchange Act Rule 17Ad-2(a), 17 C.F.R. § 240.17Ad-2(a). Items received for transfer are considered routine unless they fall within certain specified exceptions. Exchange Act Rule 17Ad-1(i), 17 C.F.R. § 240.17Ad-1(i).

15/ 17 C.F.R. § 240.17Ad-1(e). See text accompanying note 2, supra, defining transfer.

16/ Rule 17Ad-2(e)(1), 17 C.F.R. § 240.17Ad-2(e)(1).

17/ Regulation of Transfer Agents, Exchange Act Rel. No. 17111 (Sept. 2, 1980), 20 SEC Docket 1277, 1286. Non-routine items must receive "diligent and continuous attention" and must be turned around as quickly as possible. Exchange Act Rule 17Ad-2(e)(1), 17 C.F.R. § 240.17Ad-2(e)(1).

DTC issued Transfer Timeliness Reports to Phlo every two weeks. The Transfer Timeliness Reports showed, among other things, the number of transfers submitted during the period in question and the number of transfers returned within specific time frames (1-5 days, 6-10 days, 11-15 days, 16-30 days). They also showed the number of transfers still outstanding, including those from prior periods. According to these Transfer Timeliness Reports, DTC sent thirty-two SCLs containing a total of fifty-four items to Phlo in June, July, and August 2003: nineteen items in June, twenty-eight in July, and seven in August. The Transfer Timeliness Reports show that Phlo failed to meet the three-day turnaround requirement for any of these items, and Phlo introduced no evidence that it turned around any item within three business days during those months. 18/ The record contains no evidence indicating that Phlo determined that any of these items were non-routine when it received them for transfer.

DTC employees tried on eight separate occasions in July and August 2003 to contact A. Hovis about Phlo's delays in completing the transfers. Although DTC employees repeatedly left messages for A. Hovis, she responded only twice. On July 23, she represented that the delay in the transfers was caused by work on a Form 10-K filing and that she would complete the transfers in question later that week. No Form 10-K was filed during the summer of 2003, however. 19/ On August 22, A. Hovis told DTC that she would try to do some transfers shortly.

In August 2003, Geigel contacted A. Hovis about Phlo's outstanding transfers. A. Hovis stated that she would not transfer securities into the name of Cede & Co., DTC's nominee. Although Geigel stated that DTC had the right under the terms of the Order to have the securities transferred to Cede & Co., A. Hovis refused to make the transfers. Instead, in letters to DTC dated August 21, October 14, and October 16, 2003, A. Hovis asked for instructions to "issue such shares in the names of the beneficial owners thereof," instead of in the name of Cede & Co. 20/ During the fall of 2003, A. Hovis refused Geigel's repeated requests to complete the outstanding transfers, contending that DTC had no legal right to have the securities registered in the name of Cede & Co.

18/ The record includes one SCL, dated June 10, 2003, that does not appear on the Transfer Timeliness Report for the appropriate period. We note, however, that Phlo's October 14, 2003 letter to DTC includes a request for instructions related to that SCL, so it appears that at least some of the transfers requested in the June 10 SCL were still outstanding more than four months later. See text accompanying note 20, infra.

19/ We take official notice that our EDGAR database shows that Phlo did not file any Forms 10-K or 10-Q with the Commission during the summer of 2003. Rule of Practice 323, 17 C.F.R. § 201.323.

20/ These transfers were among the items listed on SCLs sent to Phlo during June, July, and August 2003.

In a letter to A. Hovis dated November 5, 2003, Geigel demanded the return of more than thirty-eight million shares of Phlo Corporation stock that DTC had submitted for registration in the name Cede & Co. Instead, on November 12, 2003, A. Hovis sent Geigel copies of three letters she had previously sent to DTC. Geigel received no other written response from Phlo to the November 5, 2003 letter. Geigel had at least two subsequent conversations with A. Hovis about the outstanding transfers in November or December 2003, in which A. Hovis continued to refuse to return the shares.

C. The Division of Market Regulation Becomes Involved

As these events were occurring, Geigel contacted our Division of Market Regulation ("Market Regulation") for help in resolving DTC's dispute with Phlo. Our staff attempted to contact Phlo and left several messages.

Ultimately, Phlo asked for a conference call, which took place in October 2003. Market Regulation staff explained to Phlo what an SCL was. 21/ The staff also informed A. Hovis that she had certain obligations with respect to the outstanding transfers. The staff tried to give A. Hovis a brief explanation about the scope of certain federal transfer agent rules. A witness testified that A. Hovis started to become "very loud and somewhat irrational" during this part of the conversation. Market Regulation staff also asked A. Hovis for her legal basis for not making the transfers in accordance with the rules. A. Hovis replied that she believed that DTC was facilitating naked short selling and that, by refusing the transfers, Phlo was protecting its shareholders from the naked short selling. 22/ A. Hovis stated that Phlo had no obligation to

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21/ Although Phlo registered with the Commission as a transfer agent in June 2002, a staff witness testified that, at the time of the conference call, A. Hovis did not know what an SCL was, or that there were federal transfer agent rules.

22/ "Naked short sale" is not a defined term under federal securities law. As generally used, a "naked short sale" occurs when a seller sells a security without owning or borrowing it and does not deliver the security when due. Order, 80 SEC Docket at 1314. Market Regulation asked A. Hovis to explain the basis for her statement that DTC was facilitating naked short selling, but A. Hovis did not provide further details.

The Order observes: "[T]he issues surrounding naked short selling are not germane to the manner in which DTC operates as a depository registered as a clearing agency. Decisions to engage in such transactions are made by parties other than DTC. DTC does not allow its participants to establish short positions resulting from their failure to deliver securities at settlement." Order, 80 SEC Docket at 1314.

We adopted Regulation SHO (17 C.F.R. § 242.200 et seq.) to provide a regulatory framework to govern short sales. The regulation imposes a close-out requirement to

(continued...)

effect the transfers requested by DTC and that she would keep the securities sent to Phlo by DTC. 23/

Market Regulation staff informed A. Hovis that, upon instructions from DTC, whose nominee was the registered owner of the securities, Phlo was obligated "under federal and state law to make those transfers." Market Regulation staff urged A. Hovis to "work with DTC to try to reconcile the situation," but A. Hovis continued to insist that she would not effect the transfers. The conversation became more and more irrational as A. Hovis continued to reiterate that she would not make the transfers, but failed to provide any legal basis for her refusal. When Market Regulation staff concluded that their attempts to rectify the situation were not having the desired result, the staff told Phlo that, in accordance with its usual procedure, the staff would refer Phlo to our Office of Compliance Inspections and Examinations ("OCIE").

Before the referral to OCIE, Market Regulation staff telephoned DTC several times to ask whether any of the outstanding transfers had been made. DTC responded that they had not. When the administrative hearing began in September 2005, sixteen of the SCLs that DTC sent to Phlo between June 2003 and August 2003 were still outstanding, involving almost 20.5 million shares of Phlo stock. 24/ A. Hovis admitted at oral argument that some shares had still not been transferred.

