SECURITIES AND EXCHANGE COMMISSION

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

MARY L. SCHAPIRO, CHAIRMAN

KATHLEEN L. CASEY, COMMISSIONER

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR

TROY A. PAREDES

38 Documents

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9078 / November 4, 2009

SECURITIES EXCHANGE ACT OF 1934
Release No. 60928 / November 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13673

In the Matter of

J.P. MORGAN SECURITIES INC.

Respondent.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, AND SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), and Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against J.P. Morgan Securities Inc. ("J.P. Morgan Securities" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

SUMMARY

1. This case involves payments by a national broker-dealer to local firms whose principals or employees were friends of Jefferson County, Alabama public officials in connection with $5 billion in County bond underwriting and interest rate swap agreement business awarded to the broker-dealer. J.P. Morgan Securities Inc. and two of its managing directors, Charles LeCroy and Douglas MacFaddin, agreed at the direction of certain County commissioners to pay more than $8.2 million in 2002 and 2003 to, in most instances, local broker-dealers. The County officials were instrumental in selecting J.P. Morgan Securities as the underwriter, and its affiliated commercial bank as the swap provider, on County transactions. The broker-dealers had no official role in the transactions and performed few, if any services.

2. J.P. Morgan Securities, LeCroy, and MacFaddin did not disclose any of the payments or the conflicts of interest raised by the agreements with individual commissioners in the swap agreement confirmations or the bond offering documents. J.P. Morgan Securities incorporated certain of the costs of these payments into higher swap interest rates it charged the County, directly increasing the swap transaction costs to the County and its taxpayers. By engaging in the conduct described above and more fully below, J.P. Morgan Securities violated Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933 ("Securities Act"), Section 15B(c)(1) of the Securities Exchange Act of 1934 ("Exchange Act"), and Municipal Securities Rulemaking Board ("MSRB") Rule G-17.

RESPONDENT

3. J.P. Morgan Securities is a Delaware corporation with its principal place of business in New York, New York. It has been registered with the Commission as a broker-dealer since 1985 and is also a registered municipal securities broker-dealer. From 2001 to 2003, J.P. Morgan Securities managed or co-managed seven County sewer bond underwritings, of which three are at issue in this complaint. Its affiliated commercial bank entered into eight interest rate swap agreements with the County, of which three are at issue in this complaint.

OTHER RELATED INDIVDUALS

4. LeCroy, 55, of Winter Park, Florida, joined J.P. Morgan Securities as a vice president in March 1999. He was subsequently promoted to Managing Director of J.P. Morgan Securities' Southeast Regional office in Orlando. LeCroy left the firm in March 2004. He held Series 7, 24, 53 and 63 securities licenses.

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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.

5. MacFaddin, 48, of Cos Cob, Connecticut, served as Managing Director and head of J.P. Morgan Securities' Municipal Derivatives Desk from 2001 until March 2008. He holds Series 7, 24, 53 and 63 securities licenses.

FACTS

A. County Sewer Bond Offerings And Swap Agreements

6. Jefferson County's sewer revenue bond offerings began in the 1990s pursuant to a consent decree with the U.S. Environmental Protection Agency and the U.S. Department of Justice to renovate the County's sewer system. To help fund the improvements, the County commission approved issuing more than $3 billion in auction, variable and fixed interest rate bonds between 2001 and 2003. J.P. Morgan Securities served as lead underwriter for the majority of the auction and variable rate debt.

7. In connection with the bond offerings, the County entered into 18 swap agreements, with a notional amount of $5.6 billion. An interest rate swap agreement is an agreement between two parties to exchange interest payments on a specified principal amount (referred to as the notional amount) for a specified period of time. J.P. Morgan Securities' affiliated commercial bank served as the largest provider for interest rate swap agreements in 2002 and 2003.

8. This matter concerns conduct and payments in connection with three County bond offerings and three security-based swap agreements between October 2002 and November 2003.

9. The three bond offerings, with a total par value of about $3 billion, are: (1) an $839 million sewer bond offering that closed on October 24, 2002 ("the 2002-C bonds"); (2) a $1.1 billion sewer bond offering that closed on May 1, 2003 ("the 2003-B bonds"); and (3) a $1.05 billion sewer bond offering that closed on August 7, 2003 ("the 2003-C bonds").

10. The three swap agreements, with a notional amount of about $2 billion, are: (1) a $1.1 billion swap agreement executed in connection with the 2003-B bonds ("the 2003-B swap agreement"); (2) a $789 million swap agreement executed in connection with the 2003-C bonds ("the 2003-C swap agreement"); and (3) a $111 million swap agreement executed on November 7, 2003 with an effective date of May 1, 2004 ("the November 2003 swap agreement").

B. The 2002-C Bonds

11. In March 2002, as J.P. Morgan Securities was vying with many firms for the County's next proposed sewer bond deal, LeCroy devised a new plan to earn the County's business. In e-mails, LeCroy described a rival firm's purportedly successful tactic for winning municipal finance business of paying small local firms in unrelated transactions to enlist those firms' political support for the County hiring the rival firm.

12. In the e-mails, LeCroy suggested that J.P. Morgan Securities pay two small local broker-dealers, Gardnyr Michael Capital and ABI Capital Management. LeCroy wrote that the

firms each had a close relationship with a County commissioner and could help win the support of the commissioners. He estimated the typical payments would be $5,000 to $25,000 per deal.

13. As discussed in more detail throughout this order, J.P. Morgan Securities made a series of payments to local firms whose principals or employees were close friends of certain County commissioners, but that were unable to participate as auction rate underwriters, or as swap providers under Alabama law. J.P. Morgan Securities did not disclose the payments in the official transaction documents. Far from the $5,000 to $25,000 originally discussed, the payments wound up running into the millions of dollars and cost the County because J.P. Morgan Securities incorporated certain of them into the cost of the swap transactions, even though the firms performed virtually no services for the County.

14. In July 2002, LeCroy and MacFaddin solicited the County on behalf of J.P. Morgan Securities for a $1.4 billion sewer bond deal. LeCroy and MacFaddin knew several County commissioners wanted to complete the transaction before November, when two commissioners would leave office and lose their ability to funnel payments to their supporters' firms. As a result, LeCroy, MacFaddin, and J.P. Morgan Securities specifically targeted their efforts at two commissioners who had just lost primary elections and would leave office in November.

15. On July 15, LeCroy told MacFaddin in a telephone conversation about his efforts to persuade the two commissioners to select J.P. Morgan Securities for the deal. He discussed beating out a rival firm by agreeing J.P. Morgan Securities would pay Gardnyr Michael and ABI Capital, whom one of the commissioners had directed them to pay in order to win his support for J.P. Morgan Securities.

16. Ultimately, the County selected J.P. Morgan Securities as underwriter on the 2002-C transaction, which was an $839 million deal that used a combination of auction rate bonds and interest rate swap agreements. Neither Gardnyr Michael nor ABI Capital had the ability to underwrite the 2002-C auction rate bonds or serve as an interest rate swap provider under Alabama law.

17. Nevertheless, LeCroy and MacFaddin arranged for J.P. Morgan Securities to pay Gardnyr Michael and ABI Capital on this transaction at the direction of a commissioner. On October 28, 2002, five days after the 2002-C bond offering closed, the two discussed in a telephone conversation that they had agreed with one commissioner to pay $250,000 each to Gardnyr Michael and ABI Capital for the 2002-C transaction.

18. MacFaddin expressed concern that anyone reviewing the payments would question them because of their size. LeCroy, however, allayed his fears by telling him other County commissioners did not know about the payments.

19. The official documents associated with the 2002-C transaction did not disclose the payments to Gardnyr Michael and ABI Capital. For example, the October 23, 2002 County resolution authorizing issuance of the 2002-C bonds listed the underwriters, swap providers, swap

advisor and remarketing agents selected to serve on the 2002-C transaction, but did not mention Gardnyr Michael or ABI Capital.

20. In its role as managing underwriter, J.P. Morgan Securities offered and sold the 2002-C bonds to investors, and in so doing transmitted the official statement to investors. The official statement disclosed the roles of numerous deal participants, including the underwriters, underwriters' counsel, bond counsel, structuring agent, and the County's financial and swap advisors. It also listed underwriting fees. However, it did not disclose the payments to ABI Capital and Gardnyr Michael.

C. The 2003-B Bonds And Swap Agreement

21. In November 2002, Larry Langford became president of the County commission and head of the commission's finance committee that had significant authority over approval of County bond deals and swap agreements. Early in his administration, Langford made it clear to the County's financial advisor that he wanted William Blount, head of the Montgomery broker-dealer Blount Parrish & Co., involved in every County financing transaction. Langford and Blount were long-time friends and political colleagues.

22. Prior to Langford involving Blount in County bond and swap deals, Blount Parrish had not received any County business from 1997 through 2002. However, Langford was able to ensure Blount's selection because his positions as commission president and head of the finance committee effectively allowed him to control the selection process for underwriters and swap providers.

23. From January until May 1, 2003, J.P. Morgan Securities solicited the County, and Langford in particular, to hire the firm as underwriter on a new sewer bond offering and to enter into another swap agreement. During that period, LeCroy met several times with Langford and/or Blount regarding this deal, which became the 2003-B transaction. Because Blount Parrish could not serve as a swap provider under Alabama law, Blount solicited Langford to select Goldman Sachs Capital Markets Inc. to participate in the 2003-B swap transaction because Blount Parrish had a consulting agreement with Goldman Sachs.

24. Goldman Sachs and another New York-based broker-dealer were also pitching swap deals to the County. To prevent Goldman Sachs and the other firm from executing their own swap transactions with the County and ensure the County selected J.P. Morgan Securities instead, LeCroy and MacFaddin agreed to Langford's request that J.P. Morgan Securities make payments to Goldman Sachs and the other firm.

25. On February 25, 2003, Langford and the County commission approved a resolution authorizing the $1.1 billion 2003-B bond offering. J.P. Morgan Securities would serve as lead underwriter, and its affiliated commercial bank would serve as swap provider for the corresponding $1.1 billion swap agreement. The swap agreement was executed on March 28, 2003, with an effective date of May 1, 2003 to coincide with the bond offering.

26. In connection with the bond deal and swap agreement, LeCroy and MacFaddin agreed in their negotiations with Langford to pay Goldman Sachs $3 million, and the other firm $1.4 million. In turn, Goldman Sachs agreed to pay Blount-Parrish, its consultant, $300,000.

27. Neither Goldman Sachs nor the other firm entered into a swap agreement with the County, or served as an advisor to the County on this transaction. J.P. Morgan Securities ultimately negotiated a separate swap agreement between its affiliated bank and Goldman Sachs as a mechanism to make the $3 million payment.

28. The official documents related to the bond offering and the swap agreement did not disclose the payments from J.P. Morgan Securities to Goldman Sachs and the other firm, or the payment from Goldman Sachs to Blount Parrish. For example, the February 25 County resolution listed the bond underwriter, swap provider, County financial advisor, bond counsel, and underwriter's counsel selected to serve on the 2003-B transaction. It did not mention Goldman Sachs, Blount Parrish, or the other firm.

29. In its role as managing underwriter, J.P. Morgan Securities offered and sold the 2003-B bonds to investors, and in doing so, transmitted the official statement to investors. The official statement listed and defined the identities and roles of numerous deal participants, including the underwriters, bond counsel, underwriters' counsel, and the County's financial advisor. But it did not mention the three firms receiving payments.

30. The swap agreement confirmation contained an itemized fee section that listed three fees J.P. Morgan Securities was paying at the County's direction. However, J.P. Morgan Securities omitted from the confirmation the $3 million payment to Goldman Sachs and the $1.4 million payment to the other firm.

31. MacFaddin did set forth the latter two payments in a separate letter he sent only to Langford on March 28, 2003 – after the swap agreement had been executed. The letter did not describe any services Goldman Sachs or the other firm performed on the 2003-B deal.

32. MacFaddin's letter did not disclose Goldman Sachs' payment to Blount Parrish. Goldman Sachs wrote separately to Langford about Blount Parrish's payment in a letter also dated March 28, 2003. The letter recommended that the payment to Blount Parrish be disclosed to the County's bond counsel. Such a disclosure was not made.

D. The 2003-C Bonds And Swap Agreement

33. On May 1, 2003, the day the 2003-B bond transaction closed, LeCroy began proposing a new bond offering and swap transaction to Langford. The next day, LeCroy told MacFaddin in a telephone call that Langford was in favor of the transaction, but suggested that J.P. Morgan Securities pay Blount directly to avoid a competing firm enlisting Blount's support. According to LeCroy, Langford told him J.P. Morgan Securities might have to pay other local firms as well. LeCroy agreed the firm should pay Blount to avoid having him represent a competing firm.

34. Over the next two months, LeCroy met several times with Langford and Blount concerning the $1.05 billion 2003-C sewer bond offering and the corresponding $789 million swap agreement. As the negotiations progressed during the first two weeks of June, LeCroy had several telephone conversations with a J.P. Morgan Securities associate about the payments to Blount Parrish and other firms. In one conversation, he referred to the payments as "free money." In another, he referred to having to "pay off" firms. And he described Blount's role in the transaction as "not messing with us" and "keeping every other firm out of this deal." Later, in July, he described the payments as "the price of doing business."

35. Ultimately, the County commission approved a resolution on July 1, 2003 that authorized the issuance of $1.05 billion in bonds, with J.P. Morgan Securities serving as lead underwriter. The bond offering closed on August 7, 2003. The resolution also authorized a swap transaction in connection with the offering, which turned into the $789 million swap agreement. The parties executed that agreement on July 14, 2003, with the effective date also being August 7.

36. J.P. Morgan Securities paid Blount Parrish $2.6 million – more than any other participant in the deal made except J.P. Morgan Securities itself. The firm also paid $250,000 each to Gardnyr Michael and ABI Capital at the direction of another commissioner. Both firms had hired as a "consultant" a long-time friend of that commissioner.

37. The official documents related to this transaction did not disclose the payments to Blount Parrish, Gardnyr Michael, and ABI Capital. For example, the July 1 County resolution specifically listed the underwriters, swap providers, County advisors, legal counsel and remarketing agents selected to serve on the 2003-C bond offering and swap agreement, but did not mention the three firms J.P. Morgan Securities was paying.

38. In its role as managing underwriter, J.P. Morgan Securities offered and sold the 2003-C bonds to investors, and in doing so, transmitted the official statement to investors. The official statement listed the roles of all participants the County had selected, including the underwriters, bond counsel, the underwriters' counsel and the County's financial advisor. But the official statement omitted mentioning payments to Blount Parrish and the other two firms.

39. The swap agreement confirmation, dated July 14, 2003, also did not disclose the fees or the fact that J.P. Morgan Securities was incorporating them into the pricing of the swap. It contained an itemized fee section listing payments J.P. Morgan Securities was making to the County's swap advisor, legal counsel, and financial advisor, but omitted the Blount Parrish, Gardnyr Michael and ABI Capital payments. Furthermore, LeCroy was specifically asked about fees J.P. Morgan Securities was paying at the July 14 swap closing, but did not mention the payments to the three firms.

40. Two weeks after the 2003-C swap transaction closed, J.P. Morgan Securities sent a letter signed by LeCroy only to Langford, listing the payments to Blount Parrish, Gardnyr Michael and ABI Capital. The letter noted J.P. Morgan Securities was making the payments even though the firms could not act as an underwriter or swap provider on this transaction. The letter also said

J.P. Morgan Securities was incorporating the payments to the three firms into the pricing of the swap, thus reducing the amount of money the County would receive from the swap.

E. The November 2003 Swap Agreement

41. Even before the 2003-C transaction closed, LeCroy solicited Langford for another swap deal. LeCroy told MacFaddin in a July 30, 2003 telephone call that Langford had told him J.P. Morgan Securities might have to pay some local firms.

42. On November 7, 2003, J.P. Morgan Securities' affiliated commercial bank and the County executed a $111 million swap agreement with an effective date of May 1, 2004. In connection with this transaction, J.P. Morgan Securities agreed to pay Blount Parrish $225,000 and $75,000 to Gardnyr Michael.

43. During the November 7, 2003 closing, LeCroy was asked specifically about fees J.P. Morgan Securities was paying. Although fees to the County's swap, legal, and financial advisors were discussed, LeCroy did not disclose the payments to Blount Parrish and Gardnyr Michael. The swap confirmation also did not mention those payments, or the fact that J.P. Morgan Securities was incorporating them into the pricing of the swap.

44. More than two weeks after the transaction closed, J.P. Morgan Securities sent a letter dated November 24, 2003, addressed only to Langford, describing the payments to Blount Parrish and Gardnyr Michael. The letter represented that the County required the payments as a condition for approving the transaction.

F. Status of County Sewer Bonds

45. In January 2008, ratings agencies downgraded the County's sewer bond insurers, and shortly thereafter, also downgraded the County's approximately $3.2 billion of sewer bonds. In February 2008, the auction market failed for the County's auction-rate sewer bonds. J.P. Morgan Securities' affiliated commercial bank and other sewer debt-related creditors entered into a series of forbearance agreements with the County starting in March 2008 to defer the County's principal and certain other payments on its variable-rate demand sewer bonds and swap agreements.

46. On March 3, 2009, the interest rate swap agreements with the County bearing reference numbers 470385, 470392, 700404, 8958034, 700157, and 7001880 (collectively, the "Swap Agreements") were terminated. On March 6, 2009, J.P. Morgan Securities' affiliated commercial bank notified the County that it owed $647,804,118.00 as the result of the termination of the Swap Agreements. Since then, J.P. Morgan Securities' affiliated commercial bank has continued to forbear from taking action in respect of its claim for payments due as a result of termination of the Swap Agreements.

47. Since March 2008, the County has engaged in negotiations with J.P. Morgan Securities and other sewer debt-related creditors and third parties, seeking a refinancing or other

restructuring of the sewer debt in an effort to achieve such a refinancing or other restructuring and avoid the County filing for bankruptcy. The Commission understands that J.P. Morgan Securities intends to continue to pursue discussions with the County and such other creditors and third parties in an attempt to resolve these issues.

VIOLATIONS

48. As a result of the conduct described above, J.P. Morgan Securities willfully[2] violated Section 17(a)(2) and 17(a)(3) of the Securities Act, which prohibit any person from obtaining money "by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading" or 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 or security-based swap agreements.

49. Also as a result of the conduct described above, J.P. Morgan Securities willfully violated Section 15B(c)(1) of the Exchange Act, which makes it unlawful for any broker, dealer or municipal securities dealer to "make use of the mails or any means or instrumentality of interstate commerce to effect any transaction in, or to induce or attempt to induce the purchase or sale of, any municipal security in contravention of any rule of" the Municipal Securities Rulemaking Board ("MSRB").

50. Pursuant to Section 15B(b)(2) of the Exchange Act, the MSRB proposes and adopts rules governing the conduct of brokers and dealers and municipal securities dealers in connection with municipal securities. Pursuant to Section 21(d)(1) of the Exchange Act, the Commission is charged with enforcing the MSRB rules.

51. As a result of the conduct described above, J.P. Morgan Securities willfully violated MSRB Rule G-17, which states that in the conduct of its municipal securities business, every "broker, dealer, and municipal securities dealer shall deal fairly with all persons and shall not engage in any deceptive, dishonest, or unfair practice."

UNDERTAKINGS

J.P. Morgan Securities has undertaken to do the following within five business days of the entry of this Order:

52. Make a $50,000,000.00 payment to and for the benefit of Jefferson County, Alabama, for the purpose of assisting displaced County employees, residents, and sewer ratepayers.

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

53. Terminate any and all obligations of the County to make any payments to JPMorgan Chase Bank, N.A. under the Swap Agreements.

In determining whether to accept the Offer, the Commission has considered these undertakings. Respondent agrees that if the Division of Enforcement believes that Respondent has not satisfied these undertakings, it may petition the Commission to reopen this matter to determine whether additional sanctions are appropriate.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in J.P. Morgan Securities' Offer.

Accordingly, pursuant to Section 8A of the Securities Act, and Sections 15(b), 21B and 21C of the Exchange Act, it is hereby ORDERED that:

A. J.P. Morgan Securities cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 15B(c)(1) of the Exchange Act and MSRB Rule G-17.

B. J.P. Morgan Securities is censured.

C. J.P. Morgan Securities shall, within five business days of the entry of this Order, pay disgorgement of $1.00 and a civil money penalty in the amount of $25,000,000.00 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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 J.P. Morgan Securities 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 Teresa J. Verges, Division of Enforcement, Securities and Exchange Commission, Miami Regional Office, 801 Brickell Avenue, Suite 1800, Miami, FL 33131.

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT of 1933
Release No. 9079 / November 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13673

In the Matter of **J.P. MORGAN SECURITIES INC.,** **Respondent.**	**ORDER UNDER RULE 602(e) OF THE SECURITIES ACT OF 1933 GRANTING A WAIVER OF THE RULE 602(c)(3) DISQUALIFICATION PROVISION**

I.

J.P. Morgan Securities Inc. has submitted a letter, dated October 27, 2009, requesting a waiver of the Rule 602(c)(3) disqualification from the exemption from registration under Regulation E arising from J.P. Morgan Securities' settlement of an administrative and cease-and-desist proceeding instituted by the Commission.

II.

On November 4, 2009, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order") against J.P. Morgan Securities. Under the Order, the Commission found that J.P. Morgan Securities, a registered broker-dealer, violated the antifraud provisions of the Securities Act of 1933 ("Securities Act"). The Commission further found that J.P Morgan Securities made payments to local firms whose principals or employees were friends of Jefferson County, Alabama public officials in connection with $5 billion in County bond underwriting and interest rate swap agreement business awarded to J.P. Morgan Securities. Without admitting or denying the findings in the Order, except as to the Commission's jurisdiction over it and the subject matter of the proceedings, J.P. Morgan Securities consented to the Order which, among other things, censures J.P. Morgan Securities and requires it to cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 15B(c)(1) of the Securities Exchange Act of 1934, and Municipal Securities Rulemaking Board Rule G-17, and orders J.P. Morgan to pay a civil penalty in the amount of $25,000,000.00.

III.

Regulation E provides an exemption from registration under the Securities Act, subject to certain conditions, for securities issued by certain small business investment companies and business development companies. Rule 602(c)(3) makes this exemption unavailable for the securities of any issuer if, among other things, any investment adviser or underwriter of the securities to be offered is "subject to an order of the Commission entered pursuant to Section 15(b)" of the Exchange Act. Rule 602(e) provides, however, that the disqualification " . . . shall not apply . . . if the Commission determines, upon a showing of good cause, that it is not necessary under the circumstances that the exemption [from registration pursuant to Regulation E] be denied." 17 C.F.R. § 230.602(e).

IV.

Based upon the representations set forth in J.P. Morgan Securities' request, the Commission has determined that pursuant to Rule 602(e) under the 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 Commission's Order is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9080 / November 4, 2009

SECURITIES EXCHANGE ACT of 1934
Release No. 60929 / November 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13673

In the Matter of **J.P. Morgan Securities Inc.,** **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**

J.P. Morgan Securities Inc. has submitted a letter, dated October 27, 2009, 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 J.P. Morgan Securities' settlement of an administrative and cease-and-desist proceeding instituted by the Commission. On November 4, 2009, the Commission issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, and Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order") against J.P. Morgan Securities.

Under the Order, the Commission found that J.P. Morgan Securities, a registered broker-dealer, violated the antifraud provisions of the Securities Act by making undisclosed payments to local firms whose principals or employees were friends of Jefferson County, Alabama public officials in connection with $5 billion in County bond underwriting and interest rate swap agreement business awarded to J.P. Morgan Securities. Without admitting or denying the findings in the Order, except as to the Commission's jurisdiction over it and the subject matter of the proceedings, J.P. Morgan Securities consented to the Order. In the Order, the Commission ordered that J.P. Morgan Securities be censured, cease and desist from committing or causing any violations and any future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act, Section 15B(c)(1) of the Securities Exchange Act of 1934, and Municipal Securities Rulemaking Board Rule G-17, and pay a $25,000,000.00 civil penalty.

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 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 upon the representations set forth in J.P. Morgan Securities' request, the Commission has determined that, under the circumstances, the request for a waiver of the disqualifications resulting from the issuance of the Commission's 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 resulting from the Commission's Order is hereby granted.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

November 4, 2009

In the Matter of: Minecore International, 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 Minecore International, Inc. ("Minecore") because it has not filed a periodic report since its 10-KSB for the fiscal year ending December 31, 2001, filed on June 30, 2004.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of Minecore. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of Minecore is suspended for the period from 9:30 a.m. EST on November 4, 2009, through 11:59 p.m. EST on November 17, 2009.

By the Commission.

Elizabeth M. Murphy
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. 60926 / November 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13672

In the Matter of: Minecore International, Inc. Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Minecore International, Inc. (CIK No. 0000792642) ("Minecore" or "Respondent").

II.

As a result of its investigation, the Division of Enforcement alleges that:

A. RESPONDENT

1. Minecore is a Delaware corporation headquartered in San Jose, California. Minecore has had a class of securities registered with the Commission pursuant to Section 12(g) of the Exchange Act. Minecore's stock is currently quoted on the Pink Sheets operated by Pink OTC Markets Inc. under the trading symbol "MCIO."

B. DELINQUENT PERIODIC FILINGS

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

3. Since June 30, 2004, when it filed a Form 10-KSB for the fiscal year ending December 31, 2001, and while its securities have been registered with the Commission, Minecore has failed to make any of its periodic reports required by Section 13(a) and Rules 13a-1 and 13a-13 of the Exchange Act.

4. As a result of the foregoing, Minecore has failed to comply with Section 13(a) and Rules 13a-1 and 13a-13 of the Exchange Act.

III.

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

A. Whether the allegations contained in Section II of this Order are true, and to afford Minecore an opportunity to establish any defenses to such allegations; and

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

IV.

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

IT IS FURTHER ORDERED that the Respondent shall file an Answer to the allegations contained in the Order Instituting Proceedings within twenty 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 the Respondent fails to file the directed Answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondent personally or by certified or registered mail or by other means of verifiable delivery.

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

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

By the Commission.

Elizabeth M. Murphy
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. 60935 / November 4, 2009

INVESTMENT ADVISERS ACT OF 1940
Release No. 2944 / November 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13674

In the Matter of **JAMES E. OTTO,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Sections 203(f) and (k) of the Investment Advisers Act of 1940 ("Advisers Act") against James E. Otto ("Otto" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges that:

Summary

1. From 2004 through the present, Otto has acted as a broker-dealer without being registered as required. In 2006, with respect to certain accounts maintained at the broker-dealer TD Ameritrade, Otto violated the antifraud provisions of the Exchange Act by effecting securities transactions under the guise of the holders of the accounts. Otto also acted as an investment adviser to an individual (the "Advisory Client"), and defrauded the Advisory Client by, on multiple occasions, contacting TD Ameritrade, where the Advisory Client maintained an account, pretending to be the Advisory Client.

Respondent

2. Otto, age 51, is a resident of Overland Park, Kansas. From approximately 1986 through 2002, Otto was employed as a registered representative of several registered broker-dealers. Otto was barred from the industry for two months in 2002 by the New York Stock Exchange and he did not associate with another registered broker-dealer thereafter. At all times relevant to these proceedings Otto was licensed to sell insurance products in the states of Missouri and Kansas.

Otto's Conduct

3. Otto acted as a broker-dealer by directing sales of securities held in approximately 159 accounts maintained at TD Ameritrade and another registered broker-dealer by individuals who were his insurance clients and the insurance clients of other insurance salespeople. Otto directed the sales of the securities to generate cash for the clients' purchase of insurance products from him and the other insurance salespeople. The clients gave Otto information, such as PIN numbers, for the accounts at TD Ameritrade and the other broker-dealer. Otto was thereby able to access the accounts via the Internet and direct the sales of the securities. Otto profited from this conduct because he was paid commissions on his sales of insurance products to these clients. In addition, the other insurance salespeople shared with Otto their commissions on their relevant sales of insurance products.

4. Through this conduct, Otto willfully violated Section 15(a) of the Exchange Act.

5. On April 11, 2006, TD Ameritrade sent Otto a letter terminating its business relationship with him. On June 12, 2006, TD Ameritrade sent Otto a letter confirming that its termination of its relationship with him barred him from having authorization or power of attorney on any TD Ameritrade accounts, from facilitating or authorizing others to conduct activities through TD Ameritrade, and from accessing any TD Ameritrade account or allowing others to access those accounts on his behalf.

6. Notwithstanding these communications from TD Ameritrade, between September 1, 2006, and March 25, 2007, Otto accessed TD Ameritrade accounts approximately 400 times under the guise of the holders of the accounts (i.e., by using PIN numbers and other information intended to allow the holders access to the accounts). Otto effected securities transactions on some of the occasions that he accessed the accounts.

7. Through this conduct, Otto willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

8. In 2002, Otto entered into an arrangement with the Advisory Client in which he facilitated a transfer of the Advisory Client's securities to an account at TD Ameritrade and acquired trading authority on that account. From 2002 through

2007, Otto traded the securities in the Advisory Client's TD Ameritrade account. The Advisory Client paid Otto a management fee of 1% of the assets in the TD Ameritrade account, with a payment of 1.5% of assets if Otto doubled the S&P 500.

9. On March 19, 2007, Otto called TD Ameritrade and claimed to be the Advisory Client. Otto provided TD Ameritrade with the last four digits of the Advisory Client's social security number as identification. Posing as the Advisory Client, Otto attempted to facilitate the payment of his advisory fee through issuance of a check from the Advisory Client's account to Otto in the amount of $1,300. The Advisory Client had authorized the issuance of the check to Otto, but did not authorize Otto to call TD Ameritrade and identify himself as the Advisory Client.

10. On March 28, 2007, Otto called TD Ameritrade and again claimed to be the Advisory Client. Otto provided TD Ameritrade with the last four digits of the Advisory Client's social security number, the Advisory Client's date of birth and identified one of the stocks held in the Advisory Client's account in order to confirm to TD Ameritrade that he was the Advisory Client. In this call, Otto requested assistance in accessing the Advisory Client's TD Ameritrade account via the Internet. The Advisory Client did not authorize Otto to call TD Ameritrade and identify himself as the Advisory Client.

11. Otto called TD Ameritrade on at least two other occasions and claimed to be the Advisory Client without the Advisory Client's authorization.

12. Through this conduct, Otto willfully violated Sections 206(1) and (2) of the Advisers Act.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b)(6) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 21B(a) and (e) of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Sections 203(i) and (j) of the Advisers Act; and

D. Whether, pursuant to Sections 21C of the Exchange Act and 203(k) of the Advisers Act, Respondent should be ordered to cease and desist from committing or causing violations of, and any future violations of, Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder and Sections 206(1) and (2) of the Advisers Act.

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro &
Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9081 / November 4, 2009

SECURITIES EXCHANGE ACT OF 1934
Release No. 60936 / November 4, 2009

INVESTMENT ADVISERS ACT OF 1940
Release No. 2945 / November 4, 2009

INVESTMENT COMPANY ACT OF 1940
Release No. 28989 / November 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13675

In the Matter of **Value Line, Inc.,** **Value Line Securities, Inc.,** **Jean Bernhard Buttner, and** **David Henigson,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b)(4), 15(b)(6) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b)(4), 15(b)(6) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Sections

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9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act"), against Value Line, Inc. ("VLI"), Value Line Securities, Inc. ("VLS"), Jean Bernhard Buttner ("Buttner") and David Henigson ("Henigson") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement ("Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b)(4), 15(b)(6) and 21C of the Securities Exchange Act of 1934, Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Order"), as set forth below.

III.

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

SUMMARY

1. From 1986 to November 2004 ("Relevant Period"), VLI, VLS, Buttner and, from the time he joined VLI in 1988 to November 2004, Henigson engaged in a fraudulent practice that misappropriated assets from the Value Line Family of Mutual Funds (the "Funds") in the form of inflated brokerage commission payments to VLS, VLI's affiliated broker-dealer. During the Relevant Period, VLI entered into arrangements with several unaffiliated brokerage firms ("Rebate Brokers") to execute, clear and settle securities trades on behalf of the Funds at a discounted commission rate that varied during the period from $.02 per share to as low as $.01 per share. Instead of passing this discount directly to the Funds, the Respondents arranged for the Rebate Brokers to charge the Funds a commission rate of $.0488 per share and then to "rebate" to VLS between $.0288 and $.0388 per share, which represented between 59% to nearly 80% of the total commissions. VLS, however, did not provide any brokerage services to the Funds for the commissions it received on these trades. In total, VLI directed over $24 million of the Funds' assets to its affiliated broker-dealer, VLS, through this so-called "commission recapture" program.

2. The Respondents misled the Independent Directors ("Independent Directors") of the Funds' Board of Directors/Trustees ("Board") and the Funds' shareholders into believing that VLS provided bona fide brokerage services for the Funds' securities trades when, in fact, VLS did not provide any such services. Rather, the Rebate Brokers performed the necessary brokerage services, *i.e.*, execution, clearing and settlement, for the Funds' trades and did so for as little as $.01 per share. The Respondents also failed to disclose to the Independent Directors and the Funds' shareholders that they required that a target percentage – as much as 70% of the Funds'

trades in securities listed on the New York Stock Exchange, Inc. ("NYSE") – be allocated to the recapture program. The target trading percentages served to undermine VLI's obligation to seek "best execution" for the Funds' securities trades. The Respondents also made materially false and misleading statements and omissions about VLS and the recapture program to the Independent Directors at Board meetings and to the Funds' shareholders in public filings with the Commission, including in the Funds' registration statements.

3. Buttner, who became Chairman and CEO of VLI in 1988 and who was the President of VLI when the commission recapture program was instituted by the predecessor CEO, continued to authorize and monitor the commission recapture program through November 2004. Buttner also discussed the program periodically with Henigson, who periodically updated her on the amount of commissions being diverted to VLS. In addition, Buttner and Henigson were both responsible for preparing and making presentations to the Independent Directors about why VLS was receiving commission payments from the Funds, and they also signed certain Commission filings that mischaracterized the reason why VLS was receiving commission payments from the Funds.

RESPONDENTS

4. **VLI**, a New York corporation with its principal place of business in New York, New York, is a publicly traded company whose common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the NASDAQ Global Select Market. Until June 2008, VLI was a registered investment adviser and advised the Funds, including 14 open-end investment companies, and other individual and institutional clients. In June 2008, VLI reorganized its investment management business by transferring its operations to a newly formed, wholly-owned subsidiary named EULAV Asset Management, LLC ("EULAV"), which replaced VLI as investment adviser to the Funds and other VLI advisory clients. VLI's most recent Form 10K filing discloses that EULAV has approximately $2.4 billion in assets under management as of April 30, 2009.

5. **VLS**, a wholly-owned subsidiary of VLI with its principal place of business in New York, New York, is registered with the Commission as a broker-dealer. VLS acts as the underwriter and distributor for the Funds. Until November 2004, VLS also purported to serve as a broker for some of the Funds' NYSE-listed securities trades. In May 2009, VLS changed its name to EULAV Securities, Inc. ("EULAV Securities").

6. **Buttner**, age 74, resides in Westport, Connecticut. Buttner is Chairman, Chief Executive Officer and President of VLI. She was also Chairman and President of VLS, and served in those positions until February 2009. Buttner effectively controls approximately 86.5% of the outstanding voting stock of VLI. From 1988 to June 2008, Buttner was Chairman of the Funds' Board and President of the Funds. In June 2008, she resigned from all of her positions with the Funds.

7. **Henigson**, age 52, resides in Riverside, Connecticut. Henigson held various positions at VLI since joining VLI in 1988, including at various times serving as a Director, Vice-President, Treasurer and/or Chief Compliance Officer of VLI, and as a Director and Vice-

President of VLS. He also held various positions at the Funds, including at various times serving as Vice President, Secretary, Treasurer and/or Chief Compliance Officer for the Funds. In February 2009, he ceased serving in any capacity with VLS and in June 2008 he resigned as VLI's Chief Compliance Officer and also resigned from all of his positions with the Funds.

FACTS

The Commission Recapture Program

8. From 1986 to November 2004, while VLI was serving as investment adviser to the Funds, the Respondents engaged in a practice to direct a portion of the Funds' securities trades to VLI's commission recapture program. For the securities trades subject to the recapture program, VLI's Trading Department ("Trading Department") sent the trades to one of three Rebate Brokers that the Respondents had recruited to fully execute, clear and settle securities trades on behalf of the Funds at a discounted commission rate as low as $.01 per share. Although the Rebate Brokers charged at the outset $.02 per share for their services, which rate was reduced over time to as little as $.01 per share for their services, the Respondents instructed the Rebate Brokers to bill the Funds $.0488 per share and then to pay the balance – from $.0288 to $.0388 – of that commission charge to VLS. In total, VLI directed over $24 million of the Funds' assets to VLS. This commission recapture practice was not fully disclosed to the Independent Directors or to the Funds' shareholders.

9. Although VLS received as much as 59% to nearly 80% of the total commissions charged on the securities trades that were allocated to the recapture program, VLS did not perform any brokerage services for the Funds in connection with those trades. VLS did not have the capacity to execute, clear and settle trades on its own. It, therefore, relied on the Rebate Brokers to access the markets and effect the trading process for the Funds' securities trades. In fact, VLS did not provide any trading services beyond the services that the Trading Department was already contractually obligated to provide the Funds under the terms of VLI's investment advisory agreements with the Funds. Having no independent brokerage operations of its own, VLS consisted of the same traders, trading facilities and offices as the Trading Department. The traders staffed to the Trading Department were told by management that they wore "two hats" – a VLI hat and a VLS hat. In practice, however, the VLI traders handled all of the Funds' securities trades in the same manner whether the trades were routed for execution to the Rebate Brokers or to other unaffiliated brokers.

10. Upon becoming CEO, Buttner was responsible for the commission rates charged by VLS. Buttner approached the negotiations with the Rebate Brokers with the goal of maximizing profits for VLS, not for the Funds. Buttner pursued fee concessions from the Rebate Brokers that ultimately resulted in agreements with the Rebate Brokers to execute, clear and settle the Funds' securities trades for only $.01 per share. This $.01 rate was significantly lower than the commission rates charged by other brokers for executing VLI trades because the Rebate Brokers did not provide other services in connection with the trades, such as "soft-dollars" services. Buttner, however, did not pass this discount to the Funds. Rather, she and the other Respondents referred to VLS as an "introducing broker" and collected from $.0288 to $.0388 per share for VLS on the Funds' securities trades that the Trading Department sent to the Rebate Brokers for

execution, clearing and settlement. This practice allowed VLS and VLI to reap the benefit of the Rebate Brokers' discounted rates at the Funds' expense.

11. Buttner and Henigson were involved in negotiating and structuring the commission recapture arrangements with the various Rebate Brokers. Over the years, they signed written agreements with the Rebate Brokers formalizing the terms of the recapture arrangements, including the "commissions split" between VLS and the Rebate Brokers. In addition, Henigson supervised the head traders working in the Trading Department and, in turn, reported to Buttner on the profitability of the recapture program for VLS and he also assisted in the preparation of reports for the Independent Directors as to the profitability of VLS.

Target Trading Percentages For Recapture Trades

12. Buttner was also responsible for requiring that a target percentage of the Funds' securities trades be allocated to the recapture program. The target percentage, which applied only to the Funds' trades in NYSE-listed securities, was initially set at approximately 50% but increased over time to as much as 70%. The purpose of the target percentages was to ensure a certain amount of revenue for VLS each quarter. Henigson relayed Buttner's target percentages to VLI's head traders and, at times, instructed them to increase the number of the Funds' securities trades being allocated to the Rebate Brokers in order to meet Buttner's target percentages. As a result, rather than selecting brokers based solely on their ability to provide best execution for the Funds' trades, the VLI traders were instructed to send securities trades to the Rebate Brokers to meet management's target trading percentages.

Misleading Disclosures To The Funds' Independent Directors

13. The Respondents misled the Independent Directors about why VLS was receiving commission payments in connection with the Funds' securities trades. The Respondents told the Independent Directors that using VLS as a broker for the Funds' securities trades was in the best interests of the Funds and their shareholders. Buttner and Henigson, in particular, told the Independent Directors at quarterly Board meetings that the "use" of VLS for the Funds' securities trades served the Funds' best interests because VLS was charging the Funds a commission rate of $.0488 per share, while other brokerage firms were charging an average commission rate of $.05 per share for the same services. The Respondents, however, failed to disclose to the Independent Directors that the Rebate Brokers were actually providing all of the brokerage services in connection with the Funds' securities trades for as little as $.02 to $.01 per share. Buttner and Henigson also failed to disclose to the Independent Directors that they had instructed the Rebate Brokers to charge the Funds $.0488 per share and to then send the balance -- $.0288 to $.0388 -- of this commission charge back to VLS, even though VLS did not provide any brokerage services on the trades.

14. The Respondents also failed to disclose to the Independent Directors the existence of Buttner's target trading percentages requiring that a fixed percentage of the Funds' NYSE-listed securities trades be allocated to VLS and the recapture program. Rather, the Respondents told the Independent Directors that VLI's decision to use VLS as a broker for the Funds' securities trades was being made consistent with VLI's obligation to seek best execution. Unaware of the target

trading percentages, the Independent Directors continued to authorize commission payments to VLS under the belief that VLI was meeting its obligation to seek best execution for the Funds' securities trades.

Misleading Disclosures To The Funds' Shareholders

15. The Respondents made similarly misleading statements about why VLS was receiving commissions to the Funds' shareholders in public filings with the Commission. These misrepresentations were made in VLI's investment advisory registration statements ("Forms ADV") and in the Funds' registration statements, which included the Funds' Prospectuses and Statements of Additional Information. Buttner and Henigson signed the Funds' registration statements in their capacities as officers of the Funds. The Forms ADV and the Funds' registration statements were provided to, or were otherwise made available to, the Funds' shareholders.

16. The Forms ADV and the Funds' registration statements mischaracterized the reason why VLS was receiving commission payments from the Funds. These documents falsely represented that VLS provided brokerage services for the Funds' securities trades and that the trades were "cleared" through unaffiliated broker-dealers. These representations were false because VLS did not provide any brokerage services in connection with the Funds' securities trades, and the unaffiliated broker-dealers did more than just "clear" the trades. The Rebate Brokers, in fact, executed, cleared and settled the trades. Furthermore, the Forms ADV and the Funds' registration statements did not disclose the fact that the VLI's traders were under orders from senior management to meet target trading percentages for allocating the Funds' NYSE-listed securities trades to the recapture program so that VLS could generate revenue on those trades. The Forms ADV and the Funds' registration statements purported to list all of the factors the Trading Department considered when selecting brokers to execute the Funds' securities trades, such as price, broker execution capability, commission rates and the value of research provided by the broker, but did not disclose the target trading percentages.