22/ (...continued)
address failures to deliver stock on the trade settlement date and to target abusive naked short selling. We continue to propose and adopt regulatory measures. See, e.g., Amendments to Regulation SHO, Exchange Act Rel. No. 54154 (July 14, 2006), 88 SEC Docket 1511 (proposing amendments intended to reduce further failures to deliver).

23/ Respondents assert in their brief that, during the conference call, A. Hovis informed Market Regulation of various complaints Phlo had regarding DTC. Phlo asserts that it complained, among other things, that DTC initially refused to recognize Phlo as a transfer agent, that DTC refused to send Phlo certificates for registration in the name of beneficial owners, and that DTC was facilitating naked short selling. Phlo further asserts that there is no evidence that either Market Regulation or anyone else at the Commission took any steps to investigate or resolve Phlo's concerns about DTC's actions.

Exchange Act Section 21(a)(1), 15 U.S.C. § 78u(a)(1), entrusts the determination whether to investigate to the Commission's discretion. The decision not to prosecute or enforce is also a matter of agency discretion. See, e.g., Heckler v. Chaney, 470 U.S. 821, 831 (1985); Chicago Bd. of Trade v. SEC, 883 F.2d 525, 530 (7th Cir. 1989). Our decision whether to undertake such matters is separate from our disposition of this proceeding.

24/ Although A. Hovis testified that the figures introduced by the Division of Enforcement ("Enforcement") regarding transfers still outstanding at the time of the hearing were incorrect, estimating that "maybe half of what is listed on the form here" had not been completed, Respondents point to no evidence showing that any of the transfers identified as outstanding by Enforcement had been completed.

D. The Request for Documents

In late October 2003, OCIE initiated a cause examination of Phlo. 25/ As the first step in the examination, OCIE staff sent Phlo a document request letter dated October 31, 2003. The letter asked Phlo to provide, among other things, information concerning the number of stock transfers during the last eight months. OCIE also requested certain documents, including an organization chart for Phlo indicating the names and number of Phlo staff engaged in transfer agent activities; copies of any written procedures for Phlo's transfer agent activities; records, journals, and logs that recorded daily transfer activities, including when transfer requests are received, when transfers are processed and effected, and the completion of transfers; and copies of any Phlo internal audit or other management or exception reports submitted to senior management pertaining to transfer agent activities. The letter requested that responsive information or documents be provided "on or before November 7, 2003." The letter was sent to Phlo by both mail and facsimile. 26/

Phlo did not respond. OCIE staff telephoned A. Hovis on November 7 and again on November 10. The staff left messages saying that a response to the document request letter was due and asking A. Hovis to return the call. A. Hovis did not respond. Several days after the November 10th call, OCIE received a telephone message from A. Hovis, confirming that Phlo had received the document request letter and advising that OCIE should expect a telephone call in about two days from Phlo's outside counsel regarding its request.

No one contacted OCIE on Phlo's behalf. OCIE staff again attempted to contact A. Hovis and left a message for Phlo on November 20 and two additional messages on November 24. On November 24, OCIE staff warned that, if Phlo did not contact OCIE by the end of that day, OCIE "would start a proceeding that could result in a revocation of Phlo's transfer agent [status]." A. Hovis called OCIE on November 24 and stated that Phlo had retained outside counsel. By letter dated November 26, 2003, A. Hovis asked OCIE "for a reasonable extension of time (taking into account the holidays) . . . in which to work with legal counsel to respond to your letter and

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25/ OCIE periodically conducts routine examinations of transfer agents. When OCIE has reason to suspect a potential violation, however, it may conduct a cause examination, such as this examination of Phlo.

26/ In a Wells submission dated April 15, 2004, which Respondents submitted to Enforcement shortly before the issuance of the Order Instituting Proceedings ("OIP") and which was attached to their Answer in this proceeding, Respondents admitted that they received the facsimile the day it was sent. Although A. Hovis testified that she did not remember when she received the facsimile, the law judge gave greater weight to the statement contained in the Wells submission, since it was prepared closer in time to the events in question. We concur in his conclusion.

comply with your requests and to address the other issues surrounding your letter." 27/ In a telephone call on December 10, OCIE staff denied A. Hovis's request. 28/

During this conversation, A. Hovis stated that Phlo was performing some of its transfer agent work in Washington, D.C. 29/ OCIE reviewed Phlo's original transfer agent registration form, Form TA-1, which showed an address on K Street NW, Washington, D.C. OCIE paid an unannounced visit to the K Street address on December 12, 2003. Phlo's name did not appear on the directory of tenants of the building, and the office suite listed in the Form TA-1 was locked. An OCIE staff attorney testified that he looked through a small window in the office door and saw office furniture, but no people, signs, or papers. He concluded that the suite "did not appear to be actually used office space." The receptionist of another company in the building told OCIE that the company and Phlo were sharing office space. A Phlo employee, who coincidentally happened to be visiting the shared offices, told OCIE that J. Hovis and A. Hovis were not present and that no examination could be conducted in their absence. The employee contacted A. Hovis. A. Hovis told OCIE that she could not come to the office, nor could she, at that time, provide a date on which OCIE could return and conduct an on-site examination. A. Hovis never contacted OCIE to schedule a date for an examination.

27/ With this letter, A. Hovis enclosed a copy of Phlo's November 25 engagement agreement with outside counsel. The engaged firm never contacted OCIE staff about the document request letter.

The November 26 letter also stated that Phlo had "reached an agreement" with DTC and "is currently processing transfer requests in accordance with such agreement." When OCIE staff contacted DTC in early December 2003 to inquire about the "agreement," DTC stated that no agreement had been reached.

28/ Respondents contend that, although an OCIE attorney told A. Hovis during the December 10 telephone call that Phlo could not have an "open-ended" extension, the staff attorney asked her to provide a date by which Phlo would comply with the document request letter. Phlo appears to argue that this inquiry as to when OCIE could expect a response should be interpreted as an implied agreement that some sort of extension might be possible.

However, the law judge, who heard both the staff attorney and A. Hovis testify, found that OCIE staff told A. Hovis that it would not grant an extension. In the face of such a statement, A. Hovis had no reason to believe that Phlo could nonetheless set its own deadline for responding to the document request. We also note that A. Hovis does not contend that she provided a date for compliance during the telephone conversation.

29/ The record shows that Phlo used various addresses during the period at issue, sometimes using one address as that of its principal executive offices and another address for its transfer agent activities. See note 9, supra. At the time of the conversation, OCIE understood that Phlo was performing transfer agent activities in either New Jersey or Florida.

E. The Division of Enforcement Begins an Investigation

OCIE referred the matter to our Division of Enforcement ("Enforcement"). On December 18, 2003, Enforcement directed Phlo to respond to OCIE's October 31 document request by December 27, 2003. In a letter dated December 30, 2003, A. Hovis stated that "[a]s Phlo's General Counsel, I handle the transfer agent responsibilities," but asserted that it would be "physically impossible" for her to compile the materials sought by OCIE before mid-January. 30/ She requested an extension of time until January 16, 2004 to provide the requested information. Enforcement did not respond to the request for an extension. On January 15 and 16, 2004, A. Hovis provided Enforcement some but not all of the information requested by the staff. 31/ To date, Phlo has not provided the remaining documents.