VIOLATIONS

17. As a result of the conduct described above,

(a) VLI, VLS, Buttner and Henigson willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

(b) VLI willfully violated Sections 206(1) and 206(2) of the Advisers Act, and VLS, Buttner and Henigson willfully aided and abetted and caused VLI's violations of Sections 206(1) and 206(2) of the Advisers Act;

(c) VLI willfully violated Section 207 of the Advisers Act; and

(d) VLI willfully violated Section 15(c) of the Investment Company Act; VLI and VLS willfully violated Section 17(e)(1) of the Investment Company Act; and VLI, Buttner and Henigson willfully violated Section 34(b) of the Investment Company Act.

IV.

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

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b)(4), 15(b)(6) and 21C of the Exchange Act, Sections 203(e), 203(f) and 203(k) of the Advisers Act, and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. VLI shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Sections 206(1), 206(2) and 207 of the Advisers Act, and Sections 34(b), 15(c) and 17(e)(1) of the Investment Company Act.

B. VLS shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 17(e)(1) of the Investment Company Act, and from causing any violations and any future violations of Sections 206(1) and 206(2) of the Advisers Act.

C. Buttner and Henigson shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder and Section 34(b) of the Investment Company Act, and from causing any violations and any future violations of Sections 206(1) and 206(2) of the Advisers Act.

D. VLI, VLS, Buttner and Henigson are censured.

E. VLI shall pay disgorgement in the amount of $24,168,979, plus prejudgment interest of $9,536,786.

F. VLI shall pay a civil money penalty in the amount of $10,000,000; Buttner shall pay a civil money penalty in the amount of $1,000,000 and Henigson shall pay a civil money penalty in the amount of $250,000.

G. Payments to be made by VLI and Buttner under Paragraphs IV.E. and F., above, shall be made within 10 days of the entry of the Order. Payments to be made by Henigson under Paragraph IV.F., above, shall be made in the following manner: (1) within 10 days of the entry of the Order Henigson shall pay $100,000, (2) within 60 days of the entry of the Order Henigson shall pay $75,000, and (3) within 90 days of the entry of the Order Henigson shall pay the remaining $75,000. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 or 31 U.S.C. 3717. Payments 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 the payee 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 Brenda Chang, Senior Attorney, Securities and Exchange Commission, Division of Enforcement, New York Regional Office, 3 World Financial Center, Suite 400, New York, NY 10281.

H. There shall be a Fair Fund created for VLI's disgorgement, interest and penalties referenced in Paragraphs IV.E. and F., above, pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002. VLI shall bear all costs associated with any Fair Fund distribution, including but not limited to retaining a Third-Party Consultant approved by the Commission staff to administer any Fair Fund distribution. Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to the 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, VLI, Buttner and Henigson agree that they shall not, after offset or reduction in any Related Investor Action based on VLI's payment of disgorgement in this action, argue that they are entitled to, nor shall they further benefit by, offset or reduction of any part of their payment of civil penalties in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, VLI, Buttner and Henigson agree that they 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 any of the Respondents 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.

I. Buttner and Henigson be, and hereby are, prohibited from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of the Exchange Act.

J. Buttner be, and hereby is, barred from association with any broker, dealer, or investment adviser, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter (collectively, "Associational Persons"), provided however, that Buttner may, for a period of one year from the entry of this Order, (i) serve as an officer or director and hold and exercise a controlling interest in any parent company of VLI that is not affiliated with any Associational Person other than through VLI and that does not have a class of securities registered pursuant to Section 12 of the Exchange Act and that is not required to file reports pursuant to Section 15(d) of the Exchange Act; (ii) continue to hold and exercise control over VLI through her beneficial ownership of VLI voting stock so long as she does not (A) attempt to influence or exercise voting control of her VLI shares concerning the operations of EULAV and

EULAV Securities so long as EULAV is an investment adviser and so long as EULAV Securities is a broker or dealer; or (B) communicate directly or indirectly with any EULAV or EULAV Securities employee concerning the operations of EULAV and EULAV Securities so long as EULAV is an investment adviser and so long as EULAV Securities is a broker or dealer, in each case except as necessary in connection with the activities contemplated by clause (iii) below; and (iii) perform tasks or functions relating to EULAV or EULAV Securities solely to the extent necessary to effectuate one or more transactions, the ultimate result of which is to terminate Buttner's affiliated person status with respect to EULAV and EULAV Securities and/or EULAV's status as an investment adviser and EULAV Securities' status as a broker or dealer and/or for VLI to cease to have a class of securities registered pursuant to Section 12 of the Exchange Act and not to be required to file reports pursuant to Section 15(d) of the Exchange Act. For the avoidance of doubt, at such time as Buttner terminates her affiliated person status with respect to EULAV and EULAV Securities, the proviso to the preceding sentence beginning with the words "provided however" shall cease to be operative. Buttner shall provide a copy of the Order to VLI's Board of Directors and notify them of the limitations placed on her participation in VLI's corporate functions.

K. Henigson be, and hereby is, barred from association with any broker, dealer, or investment adviser, and is prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter.

L. Any reapplication for association by Buttner or Henigson 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 Buttner and Henigson, 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.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 60941 / November 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13677

In the Matter of RHINO TRADING, LLC, FAT SQUIRREL TRADING GROUP, LLC, DAMON REIN, AND STEVEN PETER, Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) and 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate 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 Rhino Trading, LLC ("Rhino"), Fat Squirrel Trading Group, LLC ("FSTG"), Damon Rein, and Steven Peter (collectively, "Respondents").

II.

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

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Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

Summary

These proceedings arise out of Respondents Rhino's and FSTG's violations of Regulation SHO. At the time, Regulation SHO required "fail-to-deliver" positions[2] in certain securities that have lasted for thirteen consecutive settlement days to be immediately closed out.[3]

In this case, Respondents Rhino and FSTG engaged in certain transactions that resulted in violations of Regulation SHO's close-out requirement. The first type of transaction, known in the industry as a "reverse conversion," involves selling a put option and buying a call option – a transaction combination that creates what is known as a "synthetic" long position – while selling short the underlying stock. The short sale of the underlying stock serves as a hedge to the synthetic long position. By engaging in these transactions, Respondents Rhino and FSTG profited on the spread between the price of the put option and the price of the call option.

The second type of transaction, known as a "reset," is a transaction in which a market participant that has a "fail-to-deliver" position in a threshold security buys shares of that security while simultaneously selling short-term, deep in-the-money call options to – or buying short-term, deep in-the-money put options from – the counterparty to the share purchase. The purchase of shares creates the illusion that the market participant has satisfied Regulation SHO's close-out obligation. However, the shares that are apparently purchased during the reset transaction are never actually delivered to the purchaser because on the day after executing the reset, the option is

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

2 "Fails-to-deliver" occur when a seller fails to deliver securities to the buyer when delivery is due. Generally, investors complete or settle their security transactions within three settlement days. This settlement cycle is known as T+3 (or "trade date plus three days"). T+3 means that when a trade occurs, the participants to the trade deliver and pay for the security at a clearing agency three settlement days after the trade is executed so the brokerage firm can exchange those funds for the securities on that third settlement day. The three-day settlement period applies to most security transactions, including stocks, bonds, municipal securities, mutual funds traded through a brokerage firm, and limited partnerships that trade on an exchange. Government securities and stock options settle on the next settlement day following the trade (or T+1).

3 At the time, a "close out" of a fail position involved the purchase of shares of like kind and quantity in the amount of the fail to deliver position.

either exercised (if a call) or assigned (if a put), transferring the shares back to the party that appeared to have sold them the previous day. This paired transaction allows the market participant with the "fail-to-deliver" position to effectively borrow the stock for a day in order to appear that it has satisfied Regulation SHO's close-out requirement.

Specifically, Rhino from June 2007 through August 2007, and FSTG from February 2007 through July 2007, willfully violated Rule 203(b)(3) of Regulation SHO by engaging in a series of transactions through Respondents Rein's and Peter's use of short-term FLEX options that did not satisfy their close-out obligations in Regulation SHO threshold securities[4] that had been allocated to Rhino and FSTG by their clearing firms.

Respondents

1. Fat Squirrel Trading Group, LLC ("FSTG"), a limited liability company located in New York, New York, is a market maker registered with the Chicago Board Options Exchange, Inc. ("CBOE") since January 2007. FSTG also is a broker-dealer registered with the Commission since October 2002. During February 2007 through July 2007, Steven Peter was the managing member of FSTG and both he and Damon Rein were associated with the firm as traders.

2. Rhino Trading, LLC ("Rhino"), a limited liability company located in New York, New York, is a market maker registered with the CBOE since May 2007. Rhino also is a broker-dealer registered with the Commission since May 2007. During June 2007 through August 2007, Damon Rein was associated with Rhino as a trader.

3. Steven Peter, age 49, is a resident of Millbrook, New York and served as the managing member and a trader at FSTG during the relevant time period. Peter holds a series 63 securities license.

4. Damon Rein, age 39, is a resident of Westport, Connecticut. From February 2007 through April 2007, he worked as a trader at FSTG. He ended his association with FSTG in April 2007 and began work as a trader associated with Rhino.

Facts

5. Respondent Rhino during the period June 2007 through August 2007, and Respondent FSTG during the period February 2007 through July 2007, engaged in transactions known as "reverse conversions" with purchasers of Regulation SHO threshold securities.

[4] A "threshold security" is a security for which there is an aggregate "fail-to-deliver" position exceeding the criteria set forth in Rule 203(c)(6) of Regulation SHO for a period of five consecutive settlement days.

6. As part of these reverse conversions, Respondent Rein on behalf of Rhino, and Respondents Rein and Peter on behalf of FSTG, sold short shares of Regulation SHO threshold securities while simultaneously creating a synthetic long position by purchasing call options and selling put options (with the same strike price and expiration date) on the same threshold securities.[5] Rhino and FSTG purchased enough call options and sold enough put options so that the number of shares underlying the options equaled the number of shares they sold short. Through this set of transactions, Respondents Rhino and FSTG reduced their market risk because the short position was used to hedge the synthetic long position that had been created by purchasing call options and selling put options.

7. Respondents Rhino and FSTG profited from this set of transactions because the premium they received for the put options they sold was greater than the premium they paid to purchase the call options. As a general matter, this disparity in premiums for the put and call options (despite their same strike price and expiration date) on Regulation SHO threshold securities exists because of the additional cost that is incurred to hedge the sale of the put option. Specifically, the seller of the put option hedges that transaction by selling short the underlying security. Because these threshold securities were generally hard to borrow, they were more expensive to sell short. Consequently, the cost of hedging the sale of put options in Regulation SHO threshold securities causes the corresponding put options to trade at a higher price than that of the corresponding call options.

8. Respondents Rhino's and FSTG's short sales resulted in a "fail-to-deliver" position in the threshold security on the books and records of their clearing firms – i.e., Rhino and FSTG had not delivered the shares they sold short to their clearing firms so that the clearing firms could settle the trades.

9. Rule 203(b)(3) of Regulation SHO requires clearing firms immediately to close out any "fail-to-deliver" position in a threshold security that lasts for thirteen consecutive settlement days by purchasing securities of a like kind and quantity. In addition, pursuant to Rule 203(b)(3)(vi) of Regulation SHO, a clearing firm is permitted reasonably to allocate a "fail-to-deliver" position to a broker or dealer whose sale resulted in the position. Once the clearing firm has allocated the "fail-to-deliver" position to another broker or dealer, the obligation for complying with the mandatory close-out shifts to that broker or dealer.

10. Respondents Rhino's and FSTG's clearing firms, through electronic mail or other means, notified Rhino and FSTG that they were shifting the obligation to Rhino and FSTG to close out the "fail-to-deliver" positions and that they would close out those positions if Rhino and FSTG themselves did not do so.

11. Respondents Rhino and FSTG did not want their "fail-to-deliver" position – which resulted from the short sale portion of the reverse conversion – to be closed out by the clearing

[5] In general, a call option purchaser pays a premium to buy the call option, and a put option seller (or writer) receives a premium for selling (or writing) the put option.

firms because this would result in the clearing firms making large purchases of Regulation SHO threshold securities at a price determined by the market and allocating that cost to Rhino and FSTG. Additionally, the close-out would have exposed Respondents Rhino and FSTG to market risk on their initial reverse conversion transactions because it would eliminate the short positions that had been used to hedge the synthetic long positions created by purchasing call options and selling put options.

12. In order to avoid a close-out, Respondent Rein on behalf of Rhino, and Respondents Rein and Peter on behalf of FSTG, entered into a series of transactions that failed to satisfy Rhino's and FSTG's obligations under Regulation SHO to close out their "fail-to-deliver" positions. These complex transactions gave the appearance that Rhino and FSTG were closing out their "fail-to-deliver" position by purchasing securities of like kind and quantity.

13. Specifically, Respondent Rein on behalf of Rhino, and Respondents Rein and Peter on behalf of FSTG, effected short-term in-the-money FLEX (and, in the case of Rhino, occasionally standard in-the-money call) option transactions in conjunction with stock-purchase transactions that did not satisfy the Regulation SHO close-out requirements.

14. A FLEX option allows the investor to customize the option's terms, such as strike price and expiration date. In this case, the FLEX options allowed Respondents Rhino and FSTG to reset the close-out date so that they would have an additional thirteen days to close out any "fail-to-deliver" position. Specifically, Respondents Rhino and FSTG "purchased" stock in the Regulation SHO threshold security from another market participant and simultaneously purchased a short-term, deep in-the-money FLEX put option for a corresponding number of shares from the same market participant. On the day that they "purchased" the stock, Rhino's and FSTG's clearing firms received notice of the "purchase" and closed out the "fail-to-deliver" position. Respondents Rhino and FSTG, however, knew that the following day, or shortly thereafter, the FLEX put option would expire in-the-money, causing Rhino and FSTG to exercise the option and sell the stock.

15. Respondents Rhino and FSTG, however, did not actually receive any shares from the other market participant because that market participant was selling short the stock without having any shares to sell. Accordingly, Respondents Rhino and FSTG did not receive any shares and did not in fact close out the short position – as required by Regulation SHO – that was initially established during the reverse conversion transaction. In these instances, Rhino and FSTG knew, or should have known, that the combination of the purchase of securities and the purchase of the FLEX option would result in maintenance of the "fail-to-deliver" position.

16. Rhino's and FSTG's clearing firms, however, reset Rhino's and FSTG's Regulation SHO close-out obligation to day one (thus giving Rhino and FSTG a fresh thirteen days in which to close out the short position) based on the "purchase" of shares and the exercise of the FLEX option.

17. After receiving close-out notices from their clearing firms, Rhino and FSTG continued to engage in these and similar types of transactions until the initial options positions (call options purchase/put options sale) expired, at which point they no longer had a synthetic long position that needed to be hedged, and so closed out the short position. By engaging in this course of conduct, Rhino and FSTG impermissibly maintained "fail-to-deliver" positions in numerous Regulation SHO threshold securities.

18. During the relevant period, FSTG engaged in a large volume of reverse conversions and reset transactions in numerous threshold securities, including, but not limited to, iMergent, Inc., American Home Mortgage Investment Corp., and NovaStar Financial, Inc. As a result of FSTG's repeated violation of Regulation SHO's close-out requirement, it received ill-gotten gains of $45,000.

19. During the relevant period, Rhino engaged in a large volume of reverse conversions and reset transactions in numerous threshold securities, including, but not limited to, Medis Technologies Ltd., NovaStar Financial, Inc., and USANA Health Sciences, Inc. As a result of Rhino's repeated violation of Regulation SHO's close-out requirement, it received ill-gotten gains of $350,000.

20. In addition, in a limited number of instances, Respondent Rhino engaged in FLEX option transactions in conjunction with stock sales as the counterparty to other market participants who failed to comply with their own Regulation SHO close-out obligations.

Legal Analysis

21. At the time, Rule 203(b)(3) imposed an obligation on clearing firms to immediately close out any "fail-to-deliver" positions in a threshold security that lasts for thirteen consecutive settlement days by purchasing securities of like kind and quantity.[6] Pursuant to Rule 203(b)(3)(vi), however, a clearing firm is permitted reasonably to allocate a "fail-to-deliver" position to a broker or dealer whose short sale resulted in the position. Once the clearing firm has allocated the "fail-to-deliver" position to another broker or dealer, the obligation for complying with the mandatory close-out shifts to that broker or dealer.

22. Once the "fail-to-deliver" position is allocated to the broker or dealer, that broker or dealer, in order to satisfy the close-out requirement of Rule 203(b)(3) of Regulation SHO, must

[6] On July 27, 2009, the Commission made permanent the requirements of interim final temporary rule, Rule 204T, that seeks to reduce potentially abusive "naked" short selling in the securities market. Rule 204T amends Regulation SHO by, among other things, requiring that participants of a registered clearing agency close out fails resulting from short sales no later than the beginning of regular trading hours on the settlement day immediately after the fail occurs. The rule also requires participants of a registered clearing agency to close out fails resulting from long sales or market making activity by no later than the beginning of regular trading hours on the third settlement day after the fail occurs.

purchase securities of like kind and quantity. Borrowing securities, or otherwise entering into an arrangement that merely creates the appearance of a purchase, does not satisfy Regulation SHO's close-out requirement. Specifically, Rule 203(b)(3)(vii) provides that a clearing firm – or a broker or dealer to which the clearing firm allocated a "fail-to-deliver" position – will be deemed not to have satisfied the close-out obligation if it knows, or has reasonable grounds to believe, that the close-out purchase will result in a "fail-to-deliver."

23. By purchasing deep in-the-money FLEX (and, in the case of Rhino, occasionally standard in-the-money call) options while simultaneously purporting to "purchase" stock, Respondents Rhino and FSTG engaged in transactions that gave the appearance that they were closing out their "fail-to-deliver" positions. As a result, Rhino and FSTG willfully violated Rule 203(b)(3) of Regulation SHO.

24. As a result of their conduct, Rein willfully aided and abetted and caused Rhino's violations of Rule 203(b)(3) of Regulation SHO, and Rein and Peter willfully aided and abetted and caused FSTG's violations of Rule 203(b)(3) of Regulation SHO.

Undertakings

25. Pursuant to the CBOE Decision Accepting Offer of Settlement (File No. 09-0010), Respondents Rhino and Rein shall pay, jointly and severally, a fine in the amount of $150,000 to the CBOE's Business Conduct Committee pursuant to the entry of the CBOE's issuance of its Decision Accepting Offer of Settlement (File No. 09-0010).

26. Pursuant to the CBOE Decision Accepting Offer of Settlement (File No. 09-0009), Respondents FSTG, Rein, and Peter shall pay, jointly and severally, a fine in the amount of $30,000 to the CBOE's Business Conduct Committee pursuant to the entry of the CBOE's issuance of its Decision Accepting Offer of Settlement (File No. 09-0009).

27. Respondent Rein shall provide to the Commission, within thirty days after the end of the three-month suspension period described below, an affidavit confirming that he has complied fully with the sanctions described in Section IV(C) below.

28. Respondent Peter shall provide to the Commission, within thirty days after the end of the three-month suspension period described below, an affidavit confirming that he has complied fully with the sanctions described in Section IV(D) below.

In determining whether to accept the Offers, the Commission has considered these undertakings.

IV.

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

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

A. Respondents Rhino, Rein, FSTG, and Peter cease and desist from committing or causing any violations and any future violations of Exchange Act Rule 203(b)(3);

B. Respondents Rhino and FSTG are censured;

C. Respondent Rein be, and hereby is, suspended from association with any broker or dealer for a period of three (3) months, effective on the second Monday following the entry of this Order;

D. Respondent Peter be, and hereby is, suspended from association with any broker or dealer for a period of three (3) months, effective on the second Monday following the entry of this Order;

E. Respondent Rhino shall pay disgorgement in the amount of $350,000, which shall be deemed satisfied by entry of the CBOE's issuance of its Decision Accepting Offer of Settlement (File No. 09-0010);

F. Respondent FSTG shall pay disgorgement in the amount of $45,000, which shall be deemed satisfied by entry of the CBOE's issuance of its Decision Accepting Offer of Settlement (File No. 09-0009);

G. Respondent Rein shall comply with the undertakings enumerated in Section III, paragraph 27 above; and

H. Respondent Peter shall comply with the undertakings enumerated in Section III, paragraph 28 above.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Chairman Schapiro & Commissioner Casey Not participating

SECURITIES AND EXCHANGE COMMISSION
Washington D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 60937 / November 4, 2009

Admin. Proc. File No. 3-13414

In the Matter of

KEVIN M. GLODEK

c/o William A. Rome, Esq.
Hoffman & Pollok LLP
260 Madison Ave., 22nd Floor
New York, New York 10016

For Review of Disciplinary Action Taken by

NASD

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION – REVIEW OF DISCIPLINARY PROCEEDINGS

Material Misstatements

Conduct Inconsistent with Just and Equitable Principles of Trade

Registered representative made material misstatements to customers in connection with the offer and sale of securities, in violation of the federal securities laws and the rules of registered securities association. *Held*, association's findings of violation and the sanctions imposed are *sustained.*

APPEARANCES:

William A. Rome and *Lisa Rosenthal*, of Hoffman & Pollok LLP, for Kevin M. Glodek.

Marc Menchel, *Alan Lawhead*, *Gary J. Dernelle*, and *Jennifer C. Brooks*, for NASD.