III.

A. Failure to Complete Transfers in a Timely Manner

Exchange Act Section 17A(d)(1) provides that no registered transfer agent may engage in any activity as transfer agent in contravention of any Commission rule or regulation. 32/ As a registered transfer agent, Phlo was required to comply with the turnaround rule, and turnaround ninety percent of routine items within three business days. 33/ Exchange Act Section 17A(a)(1)(A) states, "The prompt and accurate clearance and settlement of securities transactions, including the transfer of record ownership . . . , are necessary for the protection of investors and persons facilitating transactions by and acting on behalf of investors." 34/ Failure to comply jeopardizes the efficacy of the Congressionally-mandated national system for the

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30/ In her letter, A. Hovis stated that the delay was primarily due to an unexpected loss of child care, and that she had "numerous other duties" in addition to responding to the document request letter.

31/ A. Hovis provided copies of certain requested forms, but provided no records or logs that recorded daily transfer activities. See also notes 40-42, infra, and accompanying text (discussing failure to provide such records). In lieu of the requested organization chart, A. Hovis stated, "I was the official engaged in transfer agent and related activities." A. Hovis did not submit "copies of any Phlo internal audit or other management or exception reports submitted to senior management pertaining to its transfer agent activities," but she stated that there were no documents responsive to this request.

32/ 15 U.S.C. §78q-1(d)(1).

33/ See note 14, supra, and accompanying text.

34/ 15 U.S.C. § 78q-1(a)(1)(A).

prompt and accurate clearance and settlement of transactions in securities. 35/ During June, July, and August 2003, DTC sent Phlo thirty-two SCLs with a total of fifty-four items. 36/ As of September 4, 2003, all of these items were still outstanding, for periods ranging from thirty to eighty-two days.

Phlo asserts that Enforcement did not prove that Phlo failed to turnaround within three business days ninety percent of the routine items that it received. Phlo states that it received other transfer requests directly from brokers and dealers, so that DTC's transfer requests do not equal the entire number of requests that Phlo received. Phlo argues that, because Enforcement presented no evidence as to the total number of routine items that Phlo received, it is impossible to determine whether the items it failed to turnaround constitute ninety percent of the total.

Enforcement had the initial burden of presenting evidence that Phlo violated the turnaround rule. 37/ Enforcement satisfied its burden by introducing, among other evidence, the Transfer Timeliness Reports and the SCLs they summarized, together with related correspondence and testimony. As noted above, that evidence showed that the fifty-four items sent during the summer of 2003 remained outstanding on September 4, 2003. The burden then shifted to Phlo to produce evidence that refuted or rebutted the material introduced by Enforcement. 38/

Phlo was required to keep records that could have demonstrated whether it complied with the turnaround rule. 39/ Exchange Act Rule 17Ad-6(a)(1) requires registered transfer agents to make and keep current a log or other record showing the business days that each item is received and returned. 40/ Rule 17Ad-6(a)(2) requires registered transfer agents to make and keep current

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35/ See also Exchange Act Section 17A(a)(1)(B), 15 U.S.C. §§ 78q-1(a)(1)(B) ("Inefficient procedures for clearance and settlement impose unnecessary costs on investors and persons facilitating transactions by and acting on behalf of investors.").

36/ But see note 18, supra (discussing June 10, 2003 SCL).

37/ 5 U.S.C. § 556(d). See, e.g., David Disner, 52 S.E.C. 1217, 1221 n.15 (1997); Donald T. Sheldon, 51 S.E.C. 59, 77 (1992), aff'd, 45 F.3d 1515 (11th Cir. 1995).

38/ Disner, 52 S.E.C. at 1221 n.15; Sheldon, 51 S.E.C. at 77. Absent such a shift in the burden of proof, Enforcement would be faced with an impossible task; no matter how much evidence the Division presented, a transfer agent could argue that there might be other information somewhere that would prove the Division's evidence to be insufficient.

39/ The OIP did not charge Phlo with failure to maintain the records required by Rules 17Ad-6(a)(1) and (a)(2), and we make no findings as to whether Phlo maintained those records.

40/ 17 C.F.R. § 240.17Ad-6(a)(1). Rule 17Ad-7(a), 17 C.F.R. § 240.17Ad-7(a), requires that (continued...)

a log or other record of the number of routine items received during the month that were turned around within three business days of receipt. 41/

Our staff sought these records from Phlo for a period that included June, July, and August 2003. The October 31, 2003 document request letter asked Phlo to provide, among other things, "records, journals and logs that record daily transfer activities, including when transfer requests are received, when transfers are processed and effected, and the completion of transfers." Enforcement directed Phlo to respond to those requests. Phlo did not provide any of these records. 42/ Nor did Phlo submit any documentary or testimonial evidence to show that it received and acted on transfer instructions from anyone other than DTC during the relevant months, even though information about when Phlo received and turned around items would have been more readily accessible to Phlo than to Enforcement. 43/

Phlo did produce, among the records it provided in January 2004, a document captioned "Phlo Corporation -- Transfer Agent Activity -- Requests for Issuance of Common Stock Certificates" ("Activity Document"). 44/ However, the Activity Document has no entries from the months of June, July, or August 2003; so it does not support the argument that Phlo

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40/ (...continued)
such records be maintained for at least two years, the first six months in an easily accessible place.

41/ 17 C.F.R. § 240.17Ad-6(a)(2). Rule 17Ad-7(b), 17 C.F.R. § 240.17Ad-7(b), requires that such records be maintained for at least two years, the first year in an easily accessible place.

42/ Phlo's ultimate response to the October 31 letter's request for "records, journals and logs that record daily transfer activities" was to submit, in the words of A. Hovis's transmittal letter, "letters from Phlo to DTC regarding the processing of transfer instructions" and "transfer instructions submitted by [DTC] and a number of broker-dealers."

Only two of the letters from Phlo to DTC are dated June, July, or August 2003; neither of these letters indicates that Phlo completed any transfers during that period. None of the transfer instructions from broker-dealers are dated June, July, or August 2003. OCIE staff testified that nothing in Phlo's January 2004 submissions was responsive to this request.

43/ Cf. Disner, 52 S.E.C. at 1221 n.15 (noting that respondents -- president and director of trading of broker-dealer firm -- were in better position than Enforcement to provide documentation that disclosure was made, where Enforcement charged lack of disclosure to customers).

44/ The Activity Document lists shareholder names, certificate numbers, number of shares, and dates, although it is unclear whether the "date" listed is the date of the receipt of the request or the date that the request was acted upon.

completed ninety percent of transfers in a timely manner during the months in question. 45/ Moreover, because the Activity Document shows only one date for each entry, it is not possible to compare dates of receipt and dates of transfer to determine whether any transfer on the list was timely made. The record further contains no transfer instructions from brokers or dealers from June, July, or August 2003.