Appeal filed: March 24, 2009
Last brief received: July 2, 2009

I.

Kevin M. Glodek, formerly a general securities representative associated with NASD member firm William Scott & Co. ("William Scott"), appeals from NASD disciplinary action against him.[1] NASD found that Glodek made material misrepresentations to certain of his customers in violation of Section 10(b) of the Securities Exchange Act of 1934,[2] Rule 10b-5 thereunder,[3] and NASD Conduct Rules 2110 and 2120.[4] NASD fined Glodek $25,000 and suspended him in all capacities for six months.[5] We base our findings on an independent review of the record.

II.

Glodek does not dispute NASD's findings of violations and the imposition of the $25,000 fine, but appeals the six-month suspension. We discuss NASD's findings to provide background for our discussion of the sanctions. Glodek entered the securities industry in 1993 and, after associating with several other firms, became associated with William Scott in March 1994. This matter springs from material misrepresentations that Glodek made to certain customers regarding Metropolitan Health Networks, Inc.'s ("MDPA") stock while Glodek was at William Scott.

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1 Glodek is presently employed as a general securities representative with another NASD member firm.

2 15 U.S.C. § 78j(b).

3 17 C.F.R. § 240.10b-5.

4 NASD Conduct Rule 2110 requires members to observe "high standards of commercial honor and just and equitable principles of trade," and a violation of any NASD rule constitutes a violation of Rule 2110. *Stephen H. Gluckman*, 54 S.E.C. 175, 185 (1999). NASD Conduct Rule 2120 prohibits members from effecting transactions, or inducing the purchase or sale of a security, by means of any manipulative, deceptive, or fraudulent device.

5 On July 26, 2007, the Commission approved a proposed rule change filed by National Association of Securities Dealers, Inc. ("NASD") to amend NASD's Restated Certificate of Incorporation to reflect its name change to Financial Industry Regulatory Authority, Inc., or FINRA, in connection with the consolidation of NASD and the member-regulation, enforcement, and arbitration functions of the New York Stock Exchange. *See* Securities Exchange Act Rel. No. 56146 (July 26, 2007), 91 SEC Docket 517 (Aug. 1, 2007) (SR-NASD-2007-053). Because NASD instituted the disciplinary action before that date, it is appropriate to continue to use the designation NASD.

A. MDPA's Business

MDPA was incorporated in 1996 to, according to its annual report, "develop a vertically and horizontally integrated healthcare delivery network." This business model, however, proved unsuccessful, and the company incurred substantial losses through 1999. MDPA's unaudited 1999 quarterly financial statements contained "going concern" statements from company management. The statements noted that MDPA had incurred substantial losses since its inception and that "the Company's ability to continue as a going concern is dependent upon achieving continued profitable operations and positive cash flows from operations or obtaining additional debt or equity financing." The December 1999 unaudited financial statements included the proviso that "[t]hese conditions raise substantial doubt about the Company's ability to continue as a going concern."

MDPA subsequently changed its business plan in 2000 to specialize in "managed care risk contracting." As a result of this new strategy, MDPA secured a managed care contract with Humana Medical Plan, Inc., Humana Health Insurance Company, and Employers Health Insurance Company (collectively, "Humana"). The contract with Humana accounted for more than 95% of MDPA's revenues during the fiscal year that ended on December 31, 2000, and the six months that ended on June 30, 2001, and MDPA acknowledged that "the loss of this contract with the HMO could significantly impact the operating results of the Company." MDPA's annual report for 2000 indicated that it generated $119,000,000 in annual revenues and $4,900,000 in annual profit, although a September 2001 restatement of the 2000 financial statements reduced the reported profit by $400,000.

During the period at issue in this proceeding, MDPA's common stock traded on the Over-the Counter Bulletin Board. In March 2001, the stock price ranged from $1.00 per share on March 1 to $1.84 on March 30. On April 30, 2001, the stock price reached a new high, closing the day at $3.12. The stock price peaked on May 7, at $3.34, and declined for the remainder of 2001. By the end of 2001, the stock price had fallen below $1.50 per share. In his testimony, Glodek acknowledged that MDPA was a speculative security.

B. Glodek's Advisory Agreements with MDPA

In 2002, while conducting a routine examination of William Scott, NASD discovered that Glodek had entered into an advisory agreement with MDPA in January 2000. Under the agreement's terms, MDPA gave Glodek a warrant to purchase 225,000 shares of MDPA common stock, at $0.17 per share, in exchange for assisting MDPA in negotiating an agreement with the owner of certain of MDPA's convertible stock. Glodek exercised the warrant and purchased 225,000 shares of MDPA restricted stock approximately ten months later, in October 2000.

In January 2001, Glodek and MDPA extended the advisory agreement for one year and broadened Glodek's responsibilities to include (i) bringing MDPA a strategic market maker, "which would serve as 'eyes and ears' in the trading box," (ii) maintaining a "working relationship" with MDPA's former CEO, (iii) maintaining a line of communication with MDPA "on a daily basis and periodically rais[ing] capital for the Company's daily operations," (iv) "market[ing] the Company to accredited investors to increase activity on the open market," and (v) introducing MDPA to "mid-tier hedge funds to develop awareness of the market." Pursuant to the extended advisory agreement's terms, Glodek received an additional 150,000 shares of MDPA common stock in September 2001.

After discovering the advisory agreement, NASD reviewed the transcripts of telephone conversations that Glodek had with certain of his customers between March 19, 2001, and April 30, 2001.[6]

C. Glodek's Statements to His Customers

NASD concluded, and Glodek does not dispute, that Glodek made material misstatements related to price predictions, MDPA's AMEX listing, MDPA's debt load, and MDPA's earnings projections.

1. Price Predictions

On several occasions, Glodek provided his customers with specific predictions of MDPA's future stock price.[7] For example, on March 22, 2001, Glodek's customer, Kevin Conners, expressed concern about the price of MDPA's stock, which was then trading at approximately $1.50 per share. Conners expressed to Glodek that he was "getting upset" because MDPA had not issued its 2000 financial statements at that point and that it was a "down market with everybody coming up with earnings problems." Glodek responded by telling Conners that he thought MDPA's stock price "will go to $5 and I'll be blowing out of it between five and ten," and added that "hopefully within two weeks we'll see it's over $2." A few day later, on March 27, 2001, Glodek told another customer, Alan Auerbach, that "[m]y price target . . . is like $5 on the stock." MDPA's stock price closed that day's trading at $1.78. On March 29, 2001, Lindsay Willey complained to Glodek about losses in his account, to which Glodek responded that "I think that the MDPA goes back to $5, I really feel comfortable about it." A few days later, on April 1, 2001, Glodek reiterated to Willey that "I hope that, you know, over the next two to three months we'll be selling the stock, half of our position out at $5."

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[6] NASD chose these dates because MDPA's stock exhibited a large price increase between January and April 2001. William Scott, however, had only begun recording telephone conversations on March 19, 2001. NASD introduced into evidence thirty-five telephone recordings, which included conversations between Glodek and William Scott customers.

[7] Although, as noted above, MDPA's financials improved in 2000 over the company's performance during earlier periods, there was no specific news about MDPA during the period at issue that led Glodek to make the price predictions at issue.

On April 10, 2001, Glodek made a similar statement when customer Pat Kelly asked whether MDPA was "going to do anything in the near term" that would warrant Kelly maintaining his position in MDPA stock rather than liquidating his holdings in favor of another stock. Glodek responded, "I mean, the deal could be the greatest deal, I don't know, but I wouldn't sell [MDPA] here 'cause it's so undervalued." Glodek also stated that MDPA is "going to be $5 hopefully within the next two to three months."

2. Statements that AMEX Listing Was Imminent

Glodek also made several representations that MDPA would qualify for listing on the American Stock Exchange, Inc. ("AMEX") once the company's share price reached $2 or $3 per share. For example, on March 27, 2001, Glodek told Auerbach that MDPA's "[s]tock will probably drift over $2. And then you'll see it approved for . . . the AMEX and then the stock will be off from there."

Glodek, however, had a brief conversation with MDPA's president, Fred Sternberg, on April 10, 2001, during which Glodek asked Sternberg "when do we [MDPA] drop an application for the [AMEX]?" Sternberg responded, "I really haven't had . . . final approval [from the MDPA board of directors]," and stated, "We don't know if it's national NASDAQ or American, and I can't really tell you when." Glodek's prediction of an imminent listing also focused on stock price and ignored the other factors AMEX utilizes when evaluating applications, such as the company's accounts receivables, the outstanding shareholder equity, and the large percentage of business generated from a single payer source.[8]

Later in April 2001, Glodek told customer Mel Ogrin that, if MDPA reported quarterly financial numbers "the way I predict them to come out," then "the stock will easily be over $3. And if that's the case, the company qualifies for AMEX." Glodek added that, "if it's on AMEX, you're going to get another run out of it." A day later, on April 26, 2001, Glodek told Kelly that MDPA was "basically qualifying for AMEX here by Memorial Day weekend." Four days later, MDPA's stock rose above $3 per share, at which time Glodek told Kelly, "[n]ow we're waiting for the numbers to do out [sic] and they just qualified for AMEX under my understanding, so they get the okay to get on the AMEX we're going to get a whole 'nother run of the stock."

3. Statements that MDPA was a Debt-Free Company

Glodek told several customers that MDPA was a debt-free company. For instance, Glodek told Auerbach on March 27, 2001 that "they [MDPA] have no debt." Glodek described MDPA to three other customers over the next two weeks variously as a "company [that] has no debt," a "company [that] went from astronomical amounts of debt in '99 to a debt-free company

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[8] MDPA ultimately applied for a listing on AMEX in June 2001, and AMEX questioned it about all of these areas. MDPA subsequently withdrew its application and did not begin trading on the AMEX until more than two and one-half years later on November 22, 2004.

in 2000," and "a company with no debt." MDPA's financial statements for the fiscal year ending December 31, 2000, however, showed that the company had long-term debt of more than $1.2 million, approximately half of which matured in 2001, and owed more than $2.5 million in unpaid payroll tax liabilities to the Internal Revenue Service.

4. Earnings Projections

Glodek also made quarterly earnings projections regarding MDPA to customer Michael Rosenbaum. On March 26, 2001, Glodek told Rosenbaum that MDPA's earnings were due the following day and that "they're going to do 120 million for the year, and earn about six million in cash . . . . For this quarter right now . . . . Yeah they earned like six million dollars already supposedly in the first quarter, that's what I'm hearing." In reality, MDPA's net income for the first quarter was approximately $1.2 million, which was only 20% of what Glodek predicted MDPA would earn.

D. Procedural History

After reviewing Glodek's recorded telephone conversations, NASD filed a complaint against him on August 1, 2005. NASD alleged that Glodek's statements described above included material misstatements in connection with the offer and sale of securities and that this violated Section 10(b) of the Exchange Act, Rule 10b-5 thereunder, and NASD Conduct Rules 2110 and 2120. After conducting a two-day hearing, an NASD Hearing Panel concluded that Glodek had acted recklessly and committed the violations charged by NASD. The Hearing Panel suspended Glodek in all capacities for sixty days and imposed a $25,000 fine.

NASD appealed the Hearing Panel's determination of sanctions to NASD's National Adjudicatory Council ("NAC"), seeking a bar. Glodek cross-appealed, initially asserting that the Hearing Panel's findings of violations were erroneous, but later abandoned his cross-appeal to the NAC and instead argued that the NAC should affirm the Hearing Panel's decision.

On February 24, 2009, the NAC affirmed the Hearing Panel's findings of violations and the $25,000 fine but modified the imposition of sanctions by increasing the suspension from sixty days to six months. In its decision, the NAC disagreed with the Hearing Panel's decision that there was no pattern to Glodek's misstatements. The NAC concluded that Glodek's misstatements were serious and not an isolated occurrence given that Glodek made at least fourteen misstatements over a period of six weeks to eight different customers. The NAC also noted that Glodek had a personal financial interest in MDPA's stock price and that, although several of Glodek's customers testified on his behalf, NASD "look[s] beyond the interests of particular investors in assessing the need for sanctions to protect investors generally." This appeal followed.

III.

Glodek does not dispute that he made reckless misstatements of material facts about MDPA to his customers in connection with their purchases of MDPA stock and does not dispute that those misstatements violated the antifraud provisions of the securities laws. Our *de novo* review of the record finds that the record supports NASD's findings of violations.

Glodek's specific predictions for MDPA's stock price were made repeatedly and without basis. His prediction of MDPA's quarterly earnings to Rosenbaum was similarly without basis and inaccurate. MDPA was a speculative security, as Glodek acknowledged. We have held that predictions of specific and substantial increases in the price of a speculative security within a relatively short period of time are fraudulent.[9] We have also held that predictions of specific and substantial increases in the price of any security, whether speculative or not, that are made without a reasonable basis are fraudulent.[10] NASD found, and Glodek has not disputed, that Glodek lacked an adequate basis to make these predictions about the future share price and earnings of MDPA and that he acted recklessly in making these misstatements to his customers. While several customers testified that they did not rely on these predictions, NASD is not required to prove reliance.[11]

Although NASD found that Glodek's conduct was merely reckless, rather than intentional, his misstatements with respect to MDPA being debt free and on the verge of listing on the AMEX are troubling. By simply looking at MDPA's financial statements, Glodek would have learned that, during the period that he told several customers that MDPA had no debt, MDPA still had significant debt given the size of its earnings and the length of its operating history. With respect to Glodek's statements that MDPA's listing on AMEX was imminent, Glodek had spoken to MDPA's president about this on April 10, 2001, and he knew (or, in the case of Auerbach, would have known) that MDPA had not filed the necessary application for a listing on AMEX and that MDPA's president had no idea when or for which exchange it might submit an application. In fact, MDPA was not listed on AMEX until 2004. In addition, Glodek's

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9 *See, e.g., Philip A. Lehman*, Exchange Act Rel. No. 54660 (Oct. 27, 2006), 89 SEC Docket 536, 540; *Dane E. Faber*, 57 S.E.C. 297, 306 n.15 (2004) (citing *Steven D. Goodman*, 54 S.E.C. 1203, 1210 (2001); *Joseph Barbato*, 53 S.E.C. 1259, 1273 (1999); *Cortlandt Investing Corp.*, 44 S.E.C. 45, 50 (1969)); *Donald A. Roche*, 53 S.E.C. 16, 18-19 n.2 (1997) (citing *Irving Friedman*, 43 S.E.C. 314, 320 (1967); *Alfred Miller*, 43 S.E.C. 233, 235 (1966) (noting that such "predictions are a 'hallmark' of fraud")).

10 *Steven E. Muth*, Exchange Act Rel. No. 52551 (Oct. 3, 2005), 86 SEC Docket 1217, 1229; *Barbato*, 53 S.E.C. at 1273 n.19 (citing *C. James Padgett*, 52 S.E.C. 1257, 1265 (1997), *aff'd sub nom. Sullivan v. SEC*, 159 F.3d 637 (D.C. Cir. 1998), *cert. denied*, 525 U.S. 1070 (1999)); *Roche*, 53 S.E.C. at 19 n.3 (citing *Lester Kuznetz*, 48 S.E.C. 551, 553 (1986)).

11 *Robert Tretiak*, 56 S.E.C. 209, 223 n.26 (2003).

comments to customers indicate that the share price was the sole determining factor as to whether the stock would be listed on AMEX when, in reality, other factors played an important role in that determination. The record supports NASD's finding that Glodek's misstatements were made recklessly. Accordingly, we find that Glodek violated Exchange Act Section 10(b), Exchange Act Rule 10b-5,[12] and NASD Conduct Rules 2110 and 2120.

IV.

Glodek challenges only the six-month suspension NASD imposed. We must sustain NASD's sanctions unless we find, having due regard for the public interest and the protection of investors, that the sanctions are excessive, oppressive, or impose an unnecessary or inappropriate burden on competition.[13]

We find that a six-month suspension is warranted in this case. The NASD Sanction Guidelines (the "Sanction Guidelines") recommend imposition of a fine of $10,000 to $100,000, and a suspension of ten business day to two years; in egregious cases, the Sanction Guidelines recommend a bar.[14]

Although the NAC increased the suspension, the resulting sanction, contrary to Glodek's contention that NASD "demands the most severe sanctions possible," is nonetheless at the lower end of the Sanction Guidelines for non-egregious conduct. Moreover, conduct that violates the antifraud provisions of the securities laws "is especially serious and subject to the severest of sanctions."[15] Glodek's misconduct was at least reckless, and the misstatements were repeated at least fourteen times over the six-week period examined by NASD. As discussed below, NASD

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[12] "[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information." *Basic, Inc. v. Levinson*, 485 U.S. 224, 240 (1988). If "there is a substantial likelihood that a reasonable investor would consider the information important in making an investment decision," the information is material. *SEC v. Rogers*, 790 F.2d 1450, 1458 (9th Cir. 1986).

[13] 15 U.S.C. § 78s(e)(2). Glodek does not allege, and the record does not show, that NASD's sanctions imposed an undue burden on competition. We find that the $25,000 fine is neither excessive nor oppressive.

[14] *NASD Sanction Guidelines* at 93 (2007). Although the Commission is not bound by the Sanction Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2). *Wanda P. Sears*, Exchange Act Rel. No. 58075 (July 1, 2008), 93 SEC Docket 7395, 7403. NASD found that Glodek's conduct was not egregious.

[15] *Vincent M. Uberti*, Exchange Act Rel. No. 58917 (Nov. 7, 2008), 94 SEC Docket 11406, 11416 n.26 (quoting *Marshall E. Melton*, 56 S.E.C. 695, 713 (2003)) (affirming imposition of bar where applicant had released fraudulent misleading research reports).

considered certain factors to be mitigating and accordingly elected not to impose the maximum two-year suspension for a non-egregious violation under the Sanction Guidelines. We find that a six-month suspension for Glodek's violations of the antifraud provisions is not excessive or oppressive, and we sustain it.

Glodek challenges the six-month suspension imposed by NASD on three principal grounds: 1) that the NAC improperly increased the suspension initially imposed by the Hearing Panel; 2) that NASD did not explain why a shorter suspension would be insufficient; and 3) that NASD did not give adequate weight to mitigating factors.

Glodek argues that NASD abused its power when the NAC increased the length of the suspension that the Hearing Panel initially imposed. Glodek takes the position that the sixty-day suspension assessed by the Hearing Panel is the appropriate sanction for his violations. Although Glodek cites the Hearing Panel's decision in his appeal, "it is the decision of the NAC, not the decision of the Hearing Panel, that is the final action of NASD which is subject to Commission review."[16] We have repeatedly held that the NAC reviews the Hearing Panel's decision *de novo* and has broad discretion to review the Hearing Panel's decisions and sanctions.[17] In addition, NASD Rules 9348 and 9349 state that, on appeal from a Hearing Panel decision, the NAC "may affirm, modify, reverse, increase, or reduce any sanction, or impose any other fitting sanction."[18] We therefore find no abuse of power in NASD's decision to impose a six-month suspension.

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[16] *Philippe N. Keyes*, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 800 n.17.

[17] *See Michael B. Jawitz*, 55 S.E.C. 188, 200 & n.24 (2001) (stating that the NAC conducts a *de novo* review and has broad discretion to review any finding in the Hearing Panel decision) (citing *Timothy L. Burkes*, 51 S.E.C. 356, 359 (1993), *aff'd*, 29 F.3d 630 (9th Cir. 1994) (Table)); *cf. Morton Bruce Erenstein*, Exchange Act Rel. No. 56768 (Nov. 8, 2007), 91 SEC Docket 3114, 3126 (acknowledging NAC's power to conduct a *de novo* review and make its own independent findings), *petition denied*, No. 07-15736 (11th Cir. 2008) (Unpublished). *See also Chris Dinh Hartley*, 57 S.E.C. 767, 776 (2004) (finding NASD's sanctions were not excessive or oppressive where the NAC increased a suspension imposed by Hearing Panel from thirty days to ninety days for violations involving registered representative selling away from his member firm employer); *James B. Chase,* 56 S.E.C. 149, 162 (2003) (finding NASD's sanctions not excessive or oppressive where NAC increased Hearing Panel's suspension from six months to one year for violations involving unsuitable investment recommendations); *Jim Newcomb*, 55 S.E.C. 406, 418 (2001) (finding NASD's sanctions not excessive or oppressive where NAC increased Hearing Panel's suspension from ninety days to two years for violations involving registered representative selling away from his member firm employer).

[18] These Rules were also quoted in the April 11, 2007, letter from NASD delivering the Hearing Panel decision to Glodek and informing him of his right to appeal the decision to the NAC.

Glodek argues that the NAC could not assess a six-month suspension unless its decision was "based on a factual and/or legal finding that sixty days was not sufficient to serve the remedial purpose of those sanctions." However, NASD is not required to state why a lesser sanction would be insufficient in order to justify the sanction it imposed as being remedial.[19] A sanction is appropriate "so long as its choice meets the statutory requirements that a sanction be remedial and not 'excessive or oppressive.'"[20]

Glodek cites NASD's finding that his conduct was not egregious in support of his argument that a sixty-day suspension is a more appropriate sanction for his violations than a six-month suspension. However, the finding that his misconduct was not egregious simply indicated that the Sanction Guidelines did not recommend a bar for these violations. A suspension of up to two years for non-egregious violations such as Glodek's falls within the recommended range.

Glodek also argues that the NAC's description of his misconduct as "serious" misconduct did not provide an adequate basis for its determination to increase the suspension initially imposed by the Hearing Panel because "simply calling the misconduct 'serious' does not explain anything," and that "the term 'serious' is not used anywhere in the Guidelines that apply to this case." Glodek adds that NASD's reliance on "a standard of 'serious[ness]'" was a violation of his due process rights because the term failed to give him fair notice of what type of conduct was prohibited. We have held that generally self-regulatory organizations, such as NASD, are not state actors and thus are not subject to the Constitution's due process requirements.[21] Further, the description of Glodek's conduct as "serious" did not impede the fairness of the proceeding. Glodek was aware that NASD staff was seeking a bar on appeal to the NAC, giving him notice of the gravity with which the staff viewed his conduct.[22] Glodek thus cannot credibly claim that he

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19 *Paz Sec., Inc. v. SEC,* 566 F.3d 1172, 1176 (D.C. Cir. 2009). *Cf. Horning v. SEC,* 570 F.3d 337, 346 (D.C. Cir. 2009) (holding that Commission need not state why a lesser sanction would be insufficient as long as it "articulated a reasonable, protective rationale for the penalties it selected.").

20 *Paz*, 566 F.3d at 1176.

21 *See, e.g., Scott Epstein*, Exchange Act Rel. No. 59328 (Jan. 30, 2009), 95 SEC Docket, 13833, 13855 ("[I]t is well established that self-regulatory organizations are not subject to the Constitution's due process requirements."), *appeal docketed*, No. 09-1550 (3d Cir. Feb. 24, 2009).

22 We have used the adjective "serious" to describe actions that we found to be deserving of sanctions. *See, e.g., Scott B. Gann*, Exchange Act Rel. No. 59729 (Apr. 8, 2009), 95 SEC Docket 15818, 15823 (affirming bar where applicant's conduct was "especially serious and subject to the severest sanctions" (quoting *Jose P. Zollino*, Exchange Act Rel. No. 55107 (Jan. 16, 2007), 89 SEC Docket 2598, 2608), *appeal docketed*, No. 09-60435 (5th Cir. June 5,

(continued...)

lacked fair notice that "serious" misconduct could result in a six-month suspension. Further, it was the nature of Glodek's conduct, recklessly making fraudulent misstatements, that led to NASD's determination to impose a six-month suspension, not the description of that conduct as being "serious."

In support of his argument that a sixty-day suspension would be a more appropriate sanction for his violations than the six-month suspension ultimately imposed, Glodek contends that a number of factors mitigate the severity of his violations. In choosing not to impose either the bar sought by its staff or the maximum two-year suspension under the Sanction Guidelines for non-egregious conduct, NASD gave "some credit to the fact that MDPA recently had become profitable," thus providing "some basis for Glodek's enthusiasm" in making the unfounded price and earnings predictions. NASD also noted that none of the customers suffered financial losses as a result of Glodek's admitted fraudulent misconduct. NASD further treated as mitigating the fact that three of the four customers who testified stated that they were aware of Glodek's advisory relationship with MDPA at the time he made the misstatements, as well as the fact that several of the customers were sophisticated investors.

Glodek points to other facts that he alleges further mitigate his misconduct. Although Glodek does not deny that he made the misstatements captured on the taped telephone conversations, he asserts that the taped conversations occurred over only a specific six-week period, included conversations only on Glodek's telephone extension, and did not include all conversations on Glodek's extension during the time period. Although Glodek indicates that he believes evidence not in the record might put the misstatements he made on the taped telephone conversations in a different context, he cites no evidence to support this allusion, nor does he deny the accuracy of the transcripts of the conversations.

Glodek further notes that the violations related to fourteen calls out of a total of approximately 600 originally obtained as part of the NASD investigation. NASD rejected Glodek's argument that the misstatements were not part of a pattern of misconduct, and we find that the record supports this determination. Glodek made fourteen misstatements to eight different customers over a six-week period. We disagree with Glodek's characterization of this misconduct as a "small number of violative statements." Instead, we find that the repetition of positive statements about MDPA misstating its true condition, admittedly made recklessly and without basis over a six-week period, evidences a pattern of misconduct by Glodek.

Glodek also cites the testimony of four of the customers to whom Glodek made the violative misstatements, who stated that Glodek did not mislead them, that they did not rely on

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[22] (...continued)
2009)); *Gary Kornman*, Exchange Act Rel. No. 59403 (Feb. 19, 2009), 95 SEC Docket 14246, 14261 (affirming bar where applicant had engaged in "serious misconduct"), *appeal docketed*, No. 09-1074 (D.C. Cir. Feb. 25, 2009); *Sidney C. Eng*, 53 S.E.C. 709, 722 (1998) (concluding bar was an appropriate sanction "given the serious nature of [applicant's] misconduct").

his misstatements, and that they did not lose any money as a result of the misstatements. Several of the customers also testified that they had invested in or had business relationships with MDPA prior to discussing the stock with Glodek, and that they were aware of Glodek's business relationship with MDPA and his financial interest in MDPA's stock price. Regardless of the customers' testimony, Glodek acknowledges that he violated the antifraud provisions of the securities laws. The fact that many of the customers did not lose money and did not complain about the violations does not further mitigate Glodek's misconduct.[23]

Glodek further argues that his lack of any prior disciplinary history and his "cooperation, and perhaps equally importantly, that he did not do anything to impede the investigation" mitigate the seriousness of his at least reckless misconduct and warrant a reduction of his suspension. We have consistently rejected the argument that a lack of disciplinary history should be considered as a mitigating factor in connection with the imposition of sanctions in NASD proceedings.[24] It also does not mitigate the seriousness of Glodek's misconduct that he "did not do anything to impede the investigation." When Glodek registered with NASD, he agreed to abide by its rules, and compliance with his obligation to cooperate with an investigation is not a mitigating factor.[25]

We agree with NASD that Glodek's misstatements represent serious fraudulent misconduct. Registered representatives must not make repeated, reckless, and unfounded misstatements to their customers in connection with the sale of securities, and doing so warrants the imposition of meaningful sanctions. Even though he has admitted the violations, Glodek continues to state that he "did not deceive his customers," indicating that he does not appreciate the seriousness of his misconduct. Glodek continues to be employed as a registered

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[23] *See Ronald J. Gogul*, 52 S.E.C. 307, 312 n.20 (1995) (finding the fact that no customer complained about an investment was "not persuasive" in support of respondent's argument that sanctions should be reduced).

[24] *John D. Audifferen*, Exchange Act Rel. No. 58230 (July 25, 2008), 93 SEC Docket 8129, 8148; *Michael A. Rooms*, Exchange Act Re. No. 51467 (April 1, 2005), 85 SEC Docket 444, 450, *aff'd*, 444 F.3d 1208 (10th Cir. 2006).

[25] *See, e.g., Michael Frederick Siegel*, Exchange Act Rel. No. 58737 (Oct. 6, 2008), 94 SEC Docket 10501, 10519 n. 44 (citing *Rooms*, 85 SEC Docket at 450-51 (finding sanction neither excessive nor oppressive where respondent noted lack of disciplinary history)), *appeal docketed*, No. 09-1379 (D.C.Cir. Dec. 3, 2008); *Philippe N. Keyes*, Exchange Act Rel. No. 54723 (Nov. 8, 2006), 89 SEC Docket 792, 801 & nn.20 & 22 (finding cooperation during NASD investigation and a lack of disciplinary history not mitigating) (citing cases); *Michael Markowski*, 51 S.E.C. 553, 557 (1993), *aff'd*, 34 F.3d 99 (3d Cir. 1994)). The Sanction Guidelines provide that an associated person's "substantial assistance" to NASD during an investigation is generally mitigating. Glodek's cooperation was consistent with the responsibility he agreed to fulfill when he became an associated person and does not constitute substantial assistance.

representative with an NASD member firm, and the securities industry "presents a great many opportunities for abuse and overreaching, and depends very heavily on the integrity of its participants."[26] Given Glodek's lack of understanding of his obligations as a securities professional and his continued employment in the securities industry, a six-month suspension will have the remedial effect of protecting the investing public from harm by impressing upon Glodek and other registered representatives the importance of avoiding reckless, unfounded statements about stocks they recommend to their brokerage customers.[27] We find that the six-month suspension achieves the goals of being remedial and deterring future violations, without being excessive or oppressive.[28]

We find that the sanctions imposed against Glodek are neither excessive nor oppressive and are appropriate remedial sanctions for the violations, and we sustain NASD's findings of violations.[29]

An appropriate order will issue.

By the Commission (Commissioner WALTER, AGUILAR and PAREDES); Chairman SCHAPIRO and Commissioner CASEY not participating.

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

Elizabeth M. Murphy
Secretary

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26 *Bernard D. Gorniak*, 52 S.E.C. 371, 373 (1995). *See also, e.g.*, *Frank Kufrovich*, 55 S.E.C. 616, 627 (2002) ("A propensity for dishonest behavior is of particular concern in the securities industry, an industry that presents numerous opportunities for abuses of trust."); *Mayer A. Amsel*, 52 S.E.C. 761, 768 (1996) (noting that the securities industry is "rife with opportunities for abuse").

27 *See SEC v. PAZ Sec., Inc.*, 494 F.3d 1059, 1066 (D.C. Cir. 2007) (stating that "general deterrence" may be "considered as part of the overall remedial inquiry," quoting *McCarthy v. SEC*, 406 F.3d 179, 189 (2d Cir. 2005)), *petition denied*, 566 F.3d 1172 (D.C. Cir. 2009).

28 Although we might have reached a different conclusion as to the appropriate sanction for Glodek's fraudulent conduct, we do not have authority to increase a sanction imposed by a self-regulatory organization, but only to determine whether the sanction is excessive or oppressive.

29 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. 60937 / November 4, 2009

Admin. Proc. File No. 3-13414

In the Matter of

KEVIN M. GLODEK

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Attention: William A. Rome, Esq.
260 Madison Ave., 22nd Floor
New York, New York 10016

For Review of Disciplinary Action Taken by

NASD

ORDER SUSTAINING ACTION OF REGISTERED SECURITIES ASSOCIATION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by NASD against Kevin M. Glodek be, and it hereby is, sustained.

By the Commission.

Elizabeth M. Murphy
Secretary

Florence E. Harmon

By: Florence E. Harmon
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 60940 / November 4, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13676

In the Matter of **Valcapx Acquisition Corp.,** **Valuestar Corp.,** **Vandelay, Inc.,** **VelocityHSI, Inc.,** **Ventura Entertainment Group, Ltd. (n/k/a Insight Entertainment Group, Ltd.),** **and** **Verida Internet Corp.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Valcapx Acquisition Corp., Valuestar Corp., Vandelay, Inc., VelocityHSI, Inc., Ventura Entertainment Group, Ltd. (n/k/a Insight Entertainment Group, Ltd.), and Verida Internet Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Valcapx Acquisition Corp. (CIK No. 1142056) is a revoked Nevada corporation located in Los Angeles, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Valcapx Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended December 31, 2004, which reported a net loss of $1,163 since inception on June 18, 2001.

2. Valuestar Corp. (CIK No. 895262) is a dissolved Colorado corporation located in Oakland, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Valuestar is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended June 30, 2001, which reported a net loss of $18,592,277 for the prior year. As of October 30, 2009, the company's stock (symbol "VLST") was traded on the over-the-counter markets.

3. Vandelay, Inc. (CIK No. 1172607) is a forfeited Delaware corporation located in Los Angeles, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Vandelay is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2002, which reported a net loss of $500 since inception on February 27, 2002.

4. VelocityHSI, Inc. (CIK No. 1113129) is a void Delaware corporation located in Walnut Creek, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). VelocityHSI is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2001, which reported a net loss of $2,143,682 for the prior three months. On August 14, 2001, the company filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of California, and the case was terminated on April 6, 2006. As of October 30, 2009, the company's stock (symbol "VHSIQ") was traded on the over-the-counter markets.

5. Ventura Entertainment Group, Ltd. (n/k/a Insight Entertainment Group, Ltd.) (CIK No. 828217) is an inactive Delaware corporation located in Los Angeles, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Ventura Entertainment is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1995, which reported a net loss of $2,029,314 for the prior three months. On September 18, 1996, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Middle District of Tennessee, and the case was terminated on May 6, 1999.

6. Verida Internet Corp. (CIK No. 1083523) is a permanently revoked Nevada corporation located in San Francisco, California with a class of equity securities registered with the Commission pursuant to Exchange Act Section 12(g). Verida Internet is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of $1,448,251 for the prior three months. As of October 30, 2009, the company's stock (symbol "VERY") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission (*see* Chart of Delinquent Filings, attached hereto as Appendix 1), have repeatedly failed to meet their obligations to file timely

periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

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

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

III.

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

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

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

IV.

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

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

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against it upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Attachment

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

Appendix 1

Chart of Delinquent Filings
Valcapx Acquisition Corp., et al.

Valcapx Acquisition Corp.

10-QSB	03/31/05	5/16/05	Not filed	54
10-KSB	06/30/05	9/28/05	Not filed	50
10-QSB	09/30/05	11/14/05	Not filed	48
10-QSB	12/31/05	2/14/06	Not filed	45
10-QSB	03/31/06	5/15/06	Not filed	42
10-KSB	06/30/06	9/28/06	Not filed	38
10-QSB	09/30/06	11/14/06	Not filed	36
10-QSB	12/31/06	2/14/07	Not filed	33
10-QSB	03/31/07	5/15/07	Not filed	30
10-KSB	06/30/07	9/28/07	Not filed	26
10-QSB	09/30/07	11/14/07	Not filed	24
10-QSB	12/31/07	2/14/08	Not filed	21
10-QSB	03/31/08	5/15/08	Not filed	18
10-KSB	06/30/08	9/29/08	Not filed	14
*10-Q**	09/30/08	11/14/08	Not filed	12
*10-Q**	12/31/08	2/17/09	Not filed	9
*10-Q**	03/31/09	05/15/09	Not filed	6
*10-K**	06/30/09	09/28/09	Not filed	2

Total Filings Delinquent **18**

Valuestar Corp.

10-QSB	09/30/01	11/14/01	Not filed	96
10-QSB	12/31/01	2/14/02	Not filed	93
10-QSB	03/31/02	5/15/02	Not filed	90
10-KSB	06/30/02	9/30/02	Not filed	86
10-QSB	09/30/02	11/14/02	Not filed	84
10-QSB	12/31/02	2/14/03	Not filed	81
10-QSB	03/31/03	5/15/03	Not filed	78
10-KSB	06/30/03	9/29/03	Not filed	74
10-QSB	09/30/03	11/14/03	Not filed	72
10-QSB	12/31/03	2/17/04	Not filed	69
10-QSB	03/31/04	5/17/04	Not filed	66
10-KSB	06/30/04	9/28/04	Not filed	62
10-QSB	09/30/04	11/15/04	Not filed	60
10-QSB	12/31/04	2/14/05	Not filed	57

Valuestar Corp.

10-QSB	03/31/05	5/16/05	Not filed	54
10-KSB	06/30/05	9/28/05	Not filed	50
10-QSB	09/30/05	11/14/05	Not filed	48
10-QSB	12/31/05	2/14/06	Not filed	45
10-QSB	03/31/06	5/15/06	Not filed	42
10-KSB	06/30/06	9/28/06	Not filed	38
10-QSB	09/30/06	11/14/06	Not filed	36
10-QSB	12/31/06	2/14/07	Not filed	33
10-QSB	03/31/07	5/15/07	Not filed	30
10-KSB	06/30/07	9/28/07	Not filed	26
10-QSB	09/30/07	11/14/07	Not filed	24
10-QSB	12/31/07	2/14/08	Not filed	21
10-QSB	03/31/08	5/15/08	Not filed	18
10-KSB	06/30/08	9/29/08	Not filed	14
*10-Q**	09/30/08	11/14/08	Not filed	12
*10-Q**	12/31/08	2/17/09	Not filed	9
*10-Q**	03/31/09	05/15/09	Not filed	6
*10-K**	06/30/09	09/28/09	Not filed	2

Total Filings Delinquent **32**

Vandelay, Inc.

10-QSB	06/30/02	08/14/02	Not filed	87
10-QSB	09/30/02	11/14/02	Not filed	84
10-KSB	12/31/02	03/31/03	Not filed	80
10-QSB	03/31/03	05/15/03	Not filed	78
10-QSB	06/30/03	08/14/03	Not filed	75
10-QSB	09/30/03	11/14/03	Not filed	72
10-KSB	12/31/03	03/30/04	Not filed	68
10-QSB	03/31/04	05/17/04	Not filed	66
10-QSB	06/30/04	08/16/04	Not filed	63
10-QSB	09/30/04	11/15/04	Not filed	60
10-KSB	12/31/04	03/31/05	Not filed	56
10-QSB	03/31/05	05/16/05	Not filed	54
10-QSB	06/30/05	08/15/05	Not filed	51
10-QSB	09/30/05	11/14/05	Not filed	48
10-KSB	12/31/05	03/31/06	Not filed	44
10-QSB	03/31/06	05/15/06	Not filed	42
10-QSB	06/30/06	08/14/06	Not filed	39
10-QSB	09/30/06	11/14/06	Not filed	36
10-KSB	12/31/06	04/02/07	Not filed	31
10-QSB	03/31/07	05/15/07	Not filed	30

Vandelay, Inc.

10-QSB	06/30/07	08/14/07	Not filed	27
10-QSB	09/30/07	11/14/07	Not filed	24
10-KSB	12/31/07	03/31/08	Not filed	20
*10-Q**	03/31/08	5/15/08	Not filed	18
*10-Q**	06/30/08	08/14/08	Not filed	15
*10-Q**	09/30/08	11/14/08	Not filed	12
*10-K**	12/31/08	03/31/09	Not filed	8
*10-Q**	03/31/09	05/15/09	Not filed	6
*10-Q**	06/30/09	08/14/09	Not filed	3

Total Filings Delinquent **29**

VelocityHSI, Inc.

10-Q	06/30/01	08/14/01	Not filed	99
10-Q	09/30/01	11/14/01	Not filed	96
10-K	12/31/01	04/01/02	Not filed	91
10-Q	03/31/02	05/15/02	Not filed	90
10-Q	06/30/02	08/14/02	Not filed	87
10-Q	09/30/02	11/14/02	Not filed	84
10-K	12/31/02	03/31/03	Not filed	80
10-Q	03/31/03	05/15/03	Not filed	78
10-Q	06/30/03	08/14/03	Not filed	75
10-Q	09/30/03	11/14/03	Not filed	72
10-K	12/31/03	03/30/04	Not filed	68
10-Q	03/31/04	05/17/04	Not filed	66
10-Q	06/30/04	08/16/04	Not filed	63
10-Q	09/30/04	11/15/04	Not filed	60
10-K	12/31/04	03/31/05	Not filed	56
10-Q	03/31/05	05/16/05	Not filed	54
10-Q	06/30/05	08/15/05	Not filed	51
10-Q	09/30/05	11/14/05	Not filed	48
10-K	12/31/05	03/31/06	Not filed	44
10-Q	03/31/06	05/15/06	Not filed	42
10-Q	06/30/06	08/14/06	Not filed	39
10-Q	09/30/06	11/14/06	Not filed	36
10-K	12/31/06	04/02/07	Not filed	31
10-Q	03/31/07	05/15/07	Not filed	30
10-Q	06/30/07	08/14/07	Not filed	27
10-Q	09/30/07	11/14/07	Not filed	24
10-K	12/31/07	03/31/08	Not filed	20
10-Q	03/31/08	5/15/08	Not filed	18
10-Q	06/30/08	08/14/08	Not filed	15
10-Q	09/30/08	11/14/08	Not filed	12

VelocityHSI, Inc.

	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	**33**				

Ventura Entertainment Group, Ltd. (n/k/a Insight Entertainment Group, Ltd.)

10-K	12/31/95	04/01/96	Not filed	163
10-Q	03/31/96	05/15/96	Not filed	162
10-Q	06/30/96	08/14/96	Not filed	159
10-Q	09/30/96	11/14/96	Not filed	156
10-K	12/31/96	03/31/97	Not filed	152
10-Q	03/31/97	05/15/97	Not filed	150
10-Q	06/30/97	08/14/97	Not filed	147
10-Q	09/30/97	11/14/97	Not filed	144
10-K	12/31/97	03/31/98	Not filed	140
10-Q	03/31/98	05/15/98	Not filed	138
10-Q	06/30/98	08/14/98	Not filed	135
10-Q	09/30/98	11/16/98	Not filed	132
10-K	12/31/98	03/31/99	Not filed	128
10-Q	03/31/99	05/17/99	Not filed	126
10-Q	06/30/99	08/16/99	Not filed	123
10-Q	09/30/99	11/15/99	Not filed	120
10-K	12/31/99	03/30/00	Not filed	116
10-Q	03/31/00	05/15/00	Not filed	114
10-Q	06/30/00	08/14/00	Not filed	111
10-Q	09/30/00	11/14/00	Not filed	108
10-K	12/31/00	04/02/01	Not filed	103
10-Q	03/31/01	05/15/01	Not filed	102
10-Q	06/30/01	08/14/01	Not filed	99
10-Q	09/30/01	11/14/01	Not filed	96
10-K	12/31/01	04/01/02	Not filed	91
10-Q	03/31/02	05/15/02	Not filed	90
10-Q	06/30/02	08/14/02	Not filed	87
10-Q	09/30/02	11/14/02	Not filed	84
10-K	12/31/02	03/31/03	Not filed	80
10-Q	03/31/03	05/15/03	Not filed	78
10-Q	06/30/03	08/14/03	Not filed	75
10-Q	09/30/03	11/14/03	Not filed	72

Ventura Entertainment Group, Ltd. (n/k/a Insight Entertainment Group, Ltd.)