A. Hovis and Phlo contend "that it was DTC's actions, not Phlo's, which thwarted timely share certificate transfers." They argue that "there is substantial evidence in the record that Phlo repeatedly promised to timely process the transfer requests upon receipt of the information needed." A. Hovis and Phlo cite A. Hovis's letters to DTC of August 21, 2003 and October 14, 2003, which reject DTC instructions to Phlo to issue shares in the name of Cede & Co. and request DTC to provide instructions "so that [Phlo] may issue such shares in the names of the beneficial owners thereof."

Phlo and A. Hovis cannot excuse their failure to comply with the turnaround rule by suggesting that they would have complied with different instructions they sought to require from DTC. DTC and our staff had repeatedly advised Phlo that Phlo could not withdraw from DTC the certificates evidencing Phlo's securities, or refuse DTC's instructions with respect to transferring the securities. Moreover, by the time Phlo sent the August 21 letter to DTC, requesting instructions that would allow Phlo to issue the securities in the names of their beneficial owners, the three-business-day deadline of the turnaround rule had already passed for more than fifty items. By October 14, the date of the second letter, the deadline had passed for all fifty-four of the items.

We therefore find that Phlo willfully violated the turnaround rule 46/ by failing to turnaround at least ninety percent of routine items received within three business days during the

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45/ We additionally observe that, because Phlo failed to satisfy the turnaround rule for all fifty-four items shown on the DTC Transfer Timeliness Reports for the months of June, July, and August 2003, Enforcement's case would fail as to a particular month only if Phlo had timely turned around at least 171 other items in June, 252 other items in July, or sixty-three other items in August. The record does not show that Phlo satisfied the turnaround rule with respect to any items during any of these months.

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

months of June, July, and August 2003. 47/ We further find that by violating the turnaround rule, Phlo willfully violated Section 17A(d)(1).

We also find that A. Hovis willfully aided and abetted and was a cause of Phlo's violations of Section 17A(d)(1) and Exchange Act Rule 17Ad-2. To establish aiding and abetting liability, Enforcement was required to show that (1) Phlo violated those provisions, (2) A. Hovis substantially assisted the violations, and (3) A. Hovis provided that assistance with the requisite scienter. 48/ The scienter requirement may be satisfied by showing that A. Hovis knew of, or recklessly disregarded, the wrongdoing and her role in furthering it. 49/ To establish that A. Hovis was a cause of Phlo's violations, Enforcement was required to show that (1) Phlo committed a primary violation, (2) an act or omission by A. Hovis caused the violation, and (3) A. Hovis knew or should have known that her act or omission would contribute to the violation. 50/

A. Hovis identified herself as "the official [at Phlo] engaged in transfer agent and related activities" in her response to the document request letter. A. Hovis's involvement in Phlo's failure to complete transfers in a timely manner is evident throughout the facts described above.

47/ Phlo contends that our adoption of Exchange Act Rule 17Ad-20, 17 C.F.R. § 240.17Ad-20, demonstrates that Phlo's dispute with DTC did not violate Rule 17Ad-2, the turnaround rule. See Issuer Restrictions or Prohibitions on Ownership by Securities Intermediaries, Exchange Act Rel. No. 50758A (Dec. 7, 2004), 84 SEC Docket 1177 (adopting Rule 17Ad-20). If Phlo's position had violated existing Commission rules, Phlo argues, there would have been no need for the Commission to propose and adopt Rule 17Ad-20.

We reject Phlo's argument. Rule 17Ad-20 prohibits registered transfer agents from transferring certain equity securities if those securities are subject to any restriction or prohibition (imposed, for example, by the issuer) on transfer to or from a securities intermediary (such as DTC) in its capacity as such. The provisions of that rule are not relevant to Phlo's failure to complete the transfer of ninety percent of the routine items that it received each month during the summer of 2003.

48/ See Robert J. Prager, Exchange Act Rel. No. 51974 (July 6, 2005), 85 SEC Docket 3413, 3421 & n.17 (citing additional cases).

49/ See, e.g., Monetta Fin. Servs., Inc. v. SEC, 390 F.3d 952, 956 (7th Cir. 2004); Howard v. SEC, 376 F.3d 1136, 1143, 1149 (D.C. Cir. 2004); Graham v. SEC, 222 F.3d 994, 1000 (D.C. Cir. 2000).

50/ Gateway Int'l Holdings, Inc., Exchange Act Rel. No. 53907 (May 31, 2006), 88 SEC Docket 430, 444; Robert M. Fuller, Exchange Act Rel. No. 48406 (Aug. 25, 2003), 80 SEC Docket 3539, 3545, petition for review denied, 95 Fed. Appx. 361 (D.C. Cir. 2004).

DTC and our staff repeatedly counseled A. Hovis regarding Phlo's obligation to complete transfers in a timely fashion. Thus, the record establishes both her substantial assistance to the violations and her knowledge, or reckless disregard, that her refusal to complete the transfers furthered Phlo's violative conduct. We therefore find that A. Hovis willfully aided and abetted and was a cause of Phlo's violation of the turnaround rule and of Section 17A(d)(1).

B. Failure to Make Records Available for Examination

Exchange Act Section 17(a)(1) requires, among other things, that registered transfer agents make such records as the Commission prescribes by rule and keep such records for prescribed periods. 51/ Exchange Act Section 17(b)(1) provides that "all records" of a registered transfer agent are subject at any time to reasonable investigation by representatives of the Commission as deemed necessary or appropriate in the public interest. 52/

In light of Phlo's repeated refusal to complete transfers, our staff began a cause examination of Phlo. The staff's October 31 document request letter included requests for records that registered transfer agents like Phlo are required by rule to make and keep current -- such as the records showing when transfer requests are received and effected -- and to maintain in a readily accessible place for at least six months. 53/

Phlo did not respond at all by November 7, the deadline in the staff's request. Although OCIE left messages on November 7 and November 10, A. Hovis failed to respond for several days after the November 10th call. Even then, A. Hovis merely left a message stating that Phlo's outside counsel would be contacting OCIE within about two days regarding the letter. In fact, as set forth above, Phlo did not even engage outside counsel until November 25, and no outside counsel ever contacted our staff about the request.

OCIE made further telephone calls but received little response from A. Hovis or Phlo. OCIE denied A. Hovis's request for additional time to respond to the staff's request. While A. Hovis was unavailable when OCIE visited the K Street premises, she failed to propose an alternative time for an examination. When Enforcement notified Phlo that it was beginning an investigation, and directed Phlo to submit the records requested in the October 31 letter by December 27, A. Hovis requested yet another extension, this time until January 16, 2004. Although no extension was granted, A. Hovis waited until January 15 and 16, 2004 before finally

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51/ 15 U.S.C. § 78q(a)(1).

52/ 15 U.S.C. § 78q(b)(1). See also Exchange Act Section 3(a)(37), 15 U.S.C. § 78c(a)(37) ("The term 'records' means accounts, correspondence, memorandums, tapes, discs, papers, books, and other documents or transcribed information of any type, whether expressed in ordinary or machine language.").

53/ See notes 40-41, supra, and accompanying text.

making some of the requested documents available to Commission staff. Thus, Phlo waited some two and a half months after receiving the document request letter before submitting any records at all, although it was required to maintain many of the records sought in a readily accessible place.