10-K	12/31/03	03/30/04	Not filed	68
10-Q	03/31/04	05/17/04	Not filed	66
10-Q	06/30/04	08/16/04	Not filed	63
10-Q	09/30/04	11/15/04	Not filed	60
10-K	12/31/04	03/31/05	Not filed	56
10-Q	03/31/05	05/16/05	Not filed	54
10-Q	06/30/05	08/15/05	Not filed	51
10-Q	09/30/05	11/14/05	Not filed	48
10-K	12/31/05	03/31/06	Not filed	44
10-Q	03/31/06	05/15/06	Not filed	42
10-Q	06/30/06	08/14/06	Not filed	39
10-Q	09/30/06	11/14/06	Not filed	36
10-K	12/31/06	04/02/07	Not filed	31
10-Q	03/31/07	05/15/07	Not filed	30
10-Q	06/30/07	08/14/07	Not filed	27
10-Q	09/30/07	11/14/07	Not filed	24
10-K	12/31/07	03/31/08	Not filed	20
10-Q	03/31/08	5/15/08	Not filed	18
10-Q	06/30/08	08/14/08	Not filed	15
10-Q	09/30/08	11/14/08	Not filed	12
10-K	12/31/08	03/31/09	Not filed	8
10-Q	03/31/09	05/15/09	Not filed	6
10-Q	06/30/09	08/14/09	Not filed	3

Total Filings Delinquent **55**

Verida Internet Corp.

10-KSB	12/31/00	04/02/01	Not filed	103
10-QSB	03/31/01	05/15/01	Not filed	102
10-QSB	06/30/01	08/14/01	Not filed	99
10-QSB	09/30/01	11/14/01	Not filed	96
10-KSB	12/31/01	04/01/02	Not filed	91
10-QSB	03/31/02	05/15/02	Not filed	90
10-QSB	06/30/02	08/14/02	Not filed	87
10-QSB	09/30/02	11/14/02	Not filed	84
10-KSB	12/31/02	03/31/03	Not filed	80
10-QSB	03/31/03	05/15/03	Not filed	78
10-QSB	06/30/03	08/14/03	Not filed	75
10-QSB	09/30/03	11/14/03	Not filed	72
10-KSB	12/31/03	03/30/04	Not filed	68

Verida Internet Corp.

10-QSB	03/31/04	05/17/04	Not filed	66
10-QSB	06/30/04	08/16/04	Not filed	63
10-QSB	09/30/04	11/15/04	Not filed	60
10-KSB	12/31/04	03/31/05	Not filed	56
10-QSB	03/31/05	05/16/05	Not filed	54
10-QSB	06/30/05	08/15/05	Not filed	51
10-QSB	09/30/05	11/14/05	Not filed	48
10-KSB	12/31/05	03/31/06	Not filed	44
10-QSB	03/31/06	05/15/06	Not filed	42
10-QSB	06/30/06	08/14/06	Not filed	39
10-QSB	09/30/06	11/14/06	Not filed	36
10-KSB	12/31/06	04/02/07	Not filed	31
10-QSB	03/31/07	05/15/07	Not filed	30
10-QSB	06/30/07	08/14/07	Not filed	27
10-QSB	09/30/07	11/14/07	Not filed	24
10-KSB	12/31/07	03/31/08	Not filed	20
*10-Q**	03/31/08	05/15/08	Not filed	18
*10-Q**	06/30/08	08/14/08	Not filed	15
*10-Q**	09/30/08	11/14/08	Not filed	12
*10-K**	12/31/08	03/31/09	Not filed	8
*10-Q**	03/31/09	05/15/09	Not filed	6
*10-Q**	06/30/09	08/14/09	Not filed	3

Total Filings Delinquent **35**

* Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, have been removed from the federal securities laws. *See* Release No. 34-56994 (Dec. 19, 2007). The removal took effect over a transition period that concluded on March 15, 2009. All reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB are now required to use Forms 10-Q and 10-K instead. Forms 10-QSB and 10-KSB will no longer be available, though issuers that meet the definition of a "smaller reporting company" (generally, a company that has less than $75 million in public equity float as of the end of its most recently completed second fiscal quarter) have the option of using new, scaled disclosure requirements that Regulation S-K now includes.

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 248

Release Nos. 34-60946; IA-2946; IC-28990; File No. S7-29-04

RIN 3235-AJ24

Regulation S-AM: Limitations on Affiliate Marketing; Extension of Compliance Date

AGENCY: Securities and Exchange Commission.

ACTION: Final rule; extension of compliance date.

SUMMARY: The Securities and Exchange Commission is extending the compliance date for Regulation S-AM (74 FR 40398 (Aug. 11, 2009)), which limits a person's use of certain information received from an affiliate to solicit a consumer for marketing purposes unless the consumer has been given notice and a reasonable opportunity and a reasonable and simple method to opt out of such solicitations.

DATES: The effective date for Regulation S-AM (17 CFR 248.101 through 248.128) remains September 10, 2009. The compliance date for Regulation S-AM is extended from January 1, 2010 to June 1, 2010.

FOR FURTHER INFORMATION CONTACT: For information regarding the regulation as it relates to brokers, dealers, or transfer agents, contact Brice Prince, Special Counsel, or Ignacio Sandoval, Attorney, Office of Chief Counsel, Division of Trading and Markets, (202) 551-5550, or regarding the regulation as it relates to investment companies or investment advisers, contact Penelope Saltzman, Assistant Director, or Thoreau Bartmann, 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: On August 9, 2009, the Commission adopted Regulation S-AM to implement Section 624 of the Fair Credit Reporting Act, as amended by Section 214 of the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act").[1] Section 624 required the Commission and other federal agencies to adopt rules implementing limitations on a person's use of certain information received from an affiliate to solicit a consumer for marketing purposes, unless the consumer has been given notice and a reasonable opportunity and a reasonable and simple method to opt out of such solicitations. Regulation S-AM implements the requirements of Section 624 with respect to investment advisers and transfer agents registered with the Commission, as well as brokers, dealers, and investment companies (collectively "Covered Persons"). The release adopting Regulation S-AM established an effective date of September 10, 2009, and a compliance date of January 1, 2010.[2]

Two associations representing institutions that are subject to Regulation S-AM have expressed, on behalf of their members, concerns regarding the difficulties that their members are facing in complying with the regulation.[3] Specifically, the associations assert that the period for compliance does not provide enough time to design, implement and test the system changes that will be necessary to accommodate, monitor and maintain opt out requests.

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1 Regulation S-AM: Limitations on Affiliate Marketing, Securities Exchange Act Release No. 60423 (Aug. 9, 2009) [74 FR 40398 (Aug. 11, 2009)].

2 Id.

3 See Comment Letters from the Investment Adviser Association (Sept. 24, 2009) and the Investment Company Institute (Sept. 8, 2009). The comment letters are available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm (File No. S7-29-04), and also are available on the Commission's Internet Web site: http://www.sec.gov/rules/proposed/s72904.shtml).

While we have some concerns about the effect of an extension in delaying the anticipated benefits of the regulation, the Commission is persuaded that a limited extension of the compliance date for Regulation S-AM is appropriate. Our judgment is based on the representations made by the associations (whose members are required to comply with the regulation and thus are in a position to assess the level of difficulty and time involved in such compliance) and our experience in overseeing the industry. We also believe that the additional period for compliance would allow more Covered Persons to combine or coordinate notices required under Regulation S-AM with privacy notices required under the Gramm-Leach-Bliley Act and Regulation S-P, which is specifically permitted under Section 624 of the FCRA Act.[4] Accordingly, the Commission believes it is appropriate to extend the compliance date for Regulation S-AM to June 1, 2010. The regulation's effective date of September 10, 2009 remains unchanged.

The Commission finds that, for good cause and the reasons cited above, including the brief length of the extension we are granting, notice and solicitation of comment regarding the extension of the compliance date for Regulation S-AM are impracticable,

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4 See 15 U.S.C. 1681s-3(b). See also 15 U.S.C. 6801-6809 (Gramm-Leach-Bliley Act privacy provisions); 17 CFR Part 248 (Regulation S-P).

unnecessary, or contrary to the public interest.[5] In this regard, the Commission also notes that Covered Persons need to be informed as soon as possible of the extension and its length in order to plan and adjust their implementation process accordingly.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Date: November 5, 2009

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5 See Section 553(b)(3)(B) of the Administrative Procedure Act (5 U.S.C. 553(b)(3)(B)) ("APA") (an agency may dispense with prior notice and comment when it finds, for good cause, that notice and comment are "impracticable, unnecessary, or contrary to the public interest). The change to the compliance date is effective upon publication in the Federal Register. This date is less than 30 days after publication in the Federal Register, in accordance with the APA, which allows effectiveness in less than 30 days after publication for "a substantive rule which grants or recognizes an exemption or relieves a restriction." See 5 U.S.C. 553(d)(1).

SECURITIES AND EXCHANGE COMMISSION

17 CFR Ch. II

[Release Nos. 33-9082, 34-60955, IA-2947, IC-28992, File No. S7-26-09]

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 its entirety on www.reginfo.gov in October 2009. The version of the Unified Agenda to be published in the Federal Register will include only those rules for which the agency has indicated that preparation of an analysis under the Regulatory Flexibility Act is required. Information in the Commission's agenda was accurate on November 6, 2009, 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 December 31, 2009.

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 S7-26-09 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 Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-26-09. 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, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; 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 in the next twelve months 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 that 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.

Elizabeth M. Murphy

Elizabeth M Murphy
Secretary

Dated: November 6, 2009

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 60972 / November 9, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13680

In the Matter of **Masterpiece Technology Group,** **MBC Holding Co.,** **MC Industrial Group, Inc.,** **MC Liquidating Corp.,** **Medco Health Corp.,** **Meridian National Corp.,** **MetaSource Group, Inc.,** **Micel Corp.,** **MicroENERGY, Inc., and** **Microleague Multimedia, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Masterpiece Technology Group, MBC Holding Co., MC Industrial Group, Inc., MC Liquidating Corp., Medco Health Corp., Meridian National Corp., MetaSource Group, Inc., Micel Corp., MicroENERGY, Inc., and Microleague Multimedia, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Masterpiece Technology Group (CIK No. 1041711) is an expired Utah corporation located in Loveland, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Masterpiece is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a

Form 10-Q for the period ended December 31, 2000, which reported a net loss of over $3.35 million for the prior nine months. As of November 6, 2009, the company's stock (symbol "MPTG") was traded on the over-the-counter markets.

2. MBC Holding Co. (CIK No. 913159) is an inactive Minnesota corporation located in St. Paul, Minnesota with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MBC is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2001, which reported a net loss of over $4.8 million for the prior nine months. On February 21, 2002, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Minnesota, and the case was terminated on February 4, 2009. As of November 6, 2009, the company's stock (symbol "MBRWQ") was traded on the over-the-counter markets.

3. MC Industrial Group, Inc. (CIK No. 1267760) is a void Delaware corporation located in Lakewood, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MC Industrial is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2004.

4. MC Liquidating Corp. (CIK No. 943357) is a dissolved Washington corporation located in Southfield, Michigan with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MC Liquidating is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 1997, which reported a net loss of $69,549 for the prior nine months.

5. Medco Health Corp. (CIK No. 315904) is a permanently revoked Nevada corporation located in Englewood Cliffs, New Jersey with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Medco is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1997, which reported a net loss of $490,112 since the company's July 1, 1994 inception.

6. Meridian National Corp. (CIK No. 717192) is a void Delaware corporation located in Toledo, Ohio with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Meridian is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended May 31, 2000, which reported a net loss of $139,794 for the prior three months. On May 1, 2001, the company ceased regular operations. As of November 6, 2009, the company's stock (symbol "MRCO") was traded on the over-the-counter markets.

7. MetaSource Group, Inc. (CIK No. 1098284) is a revoked Nevada corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MetaSource is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of over

$1.37 million for the prior three months. As of November 6, 2009, the company's stock (symbol "MTSR") was traded on the over-the-counter markets.

8. Micel Corp. (CIK No. 874788) is an inactive New York corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Micel is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001, which reported a net loss of $267,000 for the prior six months.

9. MicroENERGY, Inc. (CIK No. 740622) is a void Delaware corporation located in Carol Stream, Illinois with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MicroENERGY is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 1999, which reported a net loss of $954,762 for the prior nine months.

10. Microleague Multimedia, Inc. (CIK No. 1010395) is a Pennsylvania corporation located in Lancaster, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Microleague is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1997, which reported a net loss of over $5.9 million for the prior nine months. On December 23, 1997, the company filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of Pennsylvania, and the case was terminated on August 10, 2000. As of November 6, 2009, the company's stock (symbol "MLMIQ") was traded on the over-the-counter markets.

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Attachment

Appendix 1

Chart of Delinquent Filings
Masterpiece Technology Group, et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Masterpiece Technology Group					
	10-K	03/31/01	06/29/01	Not filed	101
	10-Q	06/30/01	08/14/01	Not filed	99
	10-Q	09/30/01	11/14/01	Not filed	96
	10-Q	12/31/01	02/14/02	Not filed	93
	10-K	03/31/02	07/01/02	Not filed	88
	10-Q	06/30/02	08/14/02	Not filed	87
	10-Q	09/30/02	11/14/02	Not filed	84
	10-Q	12/31/02	02/14/03	Not filed	81
	10-K	03/31/03	06/30/03	Not filed	77
	10-Q	06/30/03	08/14/03	Not filed	75
	10-Q	09/30/03	11/14/03	Not filed	72
	10-Q	12/31/03	02/17/04	Not filed	69
	10-K	03/31/04	06/29/04	Not filed	65
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-Q	12/31/04	02/14/05	Not filed	57
	10-K	03/31/05	06/29/05	Not filed	53
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-Q	12/31/05	02/14/06	Not filed	45
	10-K	03/31/06	06/29/06	Not filed	41
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36
	10-Q	12/31/06	02/14/07	Not filed	33
	10-K	03/31/07	06/29/07	Not filed	29
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-Q	12/31/07	02/14/08	Not filed	21
	10-K	03/31/08	06/30/08	Not filed	17
	10-Q	06/30/08	08/14/08	Not filed	15

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Masterpiece Technology Group					
	10-Q	09/30/08	11/14/08	Not filed	12
	10-Q	12/31/08	02/17/09	Not filed	9
	10-K	03/31/09	06/29/09	Not filed	5
	10-Q	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	34				
MBC Holding Co.					
	10-K	12/31/01	04/01/02	Not filed	91
	10-Q	03/31/02	05/15/02	Not filed	90
	10-Q	06/30/02	08/14/02	Not filed	87
	10-Q	09/30/02	11/14/02	Not filed	84
	10-K	12/31/02	03/31/03	Not filed	80
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75
	10-Q	09/30/03	11/14/03	Not filed	72
	10-K	12/31/03	03/30/04	Not filed	68
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-K	12/31/04	03/31/05	Not filed	56
	10-Q	03/31/05	05/16/05	Not filed	54
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-K	12/31/05	03/31/06	Not filed	44
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36
	10-K	12/31/06	04/02/07	Not filed	31
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-K	12/31/07	03/31/08	Not filed	20
	10-Q	03/31/08	05/15/08	Not filed	18
	10-Q	06/30/08	08/14/08	Not filed	15

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
MBC Holding Co.					
	10-Q	09/30/08	11/14/08	Not filed	12
	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	31				
MC Industrial Group, Inc.					
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	21				
MC Liquidating Corp.					
	10-K	12/31/97	03/31/98	Not filed	140
	10-Q	03/31/98	05/15/98	Not filed	138
	10-Q	06/30/98	08/14/98	Not filed	135
	10-Q	09/30/98	11/16/98	Not filed	132

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
MC Liquidating Corp.					
	10-K	12/31/98	03/31/99	Not filed	128
	10-Q	03/31/99	05/17/99	Not filed	126
	10-Q	06/30/99	08/16/99	Not filed	123
	10-Q	09/30/99	11/15/99	Not filed	120
	10-K	12/31/99	03/30/00	Not filed	116
	10-Q	03/31/00	05/15/00	Not filed	114
	10-Q	06/30/00	08/14/00	Not filed	111
	10-Q	09/30/00	11/14/00	Not filed	108
	10-K	12/31/00	04/02/01	Not filed	103
	10-Q	03/31/01	05/15/01	Not filed	102
	10-Q	06/30/01	08/14/01	Not filed	99
	10-Q	09/30/01	11/14/01	Not filed	96
	10-K	12/31/01	04/01/02	Not filed	91
	10-Q	03/31/02	05/15/02	Not filed	90
	10-Q	06/30/02	08/14/02	Not filed	87
	10-Q	09/30/02	11/14/02	Not filed	84
	10-K	12/31/02	03/31/03	Not filed	80
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75
	10-Q	09/30/03	11/14/03	Not filed	72
	10-K	12/31/03	03/30/04	Not filed	68
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-K	12/31/04	03/31/05	Not filed	56
	10-Q	03/31/05	05/16/05	Not filed	54
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-K	12/31/05	03/31/06	Not filed	44
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36
	10-K	12/31/06	04/02/07	Not filed	31
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-K	12/31/07	03/31/08	Not filed	20
	10-Q	03/31/08	05/15/08	Not filed	18

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
MC Liquidating Corp.					
	10-Q	06/30/08	08/14/08	Not filed	15
	10-Q	09/30/08	11/14/08	Not filed	12
	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	47				
Medco Health Corp.					
	10-QSB	12/31/97	02/17/98	Not filed	141
	10-QSB	03/31/98	05/15/98	Not filed	138
	10-KSB	06/30/98	09/28/98	Not filed	134
	10-QSB	09/30/98	11/16/98	Not filed	132
	10-QSB	12/31/98	02/16/99	Not filed	129
	10-QSB	03/31/99	05/17/99	Not filed	126
	10-KSB	06/30/99	09/28/99	Not filed	122
	10-QSB	09/30/99	11/15/99	Not filed	120
	10-QSB	12/31/99	02/14/00	Not filed	117
	10-QSB	03/31/00	05/15/00	Not filed	114
	10-KSB	06/30/00	09/28/00	Not filed	110
	10-QSB	09/30/00	11/14/00	Not filed	108
	10-QSB	12/31/00	02/14/01	Not filed	105
	10-QSB	03/31/01	05/15/01	Not filed	102
	10-KSB	06/30/01	09/28/01	Not filed	98
	10-QSB	09/30/01	11/14/01	Not filed	96
	10-QSB	12/31/01	02/14/02	Not filed	93
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-KSB	06/30/02	09/30/02	Not filed	86
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-QSB	12/31/02	02/14/03	Not filed	81
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-KSB	06/30/03	09/29/03	Not filed	74
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-QSB	12/31/03	02/17/04	Not filed	69
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-KSB	06/30/04	09/28/04	Not filed	62
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-QSB	12/31/04	02/14/05	Not filed	57

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Medco Health Corp.					
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-KSB	06/30/05	09/28/05	Not filed	50
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-QSB	12/31/05	02/14/06	Not filed	45
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-KSB	06/30/06	09/28/06	Not filed	38
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-QSB	12/31/06	02/14/07	Not filed	33
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-KSB	06/30/07	09/28/07	Not filed	26
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-QSB	12/31/07	02/14/08	Not filed	21
	10-QSB	03/31/08	05/15/08	Not filed	18
	10-KSB	06/30/08	09/29/08	Not filed	14
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-Q**	12/31/08	02/17/09	Not filed	9
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-K**	06/30/09	09/28/09	Not filed	2
Total Filings Delinquent	47				
Meridian National Corp.					
	10-Q	08/31/00	10/16/00	Not filed	109
	10-Q	11/30/00	01/16/01	Not filed	106
	10-K	02/28/01	05/29/01	Not filed	102
	10-Q	05/31/01	07/16/01	Not filed	100
	10-Q	08/31/01	10/15/01	Not filed	97
	10-Q	11/30/01	01/14/02	Not filed	94
	10-K	02/28/02	05/29/02	Not filed	90
	10-Q	05/31/02	07/15/02	Not filed	88
	10-Q	08/31/02	10/15/02	Not filed	85
	10-Q	11/30/02	01/14/03	Not filed	82
	10-K	02/28/03	05/29/03	Not filed	78
	10-Q	05/31/03	07/15/03	Not filed	76
	10-Q	08/31/03	10/15/03	Not filed	73
	10-Q	11/30/03	01/14/04	Not filed	70
	10-K	02/29/04	06/01/04	Not filed	65
	10-Q	05/31/04	07/15/04	Not filed	64