Even then, Phlo failed to provide all the requested information (including, most notably, the requested "records, journals, and logs that record daily transfer agent activities"). Moreover, A. Hovis could have responded immediately to some of the staff's requests. As a member of Phlo's senior management responsible for Phlo's transfer agent functions, A. Hovis must have known when she received the October 31 letter that Phlo had no documents responsive to the staff's request for internal audits and that she was the only Phlo official engaged in transfer agent functions. She could have provided this information at once. If Phlo did not maintain certain documents, A. Hovis should have stated that no such documents existed, thus allowing the examination to proceed accordingly. 54/

Phlo argues that it did not fail to make the requested records available because it submitted some records in January 2004. However, Phlo responded only in part after a lengthy delay and only after our staff had warned A. Hovis of the possibility of enforcement action. Persons subject to Commission examination are not at liberty to set their own schedules for responding. We therefore find that Phlo willfully violated Exchange Act Section 17(b)(1).

We further find that A. Hovis willfully aided and abetted Phlo's violations of Section 17(b)(1). 55/ A. Hovis, who acted on Phlo's behalf in responding to the document request letter and in dealing with our staff, rendered substantial assistance to Phlo's violation by her delays in responding and by ultimately submitting incomplete responses. As set forth above, our staff repeatedly attempted to contact A. Hovis as the deadline for the documents arrived and passed. OCIE warned A. Hovis on November 24, 2003 that any further dilatoriness in responding could lead to the commencement of a proceeding that could result in a revocation of Phlo's transfer agent status. Thus, the record fully establishes that A. Hovis acted with knowledge or reckless disregard of Phlo's wrongdoing and her role in furthering it.

By delaying Phlo's response to the document request letter and by ultimately submitting incomplete responses, A. Hovis also was a cause of Phlo's primary violations of Section 17(b)(1). Because A. Hovis had been warned that the delays in responding could result in sanctions against

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54/ See Robert A. Quiel, 53 S.E.C. 165, 168 (1997) (finding NASD rule violation based on failure to cooperate fully with NASD information request where "even if Quiel could not access readily the information that the NASD requested, . . . he failed to explain the deficiencies in his responses or answer as completely as he was able").

55/ See notes 48-49, supra, and accompanying text.

Phlo, she knew that her actions (or failure to act) would contribute to the violations. Thus, we find that A. Hovis was a cause of Phlo's primary violation of Section 17(b)(1). 56/

IV.

A. Phlo's Untimely Periodic Filings

Phlo's common stock is registered with the Commission pursuant to Exchange Act Section 12(g). 57/ At the time of the hearing, quotes for Phlo's common stock were available in The Pink Sheets, LLC. J. Hovis is Phlo's president, chief executive officer ("CEO"), and a director.

Between March 2003 and November 2005, Phlo failed to file timely three annual and eight quarterly reports with the Commission. When Phlo filed these reports, they were between two weeks and approximately twenty months late. Of the eleven filings at issue, six were filed more than one year late. 58/ Phlo was a very small company and J. Hovis was the sole signatory of these periodic reports. 59/

During the period between March 2003 and November 2005, Phlo successively retained four auditors. Phlo discharged the first of these auditors (who had been retained initially in January 1999) on July 2, 2003, in connection with a billing dispute. In July 2003, Phlo retained a second auditor, which it discharged in April 2004. During its nine-month engagement, this auditor did not issue any reports on Phlo's financial statements. 60/

56/ See note 50, supra, and accompanying text.

57/ 15 U.S.C. § 78l(g).

58/ The opinion has an Appendix showing these filings, including date due and date filed.

59/ Phlo's Forms 10-K for the fiscal years ended March 31, 2003, March 31, 2004, and March 31, 2005 represent that Phlo had no employees as of March 31, 2003 (it "utilize[d] the staff of its corporate affiliates to assist in the execution of [its] business plan") and only two employees as of both March 31, 2004 and March 31, 2005. Although it appears that more than two people worked for Phlo during this period – A. Hovis and J. Hovis plus the employee present when OCIE staff went to the K Street address, see supra -- the company appears to have been quite small during the entire period in question.

60/ J. Hovis testified that the previous auditor refused to transmit data and records for the audit period it was last involved in, so that the auditor hired in July 2003 "had to audit two years."

Phlo retained its third auditor in April 2004. This auditor issued a report on December 30, 2004 as to financial statements filed with Phlo's Form 10-KSB for the fiscal year ended March 31, 2003, which was filed with the Commission on January 4, 2005, more than eighteen months after its due date of June 30, 2003. The parties stipulated that, during its engagement, the third auditor "always lacked a sense of urgency"; there were "months of inactivity," and the auditor "continually missed deadlines." Phlo's relationship with this auditor ended in March 2005. In April 2005, Phlo engaged a fourth auditor; this relationship continued through the ensuing months as Phlo became current with respect to its periodic filing obligations. Phlo also retained an independent consultant recommended by the fourth auditor to assist in preparing its accounting books and records.

During the first eleven months of 2005, Phlo filed three annual reports on Form 10-KSB and eight quarterly reports on Form 10-QSB. None of these reports was timely. Phlo's Form 10-QSB for the quarter ended December 31, 2005 was, however, timely filed, as were its subsequent filings through its Form 10-QSB for the quarter ended September 30, 2006. 61/ Phlo is now current in its Exchange Act reporting.

B. Filing Untimely Periodic Reports

Exchange Act Section 13(a) requires, in relevant part, that issuers of securities registered with the Commission pursuant to Section 12 file with the Commission annual and quarterly reports in accordance with Commission rules. 62/ Exchange Act Rules 13a-1 and 13a-13 require that these issuers file annual and quarterly reports respectively. 63/

Respondents stipulated that the filings at issue were not timely. Liability under Section 13(a) and Rules 13a-1 and 13a-13 does not require a finding of scienter. 64/ The finding that Phlo failed to make the required filings in a timely fashion establishes the violations charged, and Phlo does not challenge the law judge's finding that it violated the reporting provisions. We therefore find that Phlo violated Section 13(a) and Rules 13a-1 and 13a-13.

61/ We take official notice of Phlo's recent filings. See supra n.19. Although Phlo's Form 10-QSB for the quarter ended December 31, 2006 was not timely filed, it was filed only a few days late.

62/ 15 U.S.C. § 78m(a).

63/ 17 C.F.R. §§ 240.13a-1 and 240.13a-13.

64/ See Ponce v. SEC, 345 F.3d 722, 737 n.10 (9th Cir. 2003); SEC v. McNulty, 137 F.3d 732, 740-41 (2d Cir. 1998); SEC v. Wills, 472 F. Supp. 1250, 1268 (D.D.C. 1978).

We next consider whether J. Hovis was a cause of Phlo's violations of Section 13(a) and Rules 13a-1 and 13a-13. 65/ J. Hovis admitted that he was responsible for the overall management of Phlo as an issuer. Respondents do not argue that any Phlo official other than J. Hovis was responsible for Phlo's periodic reporting obligations. As CEO, J. Hovis signed Phlo's quarterly and annual reports. J. Hovis admitted that he had known since Phlo became a registered issuer that Phlo had an obligation to make periodic filings with the Commission. J. Hovis failed to retain and monitor the services of effective auditors who would prepare the required reports for submission in a timely fashion and otherwise failed to ensure that Phlo's periodic reports were timely filed. Those failures caused Phlo's primary violations of Section 13(a) and Rules 13a-1 and 13a-13. J. Hovis knew of the obligation to file timely reports. He knew or should have known that his failure to arrange for Phlo's auditors to complete their work in a timely fashion and for the periodic reports to be otherwise finished would contribute to the violation.