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Meridian National Corp.					
	10-Q	08/31/04	10/15/04	Not filed	61
	10-Q	11/30/04	01/14/05	Not filed	58
	10-K	02/28/05	05/31/05	Not filed	54
	10-Q	05/31/05	07/15/05	Not filed	52
	10-Q	08/31/05	10/17/05	Not filed	49
	10-Q	11/30/05	01/17/06	Not filed	46
	10-K	02/28/06	05/30/06	Not filed	42
	10-Q	05/31/06	07/17/06	Not filed	40
	10-Q	08/31/06	10/16/06	Not filed	37
	10-Q	11/30/06	01/16/07	Not filed	34
	10-K	02/28/07	05/29/07	Not filed	30
	10-Q	05/31/07	07/16/07	Not filed	28
	10-Q	08/31/07	10/15/07	Not filed	25
	10-Q	11/30/07	01/14/08	Not filed	22
	10-K	02/29/08	05/29/08	Not filed	18
	10-Q	05/31/08	07/15/08	Not filed	16
	10-Q	08/31/08	10/15/08	Not filed	13
	10-Q	11/30/08	01/14/09	Not filed	10
	10-K	02/28/09	05/29/09	Not filed	6
	10-Q	05/31/09	07/15/09	Not filed	4
	10-Q	08/31/09	10/15/09	Not filed	1
Total Filings Delinquent	37				
MetaSource Group, Inc.					
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
MetaSource Group, Inc.					
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	27				
Micel Corp.					
	10-QSB	06/30/01	08/14/01	Not filed	99
	10-KSB	09/30/01	12/31/01	Not filed	95
	10-QSB	12/31/01	02/14/02	Not filed	93
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-KSB	09/30/02	12/30/02	Not filed	83
	10-QSB	12/31/02	02/14/03	Not filed	81
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-KSB	09/30/03	12/29/03	Not filed	71
	10-QSB	12/31/03	02/17/04	Not filed	69
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-KSB	09/30/04	12/29/04	Not filed	59
	10-QSB	12/31/04	02/14/05	Not filed	57
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-KSB	09/30/05	12/29/05	Not filed	47
	10-QSB	12/31/05	02/14/06	Not filed	45
	10-QSB	03/31/06	05/15/06	Not filed	42

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Micel Corp.					
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-KSB	09/30/06	12/29/06	Not filed	35
	10-QSB	12/31/06	02/14/07	Not filed	33
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-KSB	09/30/07	12/31/07	Not filed	23
	10-QSB	12/31/07	02/14/08	Not filed	21
	10-QSB	03/31/08	05/15/08	Not filed	18
	10-QSB	06/30/08	08/14/08	Not filed	15
	10-KSB	09/30/08	12/29/08	Not filed	11
	*10-Q**	12/31/08	02/17/09	Not filed	9
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	33				
MicroENERGY, Inc.					
	10-K	06/30/99	09/28/99	Not filed	122
	10-Q	09/30/99	11/15/99	Not filed	120
	10-Q	12/31/99	02/14/00	Not filed	117
	10-Q	03/31/00	05/15/00	Not filed	114
	10-K	06/30/00	09/28/00	Not filed	110
	10-Q	09/30/00	11/14/00	Not filed	108
	10-Q	12/31/00	02/14/01	Not filed	105
	10-Q	03/31/01	05/15/01	Not filed	102
	10-K	06/30/01	09/28/01	Not filed	98
	10-Q	09/30/01	11/14/01	Not filed	96
	10-Q	12/31/01	02/14/02	Not filed	93
	10-Q	03/31/02	05/15/02	Not filed	90
	10-K	06/30/02	09/30/02	Not filed	86
	10-Q	09/30/02	11/14/02	Not filed	84
	10-Q	12/31/02	02/14/03	Not filed	81
	10-Q	03/31/03	05/15/03	Not filed	78
	10-K	06/30/03	09/29/03	Not filed	74
	10-Q	09/30/03	11/14/03	Not filed	72
	10-Q	12/31/03	02/17/04	Not filed	69
	10-Q	03/31/04	05/17/04	Not filed	66

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
MicroENERGY, Inc.					
	10-K	06/30/04	09/28/04	Not filed	62
	10-Q	09/30/04	11/15/04	Not filed	60
	10-Q	12/31/04	02/14/05	Not filed	57
	10-Q	03/31/05	05/16/05	Not filed	54
	10-K	06/30/05	09/28/05	Not filed	50
	10-Q	09/30/05	11/14/05	Not filed	48
	10-Q	12/31/05	02/14/06	Not filed	45
	10-Q	03/31/06	05/15/06	Not filed	42
	10-K	06/30/06	09/28/06	Not filed	38
	10-Q	09/30/06	11/14/06	Not filed	36
	10-Q	12/31/06	02/14/07	Not filed	33
	10-Q	03/31/07	05/15/07	Not filed	30
	10-K	06/30/07	09/28/07	Not filed	26
	10-Q	09/30/07	11/14/07	Not filed	24
	10-Q	12/31/07	02/14/08	Not filed	21
	10-Q	03/31/08	05/15/08	Not filed	18
	10-K	06/30/08	09/29/08	Not filed	14
	10-Q	09/30/08	11/14/08	Not filed	12
	10-Q	12/31/08	02/17/09	Not filed	9
	10-Q	03/31/09	05/15/09	Not filed	6
	10-K	06/30/09	09/28/09	Not filed	2
Total Filings Delinquent	41				
Microleague Multimedia, Inc.					
	10-KSB	12/31/97	03/31/98	Not filed	140
	10-QSB	03/31/98	05/15/98	Not filed	138
	10-QSB	06/30/98	08/14/98	Not filed	135
	10-QSB	09/30/98	11/16/98	Not filed	132
	10-KSB	12/31/98	03/31/99	Not filed	128
	10-QSB	03/31/99	05/17/99	Not filed	126
	10-QSB	06/30/99	08/16/99	Not filed	123
	10-QSB	09/30/99	11/15/99	Not filed	120
	10-KSB	12/31/99	03/30/00	Not filed	116
	10-QSB	03/31/00	05/15/00	Not filed	114
	10-QSB	06/30/00	08/14/00	Not filed	111
	10-QSB	09/30/00	11/14/00	Not filed	108

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Microleague Multimedia, Inc.					
	10-KSB	12/31/00	04/02/01	Not filed	103
	10-QSB	03/31/01	05/15/01	Not filed	102
	10-QSB	06/30/01	08/14/01	Not filed	99
	10-QSB	09/30/01	11/14/01	Not filed	96
	10-KSB	12/31/01	04/01/02	Not filed	91
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Microleague Multimedia, Inc.					
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3

Total Filings Delinquent 47

* Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, have been removed from the federal securities laws. *See* Release No. 34-56994 (Dec. 19, 2007). The removal took effect over a transition period that concluded on March 15, 2009. All reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB are now required to use Forms 10-Q and 10-K instead. Forms 10-QSB and 10-KSB will no longer be available, though issuers that meet the definition of a "smaller reporting company" (generally, a company that has less than $75 million in public equity float as of the end of its most recently completed second fiscal quarter) have the option of using new, scaled disclosure requirements that Regulation S-K now includes.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 60982 / November 10, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13682

In the Matter of Tolan S. Furusho, Esq., **Respondent.**	: : : : : : :	**ORDER OF FORTHWITH SUSPENSION, PURSUANT TO RULE 102(e)(2) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission deems it appropriate to issue an order of forthwith suspension of Tolan S. Furusho ("Furusho") pursuant to Rule 102(e)(2) of the Commission's Rules of Practice [17 C.F.R. 200.102(e)(2)].[1]

II.

The Commission finds that:

1. Furusho is an attorney having been admitted to practice law in the State of Washington in 1995.

2. On November 28, 2007, the United States Attorney for the Western District of Washington filed a Criminal Information against Furusho alleging one count of conspiracy to commit securities fraud and two counts of tax evasion. The Information alleged that Furusho knowingly and willfully participated in a fraudulent scheme to defraud members of the investing public by tendering an opinion of counsel to a transfer agent that wrongfully authorized it to remove the

[1]Rule 102(e)(2) provides in pertinent part: "Any attorney who has been suspended or disbarred by a court of the United States or any State [or] any person who has been convicted of a felony or misdemeanor involving moral turpitude shall be forthwith suspended from appearing or practicing before the Commission."

restrictive legend from the stock of a publicly traded company, resulting in the sale of unregistered stock in this company.

3. On November 28, 2007, Furusho pled guilty to that information.

4. On August 4, 2008, the Disciplinary Board of the Washington State Bar Association entered an order approving a Stipulation of Disbarment against Furusho.

5. On June 30, 2009, the United States District Court for the Western District of Washington at Seattle entered a judgment convicting Furusho of conspiracy to commit securities fraud and two counts of willful failure to file income tax returns. The court imposed a sentence of imprisonment, other penalties, and costs.

III.

In view of the foregoing, the Commission finds that Furusho is an attorney who has been disbarred by a State court and has been convicted of a felony involving moral turpitude within the meaning of Rule 102(e)(2) of the Commission's Rules of Practice.

Accordingly, it is ORDERED, that Furusho is forthwith suspended from appearing or practicing before the Commission pursuant to Rule 102(e)(2) of the Commission's Rules of Practice.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Casey
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 60976 / November 10, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13681

In the Matter of **MERRIMAN CURHAN FORD & CO., D. JONATHAN MERRIMAN, and CHRISTOPHER AGUILAR,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate 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 Merriman Curhan Ford & Company (the "Merriman Firm"), D. Jonathan Merriman ("Jon Merriman") and Christopher Aguilar ("Aguilar") (collectively, "Respondents").

II.

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

Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

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

RESPONDENTS

1. **Merriman Curhan Ford & Co. (the "Merriman Firm")** is a San Francisco, California-based broker-dealer that has been registered with the Commission since April 2003. Merriman is a wholly owned subsidiary of Merriman Curhan Ford Group, Inc., which is a public company that lists its common stock on the NASDAQ Capital Market under the ticker symbol MERR.

2. **D. Jonathan Merriman ("Jon Merriman")**, age 48, resides in San Francisco, California. At all relevant times, Jon Merriman was the founder and CEO of the Merriman Firm, and held Series 7, 63 and 24 licenses with the Financial Industry Regulatory Authority ("FINRA"). Jon Merriman resigned from his position as CEO of the Merriman Firm on June 30, 2009.

3. **Christopher Aguilar ("Aguilar")**, age 46, resides in San Francisco, California. At all relevant times, Aguilar was the General Counsel and Chief Compliance Officer for the Merriman firm, and held Series 7, 24, 55 and 63 licenses with FINRA. Beginning in November 2008, Aguilar no longer served as the Chief Compliance Officer of the Merriman Firm, but retained his role as General Counsel. Aguilar resigned from his position as General Counsel of the Merriman Firm on April 1, 2009.

OTHER RELEVANT PERSON

4. **D. Scott Cacchione ("Cacchione")**, age 43, resides in Woodside, California. From 1989 through June 4, 2008, Cacchione was a registered representative with various registered broker-dealers and was most recently employed at the Merriman Firm. At all relevant times, Cacchione held a Series 7 license with FINRA. Cacchione was the Managing Director of the Merriman Firm's Client Services Group from December 2005 through June 4, 2008 when his employment was terminated. Cacchione has a disciplinary history.

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

FACTS

A. Overview

5. These proceedings arise out of Respondents' failure to supervise reasonably Cacchione, a registered representative who served as the former Managing Director of Client Services at the Merriman Firm. During his employment at the Merriman Firm, Cacchione perpetrated two distinct fraudulent schemes. First, from at least August 2007 through May 2008, Cacchione provided account statements of Merriman Firm customers to his customer and friend, William "Boots" Del Biaggio III ("Del Biaggio"), so that Del Biaggio could fraudulently pledge the securities held in the innocent customers' accounts to obtain more than $45 million in personal loans. Second, from at least March 2006 through October 2007, Cacchione engaged in fraudulent unauthorized trading in several customer accounts in which he purchased risky microcap securities without his customers' permission, and then was paid the commissions generated from the unauthorized trades.

6. On March 24, 2009, the Commission filed a civil enforcement action against Cacchione, alleging violations of the antifraud provisions of the federal securities laws, related to his two fraudulent schemes. *See SEC v. David Scott Cacchione*, CV-09-01259 CRB (N.D. Cal.). On March 31, 2009, the Court entered a final judgment in which Cacchione, by consent, was permanently enjoined from violating Section 17(a) of the Securities Act of 1933 and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder. On April 22, 2009, the Commission instituted and simultaneously settled administrative proceedings against Cacchione, barring him from associating with any broker or dealer, pursuant to Section 15(b)(6) of the Exchange Act. On March 31, 2009, Cacchione also pled guilty to criminal securities fraud charges that arose from his fraudulent pledging scheme. *See US v. David Scott Cacchione,* CR-09-00296 (N.D. Cal.).

7. In addition to Respondents' failure to supervise Cacchione reasonably, the Merriman Firm also violated Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder, and Jon Merriman and Aguilar aided and abetted the Merriman Firm's violations by allowing Cacchione to supervise other registered representatives when Cacchione did not hold a Series 24 license.

8. The Merriman Firm also violated Rule 10(a) of Regulation S-P, 17 C.F.R. § 248.10(a), based on Cacchione's disclosure of personal customer information, including confidential customer account statements, to parties outside the firm. Cacchione used the Merriman Firm's email system to forward the confidential customer information to third parties.

B. Cacchione Was Subject to Heightened Supervision at the Merriman Firm

9. After being recruited to the Merriman Firm by his friend and former co-worker Jon Merriman, Cacchione was hired in December 2005 as the Managing Director of Merriman's Client Services Group. Cacchione was hired primarily to promote corporate business for the Merriman Firm, but he also brought with him a customer base of over a hundred retail brokerage accounts held by individuals and small institutions. While the Merriman Firm had very limited retail brokerage business when Cacchione joined, which consisted primarily of its employees' personal

brokerage accounts and accounts of corporate officers that were incidental to investment banking business completed by the Merriman Firm, Cacchione's retail brokerage business represented an expansion into that business line for the Merriman Firm. Cacchione's Client Services Group was a newly created department to accommodate both his corporate and retail business.

10. Jon Merriman, the former CEO of the Merriman Firm, was Cacchione's direct supervisor for the relevant portion of Cacchione's employment with the Merriman Firm. Jon Merriman also delegated some supervisory responsibility over Cacchione to Aguilar, who served as the Merriman Firm's General Counsel and Chief Compliance Officer when Cacchione was employed at the firm. Aguilar was responsible for overseeing all of the legal work of the Merriman Firm in addition to his responsibilities as head of the firm's compliance department.

11. Both Jon Merriman and Aguilar knew that Cacchione had a disciplinary history with FINRA before he began his employment at the Merriman Firm. Specifically, in January 2004, Cacchione consented to a thirty day suspension and was fined $30,000 after the NASD found that he sold unregistered securities to public customers without proper disclosure. In addition, according to his records maintained by FINRA, in 1995 a customer alleged that Cacchione made an unauthorized disbursement from her account to a third party, although FINRA did not discipline Cacchione.

12. Based upon Cacchione's disciplinary history, Aguilar placed Cacchione on a heightened supervisory plan in December 2005, and took responsibility for implementing the plan. As part of the heightened supervisory plan, the compliance department was supposed to review Cacchione's emails and trading activity on a daily basis. In addition, Cacchione was prohibited from signing any documents on the Merriman Firm's behalf.

13. Aguilar delegated the review function of Cacchione's trading and emails to Aguilar's subordinate, who held the title of Compliance Manager. This employee was responsible for most of the day-to-day compliance functions for the Merriman Firm, including random email reviews of more than one hundred registered representatives within the firm. During Cacchione's employment with the firm, the Merriman Firm's compliance department was thinly staffed, employing no more than four compliance personnel some of whom were also responsible for general legal work for the firm. Despite the extra burden of having to review Cacchione's emails and trading, no new staff was added to the Merriman Firm's compliance department to assist with Cacchione's heightened review and the expansion of the retail business line and addition of the Client Services Group to the Merriman Firm.

C. Respondents Allowed Cacchione to Supervise Others While He Lacked the Requisite Qualifications

14. When Cacchione was hired as the Managing Director of the Merriman Firm's newly created Client Services Group, he had not attained his Series 24 license with FINRA. The Series 24 license, or General Securities Principal license, allows registered representatives to supervise and manage broker-dealer branch activities. Jon Merriman informed Cacchione as part of his written offer of employment that Cacchione's "role requires that [Cacchione] successfully complete the NASD Series 24 exam" and it was anticipated that Cacchione would "fulfill this

requirement as a priority within the first 30 days of [his] employment." Cacchione's role as Managing Director required that he hold a Series 24 license because he would be in charge of supervising the registered representatives in the Client Services Group some of whom maintained their own retail customer accounts.

15. Cacchione never passed the Series 24 examination during his more than two year tenure at the Merriman Firm. Both Jon Merriman and Aguilar knew that Cacchione repeatedly failed the Series 24 exam, and therefore, never held the required Series 24 licensure.

16. Although he did not hold a Series 24 license, Jon Merriman and Aguilar allowed Cacchione to remain the Managing Director of the Client Services Group. In that role, Cacchione supervised at least five registered representatives during his tenure. Each of Cacchione's direct reports held a Series 7 license with FINRA, and they had their own customer accounts for which they were the designated registered representative.

17. During the time Cacchione supervised the Client Services Group, the Merriman Firm published Written Supervisory Procedures ("WSP") that it provided to its registered representatives, which Cacchione attested that he had read. During the relevant period, the WSP stated that "Promissory notes are considered to be securities, and associated persons of the firm are not allowed to sell promissory notes in a private securities transaction, whether compensation is involved or not."

18. Despite the prohibition on the sale of promissory notes, Cacchione recommended that certain of his customers purchase or renew promissory notes that were offered by his friend and customer, William "Boots" Del Biaggio III ("Del Biaggio"), and at least eight of Cacchione's customers purchased or renewed these notes. Cacchione also directed a registered representative whom he supervised to facilitate the promissory note sales and had this person act as a liaison between his customers and Del Biaggio regarding the note investments.

19. The Commission recently brought a securities fraud action against Del Biaggio for operating a Ponzi scheme with the funds he received as part of the promissory note offering. *See SEC v. William "Boots" Del Biaggio III*, CV-08-5450 CRB (N.D. Cal.). In a related criminal action against Del Biaggio, the criminal authorities are also seeking restitution of the money Del Biaggio earned through his Ponzi scheme, including millions of dollars from Cacchione's customers. *See US v. William "Boots" Del Biaggio III*, CR-08-874 CRB (N.D. Cal.).

D. Cacchione Used the Merriman Firm's Systems to Perpetrate His Fraud

i. Cacchione's Fraudulent Pledging and Regulation S-P Violations

20. As part of the background check process for his employment, the Merriman Firm learned that Cacchione had filed for personal bankruptcy in 2003. His financial difficulties continued during his employment, and he received $200,000 in personal loans from the Merriman Firm, which Jon Merriman approved. Cacchione also sought more than $2 million in loans from his friend and customer, Del Biaggio, to save his home from foreclosure and to pay other expenses. Accepting loans from customers was prohibited by the Merriman Firm's policies and procedures,

but Cacchione solicited and accepted loans from Del Biaggio anyway. Cacchione and Del Biaggio corresponded about these loans by email, using Cacchione's email address at the Merriman Firm.

21. In the Summer of 2007, Del Biaggio was in the midst of negotiating a deal to buy an interest in the Nashville Predators NHL hockey team. Because Del Biaggio did not have the $25 million in cash he needed for the purchase of the Predators or sufficient collateral to secure a $25 million loan, Del Biaggio asked Cacchione to help him make it appear that Del Biaggio had ample collateral for the loans he was seeking and to help him inflate his net worth on his NHL application.

22. In August 2007, Del Biaggio and Cacchione hatched a scheme where Cacchione provided Del Biaggio with an account statement from a Merriman Firm institutional customer that reflected nearly $19 million in assets. Cacchione requested and received the statement via email from another registered representative in the Merriman Firm who serviced the institutional customer. There was no legitimate business reason for Cacchione to have a copy of the account statement. The account statement contained confidential information related to the customer, including the customer's account balance, account number, and personal identifying information. Cacchione emailed a .pdf version of the account statement from his work email address at the Merriman Firm to his personal email account and then forwarded it to Del Biaggio. Del Biaggio then had his name and address pasted over the real customer's name. It was then copied and scanned into a .pdf file. Del Biaggio then forwarded the statement to the NHL to demonstrate his financial wherewithal to purchase the Predators team.

23. In August and September 2007, Cacchione supplied Del Biaggio with account statements belonging to two unknowing individual clients of Cacchione. These statements also contained confidential customer information, such as the customers' account balances, account numbers, and personal identifying information. Cacchione forwarded the statements from his Merriman Firm email address to his home email account, and then forwarded the statements to Del Biaggio. Del Biaggio forged his name and information onto the statements after receiving them from Cacchione. Del Biaggio then emailed at least two sets of the doctored statements back to Cacchione at Cacchione's Merriman Firm email account. From November 2007 through April 2008, Del Biaggio doctored the individuals' statements and the institutional customer's statements and provided them to at least seven banks and private lenders. Del Biaggio obtained roughly $45 million in loans based upon his and Cacchione's representations that the accounts belonged to Del Biaggio.

24. In addition to providing the doctored account statements to Del Biaggio's lenders, Cacchione and Del Biaggio also signed and provided the lenders with Account Control Agreements in which they pledged the securities contained in the individuals' Merriman Firm accounts as collateral for the loans Del Biaggio obtained. Cacchione signed the agreements without authority on behalf of the Merriman Firm, certifying that the pledged accounts belonged to Del Biaggio. Cacchione sent Del Biaggio a copy of another Merriman Firm customer's Account Control Agreement from his Merriman Firm email account so that Del Biaggio would have a sample by which to model the fake Account Control Agreements for his loans. The agreement sent to Del Biaggio contained confidential account information of the customer, including the customer's contact information and account number. Del Biaggio used the agreement as a sample

to draft the Account Control Agreements for some of his loans. Cacchione received copies of one of the unsigned Account Control Agreements drafted by Del Biaggio by email at his Merriman Firm email address and exchanged numerous emails with Del Biaggio regarding execution of the agreements.