J. Hovis contends that he "made every effort" to prevent Phlo from failing to make timely filings and to cause Phlo to become current in its filings. The record does not support this characterization of J. Hovis's conduct. Although J. Hovis and A. Hovis testified about their dissatisfaction with the various auditors retained during the period in question, their testimony does not show that J. Hovis actively attempted to get the auditors to conclude their work or to retain auditors who would perform on a timely basis. To the extent the auditors were lackadaisical in the performance of their duties, J. Hovis appears to have tolerated their lack of zeal for lengthy periods. For example, Respondents and Enforcement stipulated that "there were months of inactivity" by one auditor. Because J. Hovis was responsible for seeing that Phlo's filings were timely, his toleration of "months of inactivity" by the auditor contradicts the assertion that he "made every effort" to see that the filings were timely. Moreover, the fact that Phlo eventually cleared up its backlog of overdue filings does not cure its earlier violations, nor does it absolve J. Hovis of liability for causing those violations. Thus, we find that J. Hovis was a cause of Phlo's violations of Section 13(a) and Rules 13a-1 and 13a-13. 66/

65/ See note 50 supra and accompanying text.

66/ See Gateway Int'l Holdings, Inc., 88 SEC Docket at 445 (finding "causing" liability for Section 13(a) and Rules 13a-1 and 13a-13 violations by president and CEO). At oral argument, counsel for J. Hovis argued that J. Hovis could not be held liable for being a cause of Phlo's violations of Section 13(a) and Rules 13a-1 and 13a-13 because J. Hovis did not, as the respondent in Gateway did, make a "conscious decision to disregard the issuer's reporting obligations" and did not, as the respondent in Gateway did, have the ability to obtain certain information necessary to perform audits required for annual reports. The fact that the specifics of J. Hovis's conduct are not identical to those present in Gateway is irrelevant. Applying the same standard we used in Gateway to J. Hovis's conduct, we find, as discussed above, that J. Hovis engaged in acts and omissions that he knew or should have known would result in Phlo's reporting violations and therefore was

(continued...)

V.

During the proceeding, Respondents asked the law judge to withdraw due to alleged personal bias. In their motion, Respondents complained of various findings and rulings by the law judge, most notably with respect to their request to postpone a scheduled hearing date. The law judge denied the motion to withdraw. On appeal, Respondents argue that the law judge should have withdrawn. Respondents additionally argue that the law judge's conduct subsequent to the denial of the motion to withdraw further supports a finding of bias.

We find no bias in the law judge's rulings in this proceeding. Even if there were such bias, bias by a hearing officer is disqualifying only when it stems from an extrajudicial source and results in a decision on the merits based on matters other than those gleaned from participation in a case. 67/ Neither of these factors is present here. We therefore find that recusal is unwarranted.

VI.

A. Revocation and Bar

Exchange Act Sections 17A(c)(3)(A) and 17A(c)(4)(C) respectively allow us, among other things, to revoke the registration of a transfer agent and to bar any person from becoming associated with a transfer agent. 68/ We may take such action if we determine that the transfer agent or associated person has willfully violated the Exchange Act or the rules and regulations thereunder or aided and abetted such violation, and that such action is in the public interest. 69/

We have already found willful violations of the Exchange Act and transfer agent rules by Phlo, violations that A. Hovis willfully aided and abetted. In determining whether a sanction is in the public interest, we consider the factors articulated in Steadman v. SEC. 70/ These factors include the egregiousness of the actions at issue, the isolated or recurrent nature of the infraction

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66/ (...continued)
a cause of those violations. Because we find that J. Hovis was a cause of those violations, however, we do not reach the allegation that he willfully aided and abetted the violations.

67/ United States v. Grinnell Corp., 384 U.S. 563, 583 (1966).

68/ 15 U.S.C. §§ 78q-1(c)(3)(A), 78q-1(c)(4)(C).

69/ Exchange Act Sections 15(b)(4)(D), 15 U.S.C. § 78o(b)(4)(D), 15(b)(4)(E), 15 U.S.C. § 78o(b)(4)(E), 15(c)(3)(A), 15 U.S.C. § 78q-1(c)(3)(A).

70/ 603 F.2d 1126, 1140 (5th Cir. 1979), aff'd on other grounds, 450 U.S. 91 (1981).

at issue, the degree of scienter involved, the recognition of the wrongful nature of the conduct and the sincerity of any assurances against future violations, and the likelihood that a respondent's occupation will present opportunities for future violations. 71/

The infractions of the turnaround rule and of the requirement to make records available for examination were egregious, recurrent, and prolonged. Phlo did not comply with the turnaround rule during the three months at issue and affirmatively opposed repeated requests from DTC for compliance. At the time of the oral argument in this proceeding, Phlo had still not completed all the transfers. Phlo did not make any records available for examination for more than two months after a response to the October 31 document request letter was due, and even then, not all of the requested documents were made available. The degree of scienter was knowing and intentional, or, at least, highly reckless.

With respect to the turnaround rule, A. Hovis, who acted for Phlo in this regard, refused to complete transfers despite repeated warnings that her basis for doing so was untenable. A. Hovis knew that the records requested were long overdue but failed to make responding to the examination request a priority. There is little, if any, recognition of the wrongfulness of the conduct or assurance against future violations. A. Hovis continues to contend that Phlo's response to the document request letter was reasonable and to blame DTC for Phlo's failure to make timely transfers. This attitude demonstrates a lack of understanding of the duty of a transfer agent to comply with regulatory directives and inquiries. Phlo continued to serve as a transfer agent for its own shares until January 2007. Although A. Hovis represented at oral argument that Phlo had retained a new transfer agent, the possibility exists that Phlo or A. Hovis may decide in future to resume its functions as or with a transfer agent. Thus, there is an opportunity for future violations.

Based on the Steadman factors, we find it in the public interest to revoke Phlo's registration as a transfer agent and to bar A. Hovis from association with a transfer agent.

B. Cease-and-Desist Orders

Exchange Act Section 21C(a) authorizes the Commission to impose a cease-and-desist order upon any person who "is violating, has violated, or is about to violate" any provision of the Exchange Act or any rule or regulation thereunder, or against any person who "is, was, or would be a cause of [a] violation, due to an act or omission the person knew or should have known would contribute to such violation." 72/ In determining whether a cease-and-desist order is an

71/ Id.

72/ 15 U.S.C. § 78u-3(a).

appropriate sanction, we analyze the risk of future violations. 73/ The existence of a violation raises an inference that the violation will be repeated, and where the misconduct that results in the violation is egregious, the inference is justified. 74/ We also consider whether other factors demonstrate a risk of future violations. Beyond the seriousness of the violation, these may include the isolated or recurrent nature of the violation, whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, the respondent's state of mind, the sincerity of assurances against future violations, the opportunity to commit future violations, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions sought in the proceeding. 75/ Not all of these factors need to be considered, and none of them, by itself, is dispositive.

All of the violations we have found in this proceeding -- the violation of the turnaround rule, the failure to make records available for examination, and the periodic reporting violations -- are serious. The violation of the turnaround rule delayed the receipt by DTC's nominee and investors of shares they owned for a period of time; it also interfered with the efficacy of the national clearance and settlement system. The failure to make records available impeded the staff's examination. 76/ The failure to timely file periodic reports deprived the investing public of information necessary for a full understanding of Phlo's financial situation for more than two years. As discussed above, all of the violations lasted for extended periods, ranging from months in the case of the failure to provide documents to years in the case of failure to make timely periodic filings. These violations were recent. With respect to the transfer agent violations, the degree of scienter was extremely high. The opportunity to commit future violations of the reporting requirements continues. Although we are ordering revocation of transfer agent status, an associational bar, and the payment of civil penalties, Phlo continues to function as an issuer, and the issuance of cease-and-desist orders should serve the remedial

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73/ KPMG Peat Marwick, 54 S.E.C. 1135, 1185 (2001), reconsideration denied, 55 S.E.C. 1 (2001), petition for review denied, 289 F.3d 109 (D.C. Cir. 2002).

74/ See Geiger v. SEC, 363 F.3d 481, 489 (D.C. Cir. 2004) and cases cited therein.

75/ KPMG Peat Marwick, 54 S.E.C. at 1192.

76/ See Recordkeeping Requirements for Transfer Agents, Exchange Act Rel. No. 44227 (Apr. 27, 2001), 74 SEC Docket 2281, 2282 (Commission oversight of transfer agents is substantially dependent on transfer agent examination process, which, in turn, relies on records that transfer agents make and retain); Schield Mgmt. Co., Exchange Act Rel. No. 53201 (Jan. 31, 2006), 87 SEC Docket at 848, 865 (recognizing that deliberately thwarting a Commission examination may undermine the regulatory system). See also Michael Markowski, 51 S.E.C. 553, 559-60 (1993) (stating that NASD member firm's or associated person's refusal to supply requested information seriously undermines NASD's ability to carry out self-regulatory functions; "Meaningful sanctions are warranted for a violation of this nature."), aff'd, 34 F.3d 99 (2d Cir. 1994).

purpose of encouraging Phlo and A. Hovis to take their responsibilities more seriously in their future dealings with the clearance and transfer systems and the Commission. 77/

We find that the record as a whole, especially the evidence with regard to the seriousness, recentness, and recurrent nature of the violations, the harm to the marketplace and the regulatory scheme, and the very high degree of scienter, establishes a sufficient risk that Respondents would commit future violations to warrant imposition of cease-and-desist orders. Based on all of these factors, we find cease-and-desist orders against Respondents to be in the public interest.

C. Civil Penalties

Under Exchange Act Section 21B, we may impose civil money penalties in a proceeding instituted under Exchange Act Section 17A when a respondent has willfully violated, or willfully aided and abetted the violation of, any provision of the Exchange Act or the rules and regulations thereunder, and such penalties are in the public interest. 78/ In determining whether a penalty is in the public interest, the statute provides that we may consider (1) whether the violation involved deliberate or reckless disregard of a regulatory requirement, (2) the resulting harm to other persons, (3) any unjust enrichment, (4) the respondent's or respondents' prior regulatory record, (5) the need to deter the respondent or respondents and other persons, and (6) such other matters as justice may require. 79/

If we determine that the imposition of a civil penalty is in the public interest, a three-tier system establishes the maximum civil money penalty that may be imposed for each violation found. 80/ For each act or omission involving deliberate or reckless disregard of a regulatory requirement, a second-tier civil penalty may be warranted. 81/ The statutory maximum amount that may be imposed as a second-tier penalty against a corporation is $300,000 for each act or omission occurring after February 2, 2001 but before February 15, 2005; against an individual, the maximum second-tier penalty that may be imposed for each such act or omission is

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77/ See McCurdy v. SEC, 396 F.3d 1258, 1265 (D.C. Cir. 2005) (recognizing that order suspending auditor from practice before the Commission for one year had remedial purpose of encouraging more rigorous compliance with generally accepted auditing standards in future).

78/ 15 U.S.C. § 78u-2.

79/ Exchange Act Section 21B(c), 15 U.S.C. § 78u-2(c).

80/ Exchange Act Section 21B(b), 15 U.S.C. § 78u-2(b).

81/ Exchange Act Section 21B(b)(2), 15 U.S.C. § 78u-2(b)(2).

$60,000. 82/ Within this statutory framework, we have discretion in setting the amount of penalty.

We consider first whether civil penalties should be imposed against A. Hovis. A. Hovis aided, abetted, and was a cause of Phlo's violation of the turnaround rule and failure to make records available for examination. Her conduct constituted deliberate disregard of regulatory requirements. A. Hovis refused to complete transfers, delayed making records available for examination, and belatedly submitted less than wholly responsive records. The administrative record does not quantify any harm done by the violations, although it is likely that the failure to complete transfers, in some cases for months, may have harmed investors by impeding their intended transactions, as well as disruption of the clearance and settlement process. We have held previously that the failure to cooperate with an examination is serious misconduct that justifies strong sanctions because of its potential to thwart the protection of shareholders and market participants. 83/

There is also a strong need for deterrence. Persons associated with issuers who decide to serve as transfer agents for their own securities must understand that they and the issuers are required to conform to statutory and regulatory requirements associated with that status, and persons subject to our oversight must understand that they have a duty to make records available for examination.

For the reasons set forth above, we find that civil penalties in the total amount of $100,000 against A. Hovis are appropriate. 84/ This represents second-tier penalties of $25,000

82/ See Debt Collection Improvement Act of 1996, Pub. L. 104-134, title III, §31001; 17 C.F.R. § 201.1001.

83/ Schield Mgmt. Co., 87 SEC Docket at 862 & n.48 (citing Barr Fin. Group, Inc., Investment Advisers Act Rel. No. 2179 (Oct. 2, 2003), 81 SEC Docket 828, 843)).

84/ We reach this conclusion even though there is no evidence that unjust enrichment resulted from the violations and even though A. Hovis does not have a history of regulatory violations.