25. To perpetuate the fraud, from December 2007 through May 2008, Cacchione continued to supply Del Biaggio with electronic copies of the individuals' monthly account statements by email so that Del Biaggio could send the forged statements to some of the lenders on a monthly basis to show that the collateral remained intact. Cacchione sent these statements from his Merriman Firm email address to his home email account and, on at least two occasions, to Del Biaggio directly.

26. On September 14, 2007, early in the scheme, Del Biaggio sent an email to Cacchione's Merriman Firm address in which he stated that he was "worried" that one of the parties he had provided with doctored account statements would send a letter to Cacchione's firm seeking "verification" that the other customers' assets belonged to him. Some of the lenders did, in fact, contact Cacchione who "verified" that the other customers' accounts belonged to Del Biaggio. Del Biaggio and Cacchione continued their fraud until May 2008 when SEC exam staff conducting an examination of the Merriman Firm uncovered the scheme through a review of Cacchione's emails.

ii. Cacchione's Unauthorized Trading

27. Between at least March 2006 and October 2007, Cacchione engaged in a pattern of unauthorized trading in certain of his customers' accounts. As part of the unauthorized trading, Cacchione chose risky, thinly-traded stocks for his customers. Jon Merriman, Cacchione's direct supervisor, encouraged Cacchione to recommend these stocks to his customers.

28. During the relevant time period, Cacchione did not have written agreements with any of his customers allowing him to trade in their accounts without permission. In fact, he acknowledged in writing in his annual compliance reviews with the Merriman Firm that he did not have any customer accounts in which he could trade without permission (i.e., discretionary authority).

29. Despite his lack of discretionary authority, Cacchione traded in certain of his customers' accounts without obtaining their permission. Cacchione made unrealistic promises to his boss, Jon Merriman, about the number of shares he could sell to customers from initial public offerings ("IPOs") that the Merriman Firm handled. In at least four offerings in which the Merriman Firm participated during May through November 2007, Cacchione agreed to take large blocks of shares when he did not have customers to take all of these shares. Cacchione then placed these unwanted and unallocated shares into certain of his customers' accounts where the accounts had excess cash to pay for the shares without first obtaining his customers' permission. One of the registered representatives whom Cacchione supervised assisted him in his unauthorized trading scheme by preparing lists of customers who had excess cash in their accounts to take these unallocated shares. Several customers complained to Cacchione about the unauthorized trading in their accounts in emails that were sent to Cacchione's Merriman Firm email account.

30. In addition, in the late Summer of 2006, one of Cacchione's customers, an elderly widow, discovered unauthorized purchases of a risky, thinly-traded stock in her account, and immediately began contacting Cacchione to determine why the purchases were made and how they could be undone. For months, she unsuccessfully tried to get Cacchione to liquidate these holdings. Ultimately, in December 2006, after she contacted Jon Merriman, the Merriman Firm liquidated her holdings and paid her a settlement for her losses. Jon Merriman spoke to the customer about her complaint, and Aguilar was involved in preparing the settlement papers that resolved her claims.

31. Similarly, from May to October 2007, Cacchione made twenty unauthorized trades in the portfolio of another one of his customers, a local children's charity. Cacchione did not have authority to trade in the charity's account, and all trading decisions were to be made by the charity's investment adviser. Despite his lack of trading authority, Cacchione purchased in the charity's account several risky penny stocks and shares from three IPOs. The charity complained to Cacchione about the trades in the Fall of 2007, and the Merriman Firm agreed to cancel the trades (months after they were placed), but ultimately sold all of the unauthorized stocks held by the charity, and paid the charity a settlement for its losses.

E. Jon Merriman and Aguilar Failed Reasonably to Supervise Cacchione

i. Jon Merriman and Aguilar Unreasonably Delegated Their Supervisory Responsibilities Over Cacchione

32. As the CEO and a principal of the Merriman Firm, Jon Merriman was ultimately responsible for all supervision matters, including the supervision of all of the Merriman Firm's registered representatives, unless and until he reasonably delegated particular functions to another person in the firm, and neither knew, nor had reason to know, that such person's performance was deficient.

33. When Cacchione was hired at the Merriman Firm, he reported directly to Jon Merriman, and the two men who were friends worked closely throughout Cacchione's tenure at the Merriman Firm. Cacchione and Jon Merriman sat back-to-back at desks on the Merriman Firm's trading floor, and Jon Merriman was responsible for overseeing Cacchione's day-to-day business activities. As his direct boss, Jon Merriman was also responsible for providing Cacchione with annual performance evaluations and for recommending the amount of his compensation.

34. Although Cacchione reported to Jon Merriman regarding his daily business activities, Jon Merriman delegated some of his supervisory responsibilities over Cacchione to Aguilar, who was the Merriman Firm's Chief Compliance Officer and General Counsel during the relevant time period. Jon Merriman's delegation of responsibility to Aguilar was unreasonable, however, because he never followed up to ensure that Aguilar was supervising Cacchione. As discussed below, Jon Merriman did not follow up with Aguilar regarding his supervision of Cacchione even after Jon Merriman became aware of a customer complaint and other red flags related to Cacchione's work. In fact, Jon Merriman was unaware that Aguilar had placed Cacchione on a heightened supervisory plan, although he knew that Cacchione had a disciplinary history when he joined the Merriman Firm.

35. While Aguilar placed Cacchione on a heightened supervisory plan that entailed a daily review of his emails and trading, he delegated the day-to-day review of Cacchione's emails to his subordinate who held the title Compliance Manager. This employee already had responsibility for the bulk of the daily compliance functions at the firm, including random email reviews of more than one hundred registered representatives within the Merriman Firm. During the period that Cacchione was subject to heightened supervision from December 2005 through at least April 2007, Aguilar did not follow up to ensure that the daily email and trading review was being conducted. In fact, numerous suspicious emails were missed.

36. In May 2007, after employee turnover in the compliance department, Aguilar did not inform his newly hired Compliance Manager about the heightened review of Cacchione's emails and trading. Even though Cacchione had a disciplinary history when he joined the Merriman Firm, and the firm received a new customer complaint in December 2006, Cacchione's heightened supervision was discontinued when Aguilar failed to tell the new employee to perform daily reviews of Cacchione's emails and trading. By May 2007, Cacchione and Aguilar had developed a friendship in addition to their working relationship.

ii. Jon Merriman and Aguilar Failed to Act On "Red Flags" Relating to Cacchione's Unauthorized Trading

37. As noted in Paragraph 30, above, in the Fall of 2006, both Jon Merriman and Aguilar were aware that one of Cacchione's customers, an elderly widow, had complained about Cacchione purchasing risky, thinly traded stocks for her account. To resolve the claim, Aguilar prepared settlement papers and Jon Merriman signed a settlement check that was provided to the customer. Jon Merriman also counseled Cacchione about refraining from engaging in the same trading activity in the future.

38. Throughout his tenure at the Merriman Firm, Cacchione's unauthorized trading created significant operational problems some of which were brought to the attention of Aguilar and Jon Merriman. For instance, during 2007, Cacchione represented to Jon Merriman that he had customers who were interested in buying large blocks of shares in four separate offerings in which the Merriman Firm was acting as underwriter. In reality, Cacchione did not have customers to take all of the shares he requested so many of the share blocks remained unallocated for days or weeks while Cacchione determined which of his customer accounts had sufficient cash to take the unwanted (and unauthorized) shares. The allocation issues were elevated to Aguilar's attention by the Merriman Firm's operations department because the Merriman Firm was ultimately going to be responsible to pay for the shares if Cacchione's customers did not pay for them. Cacchione provided various excuses to Aguilar regarding why the shares were unallocated, including that customers had changed their minds about taking the stock. Aguilar failed to follow up on these issues beyond speaking with Cacchione.

39. From May 2007 through October 2007, Cacchione also made twenty unauthorized trades in the account of a local children's charity. Cacchione did not have discretionary authority to trade without permission in the account. When the charity discovered the trades in the Fall of 2007, it sought to have all of the trades canceled and the commissions generated from the trades reimbursed. Cacchione had to inform Aguilar about the charity's request to obtain approval to

cancel the twenty trades, many of which had been executed months before. Despite this unusual request, Aguilar approved the cancellations and agreed to reimburse the charity the commissions it paid on the trades without following up with the charity to determine why it sought cancellation of the transactions. Aguilar accepted at face value Cacchione's story that the charity had business reasons for canceling the trades. In addition, in November 2007, Jon Merriman received a Daily Error Report reflecting the twenty canceled trades in the charity's account. Jon Merriman did not follow up with either Cacchione or the charity to determine why the trades were canceled.

40. Cacchione continued to place unauthorized trades in some of his customers' accounts in 2008 until his fraud came to light as part of an SEC examination of the Merriman Firm. Cacchione's suspicious trading activity included frequent unallocated trades, canceled trades, and numerous extensions before trades were allocated to customer accounts, clear "red flags" as set forth in the Merriman Firm's WSP. ("Unusual account activity, such as cancels and re-bills, sellouts, or numerous extensions can be a sign of unauthorized trading.") The WSP also noted that trading activity would be monitored on a daily basis to detect any unusual account activity. Jon Merriman and Aguilar did not discharge their supervisory duties adequately and failed to investigate the "red flags" presented by Cacchione's unauthorized trading.

F. The Merriman Firm and Jon Merriman Failed Reasonably to Supervise Cacchione

41. During the relevant time period, the Merriman Firm's WSP described the firm as "a publicly-traded securities broker-dealer and investment bank focused on fast growing companies and institutional investors." The WSP also stated that the Merriman Firm provides "investment research, brokerage and trading services primarily to institutions." When Cacchione joined the Merriman Firm in December 2005, he brought over a hundred individual customer accounts with him to the firm. As a result, the Merriman Firm expanded its retail brokerage business beyond services mainly offered to officers of existing corporate business clients. Although this was a new area for the Merriman Firm, it did not add any additional compliance personnel or provide training to its supervisors relating to the supervision of this newly expanded line of business. During the relevant time, the Merriman Firm had a thinly staffed compliance department with a Chief Compliance Officer, who also handled all of the day-to-day legal work of the Merriman Firm as general counsel, a Director of Compliance who handled nearly all of the daily compliance responsibilities for the firm, and an assistant who performed administrative functions. In addition, the Chief Compliance Officer, Aguilar, was inexperienced with supervising retail brokerage activities, as the Merriman Firm was his first employment in the brokerage industry.

APPLICABLE LAW

The Merriman Firm, Jon Merriman and Aguilar Failed Reasonably to Supervise Cacchione

42. Section 15(b)(4)(E) of the Exchange Act requires broker-dealers reasonably to supervise persons subject to their supervision, with a view toward preventing violations of the federal securities laws. See, e.g., Dean Witter Reynolds, Inc., Exchange Act Rel. No. 46578 (October 1, 2002). The Commission has emphasized that the "responsibility of broker-dealers to

supervise their employees by means of effective, established procedures is a critical component in the federal investor protection scheme regulating the securities markets." Id. Section 15(b)(4)(E) of the Exchange Act provides for the imposition of a sanction against a broker or dealer who "has failed reasonably to supervise, with a view to preventing violations of the securities laws, another person who commits such a violation, if such other person is subject to his supervision." Section 15(b)(6)(A)(i) incorporates by reference Section 15(b)(4)(E).

43. As a result of the conduct described above, the Merriman Firm, Jon Merriman and Aguilar failed reasonably to supervise Cacchione with a view to detecting and preventing his violations of the federal securities laws. Jon Merriman and Aguilar unreasonably delegated their supervisory responsibility over Cacchione, and then failed to follow up to ensure that Cacchione was adequately supervised. Both Jon Merriman and Aguilar also failed to act on red flags that came to their attention regarding Cacchione's unauthorized trading. Had they adequately supervised Cacchione, it is more likely that Cacchione's fraudulent pledging scheme and his unauthorized trading in his customers' accounts could have been discovered.

44. The Merriman Firm and Jon Merriman also failed reasonably to supervise Cacchione by failing to provide adequate resources to implement the firm's supervisory procedures. Had they provided adequate resources to manage the Merriman Firm's newly added retail brokerage business, including sufficient personnel to implement Cacchione's heightened supervisory plan, it is more likely that they could have detected and prevented Cacchione's misconduct.

The Merriman Firm Violated Section 15(b)(7) of the Exchange Act and Rule 15b7-1 Thereunder, and Jon Merriman and Aguilar Aided and Abetted and Caused the Violations

45. Rule 15b7-1, promulgated under Section 15(b)(7) of the Exchange Act, provides in pertinent part that "[n]o registered broker or dealer shall effect any transaction in, or induce the purchase or sale of, any security unless any natural person associated with such broker or dealer who effects or is involved in effecting such transaction is registered or approved in accordance with the standards of training, experience, competence and other qualification standards . . . established by the rules of any national securities exchange or national securities association of which such broker or dealer is a member."

46. For more than two years, the Merriman Firm, Jon Merriman and Aguilar delegated the supervision of the registered representatives in the Merriman Firm's Client Services Group to Cacchione, an individual who did not pass the required supervisory examination and was not registered as a supervisor under NASD Rules 1021 and 1022. Jon Merriman and Aguilar knew, or were reckless in not knowing, that the individual to whom they delegated supervisory authority was not registered as a supervisory principal.

47. As a result of the conduct described above, the Merriman Firm willfully violated Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder, and Jon Merriman and Aguilar willfully aided and abetted and caused the Merriman Firm's violations.

The Merriman Firm Violated Rule 10(a) of Regulation S-P as a Result of Cacchione's Conduct

48. Rule 10(a) under Regulation S-P provides, in part, that broker-dealers may not "directly or through any affiliate, disclose any nonpublic personal information about a consumer to a nonaffiliated third party unless: . . . (iii) [y]ou have given the consumer a reasonable opportunity, before you disclose the information to the nonaffiliated third party, to opt out of the disclosure; and (iv) [t]he consumer does not opt out."

49. As a result of the conduct described above in which Cacchione used the Merriman Firm's computer system to disseminate confidential customer information to third parties, the Merriman Firm willfully violated Rule 10(a) of Regulation S-P (17 C.F.R. § 248.10(a)).

THE RESPONDENTS' REMEDIAL EFFORTS

50. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by the Merriman Firm and cooperation afforded the Commission staff by Respondents. This included undertaking an internal investigation, reviewing hundreds of thousands of electronic and paper documents and interviewing witnesses; cooperating with the SEC staff; promptly suspending and then firing Scott Cacchione; making comprehensive management and structural changes such as: reorganizing the firm's management structure, separating the role of the Chief Compliance Officer from the role of the General Counsel, hiring a former FINRA examiner as the Chief Compliance Officer, vastly scaling back the firm's retail accounts and related business activities, reviewing the firm's compliance procedures; agreeing to hire an Outside Compliance Consultant and Monitor who will provide reports to the Board of Directors (and the SEC), and refocusing the firm's business into its core fields of sales and trading for institutions, research and investment banking.

UNDERTAKINGS

51. The Merriman Firm has undertaken to:

a. Devise and implement, within 30 days after the issuance of this Order: a policy and a set of procedures for communicating and documenting supervisory relationships for all registered representatives; and a plan for allocating adequate resources to regulatory supervision.

b. Retain, within ten (10) days of the date of entry of this Order, the services of an Independent Consultant not unacceptable to the staff of the Commission for the period of one year. The Merriman Firm shall exclusively bear all costs, including compensation and expenses, associated with the retention of the Independent Consultant. The Merriman Firm shall retain the Independent Consultant to: (i) review the Merriman Firm's written policies and procedures relating to the supervision of registered representatives; (ii) make recommendations concerning these policies and procedures with a view to assuring compliance with supervisory responsibilities and dedication of sufficient resources to supervision of its registered representatives; and (iii) to ensure that the Merriman Firm and Jon Merriman are complying with all remedies ordered in Section IV below.

c. No later than ten (10) days following the date of the Independent Consultant's engagement, provide to the Commission staff a copy of an engagement letter detailing the Independent Consultant's responsibilities pursuant to paragraph 51.b. above.

d. Arrange for the Independent Consultant to issue its report within 90 days after the date of the engagement. Within ten (10) days after the issuance of the report, the Merriman Firm shall require the Independent Consultant to submit a copy of the Independent Consultant's report to Michael Dicke, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California, 94104. The Independent Consultant's report shall describe the review performed and the conclusions reached and shall include any recommendations deemed necessary for changes in or improvements to the Merriman Firm's written policies and procedures and a procedure for implementing the recommended changes or improvements.

e. Within 30 days of receipt of the Independent Consultant's Report, adopt all recommendations contained in the Report and remedy any deficiencies in its written policies and procedures; provided, however, that as to any recommendation that the Merriman Firm believes is unnecessary or inappropriate, the Merriman Firm may, within fifteen (15) days of receipt of the Report, advise the Independent Consultant and the Commission's staff in writing of any recommendations that it considers to be unnecessary or inappropriate. With respect to any recommendation that the Merriman Firm considers unnecessary or inappropriate, the Merriman Firm shall propose in writing an alternative policy or procedure designed to achieve the same objective or purpose.

f. With respect to any recommendation with which the Merriman Firm and the Independent Consultant do not agree, attempt in good faith to reach an agreement with the Independent Consultant within 30 days of receipt of the Report. In the event that the Merriman Firm and the Independent Consultant are unable to agree on an alternative proposal acceptable to the Commission's staff, the Merriman Firm will abide by the original recommendation of the Independent Consultant.

g. Within 180 days of the entry of this Order, submit an affidavit to the Commission's staff stating that it has implemented any and all recommendations of the Independent Consultant, or explaining the circumstances under which it has not implemented such recommendations.

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

i. The Merriman Firm shall require the Independent Consultant to enter into an agreement that provides that for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with the Merriman Firm, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity. The agreement will also provide that the Independent Consultant will require that any firm with which he is affiliated or of which he is a member, and any person engaged to assist the Independent Consultant in performance of his duties under this Order shall not, without prior written consent of the Commission's staff in the San Francisco Regional Office, enter into any employment, consultant, attorney-client, auditing or other professional relationship with the Merriman Firm, 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.

j. For good cause shown, and upon timely application from the Merriman Firm or the Independent Consultant, the Commission's staff may extend any of the procedural dates set forth above.

52. Respondent Jon Merriman shall provide to the Commission, within thirty (30) days after the end of the ordered twelve month suspension period, an affidavit that he has complied fully with this sanction. Such affidavit shall be submitted under cover letter that identifies Jon Merriman as a Respondent and the file number of these proceedings, and hand-delivered or mailed to Michael Dicke, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California, 94104.

53. Respondent Aguilar shall provide to the Commission, within thirty (30) days after the end of the ordered twelve month suspension period, an affidavit that he has complied fully with this sanction. Such affidavit shall be submitted under cover letter that identifies Aguilar as a Respondent and the file number of these proceedings, and hand-delivered or mailed to Michael Dicke, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California, 94104.

IV.

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

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

A. Pursuant to Section 15(b)(4) of the Exchange Act, the Merriman Firm is hereby censured.

B. Pursuant to Section 21C of the Exchange Act, the Merriman Firm shall cease and desist from committing or causing any violations and any future violations of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder, and Rule 10(a) of Regulation S-P (17 C.F.R. § 248.10(a)).

C. The Merriman Firm shall pay civil penalties of $100,000 to the United States Treasury. Payment shall be made in the following installments: (1) $50,000 within 15 days of entry of this Order; and (2) $50,000 within 180 days of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payments 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 the Merriman Firm 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 Michael S. Dicke, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California 94104.

D. Pursuant to Section 21C of the Exchange Act, Jon Merriman shall cease and desist from causing any violations and any future violations of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder.

E. Pursuant to Section 15(b)(6) of the Exchange Act, Jon Merriman be, and hereby is, suspended from acting in a supervisory capacity for any broker or dealer for a period of twelve (12) months, effective beginning the second Monday following the issuance of this Order.

F. Jon Merriman shall comply with his undertaking enumerated in Section III, paragraph 52, above.

G. Jon Merriman shall, within ten (10) days of the entry of this Order, pay civil penalties of $75,000 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 Jon Merriman 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 Michael S. Dicke, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California 94104.

H. Pursuant to Section 21C of the Exchange Act, Aguilar shall cease and desist from causing any violations and any future violations of Section 15(b)(7) of the Exchange Act and Rule 15b7-1 thereunder.

I. Pursuant to Section 15(b)(6) of the Exchange Act, Aguilar be, and hereby is, suspended from acting in a supervisory capacity for any broker or dealer for a period of twelve (12) months, effective beginning the second Monday following the issuance of this Order.

J. Aguilar shall comply with his undertaking enumerated in Section III, paragraph 53, above.

K. Aguilar shall pay civil penalties of $40,000 to the United States Treasury. Payment shall be made in the following installments: (1) $20,000 within fifteen (15) days of entry of this Order; and (2) $20,000 within 180 days of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest accrued pursuant 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payments 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 Aguilar 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 Michael S. Dicke, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 44 Montgomery Street, Suite 2600, San Francisco, California 94104.

L. The Merriman Firm shall comply with the undertakings enumerated in Section III, paragraph 51, above.

By the Commission.

Elizabeth M. Murphy
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. 9083 / November 12, 2009

SECURITIES EXCHANGE ACT OF 1934
Release No. 60993 / November 12, 2009

INVESTMENT ADVISERS ACT OF 1940
Release No. 