Respondents contend that lesser penalties have been imposed in settled cases, and that these cases should be considered here because Respondents would willingly have settled the proceeding. Because the rationale for the imposition of lower sanctions in settled proceedings is, at least in part, that settlement lets the Commission avoid time-consuming adversary proceedings and the concomitant expenditure of staff resources, Respondents argue that their willingness to settle should entitle them to similar consideration. We reject Respondents' argument. The proffered settlement offers were not accepted, and settlement negotiations are not part of the administrative record. Rule of Practice 240(6),

(continued...)

for each month in which she aided and abetted Phlo's violation of the turnaround rule and $25,000 for her aiding and abetting Phlo's failure to respond in a timely fashion to the Commission's examination. 85/

Phlo argues that, as "a company that is developing technology prior to the maturing of revenue associated therewith," it is unable to pay a civil penalty. Phlo notes that its annual report on Form 10-K for the fiscal year ended March 31, 2005 showed net losses of nearly three million dollars and no revenues. We take official notice that Phlo's Form 10-K for the fiscal year ended March 31, 2006 shows a similar situation, with revenues of only $1,544 and net losses slightly higher than in the previous year. With respect to the financial statements for both of these years, auditors opined that Phlo's "recurring losses from operations and . . . difficulty in generating sufficient cash flow to meet [its] obligations and sustain its operations" raised substantial doubt about Phlo's ability to continue as a going concern. Under Exchange Act Section 21B(d), 86/ the Commission may in its discretion consider such evidence in determining whether a civil penalty is in the public interest. Thus, although Phlo's conduct warrants a second-tier penalty, under the circumstances of this case, we find that the imposition of a penalty is not in the public interest.

Section 21B gives us the authority to impose civil penalties in administrative proceedings instituted pursuant to Exchange Act 17A but not those instituted pursuant to Sections 12(j) or 21C. This proceeding was brought pursuant to Sections 12(j), 17A, and Section 21C. The law judge found that J. Hovis was an associated person of the transfer agent and imposed a civil money penalty. However, because the violations that J. Hovis was found to have aided and abetted were charged in the OIP only under Sections 12(j) and 21C, under the circumstances presented, we do not impose a civil penalty upon J. Hovis. For the same reason, we do not impose a civil penalty against Phlo for its reporting violations.

84/ (...continued)
17 C.F.R. § 201.240(6). The penalties we impose are based on Respondents' conduct as established by the record.

85/ We note that the statutory scheme would have allowed the imposition of much higher penalties for second-tier violations such as these. See 17 C.F.R. §201.1002. A. Hovis states that she did not receive a salary from Phlo in the fiscal years ending March 31, 2004 and March 31, 2005, but she has not submitted evidence of her overall inability to pay a civil penalty.

86/ 15 U.S.C. § 78u-2(d).

D. Revocation of Registration of Phlo's Common Stock

Enforcement asks us to revoke the registration of Phlo's common stock. 87/ Under Exchange Act Section 12(j), the Commission is authorized, "as it deems necessary or appropriate for the protection of investors," to revoke the registration of a security or suspend the registration of a security for a period not exceeding twelve months if it finds, after notice and an opportunity for hearing, that the issuer of the security has failed to comply with any provision of the Exchange Act or the rules thereunder. 88/ In determining what sanctions will ensure that investors will be adequately protected, we consider the effect on the investing public of both the issuer's violations and the Section 12(j) sanctions. 89/ In making this determination, we consider, among other things, the seriousness of the issuer's violations, the isolated or recurrent nature of the violations, the degree of culpability involved, and the extent of the issuer's efforts to remedy its past violations and ensure future compliance. 90/

Phlo's violation of its reporting obligations was serious, egregious, and recurrent. Phlo, through its CEO J. Hovis, knew of its reporting obligations, yet failed to file a total of eleven annual and quarterly reports between March 2003 and November 2005. However, Phlo has now devoted significant resources to satisfying its reporting obligations and has become current with

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87/ We deny Phlo's motion to strike the portion of Enforcement's brief urging revocation. In a previous order, we determined to review sanctions in this proceeding on our own initiative pursuant to Rule of Practice 411(c), 17 C.F.R. § 201.411(c). Order Granting Petition for Review (Mar. 17, 2006). Thus, Enforcement's briefing of this issue was not improper.

88/ 15 U.S.C. § 78*l*(j).

89/ Gateway Int'l Holdings, Inc., 88 SEC Docket at 438-39.

90/ Id. at 439.

respect to its periodic filing obligations. Moreover, Phlo has retained a consultant recommended by its current auditor to improve its internal accounting function. We have imposed a cease-and-desist order against future violations. Thus, we decline to revoke the registration of Phlo's common stock. 91/

An appropriate order will issue. 92/

By the Commission (Chairman COX and Commissioners ATKINS, CAMPOS, NAZARETH and CASEY).

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

91/ Compare id. at 439-40 (revoking registration of common stock where, in addition to failure to file a total of seven periodic reports, record showed that issuer was not current with respect to filing obligations, issuer had not addressed an outstanding deficiency in one overdue report that it had filed, and issuer had made insufficient efforts to ensure future compliance with periodic reporting requirements).

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.

APPENDIX

The following chart summarizes Phlo's history of untimely filings between March 2003 and November 2005:

Period ended	Form	Due Date	Date Filed	How Late
3/31/03	10-KSB	6/30/03	1/04/05	18 months +
6/30/03	10-QSB	8/14/03	4/18/05	20 months +
9/30/03	10-QSB	11/14/03	4/25/05	17 months +
12/31/03	10-QSB	2/16/04	5/02/05	15 months +
3/31/04	10-KSB	6/29/04	7/08/05	12 months +
6/30/04	10-QSB	8/16/04	9/23/05	13 months +
9/30/04	10-QSB	11/15/04	10/05/05	10 months +
12/31/04	10-QSB	2/14/05	10/12/05	8 months
3/31/05	10-KSB	6/29/05	11/15/05	4 months +
6/30/05	10-QSB	8/15/05	11/28/05	3 months +
9/30/05	10-QSB	11/14/05	11/29/05	2 weeks

UNITED STATES OF AMERICA

before the

SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934

Rel. No. 55562 / March 30, 2007

Admin. Proc. File No. 3-11909

In the Matter of

PHLO CORPORATION,

JAMES B. HOVIS, and ANNE P. HOVIS

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day it is

ORDERED that the registration of Phlo Corporation as a transfer agent be, and it hereby is, revoked; and it is further

ORDERED that Anne P. Hovis be, and she hereby is, barred from associating with any registered transfer agent; and it is further

ORDERED that Phlo Corporation cease and desist from committing or being a cause of any violations or future violations of Sections 13(a), 17A(d)(1), and 17(b)(1) of the Securities Exchange Act of 1934 and Rules 13a-1, 13a-13, and 17Ad-2 thereunder; and it is further

ORDERED that James B. Hovis cease and desist from being a cause of any violations or future violations of Section 13(a) of the Securities Exchange Act of 1934 and Rules 13a-1, 13a-13 thereunder; and it is further

ORDERED that Anne P. Hovis cease and desist from committing or being a cause of any violations or future violations of Sections 17A(d)(1) and 17(b)(1) of the Securities Exchange Act of 1934 and Rule 17Ad-2 thereunder; and it is further

ORDERED that Anne P. Hovis pay civil money penalties of $100,000.

Payment of the civil money penalties shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed or delivered by hand to the Office of Financial Management, Securities and Exchange Commission, Operations Center, 6432 General Green Way, Alexandria, VA 22312; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

A copy of the cover letter and check shall be sent to Scott A. Masel, Division of Enforcement, Southeast Regional Office, Securities and Exchange Commission, 801 Brickell Ave., Suite 1800, Miami, FL 33131.

By the Commission.

Nancy M. Morris
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary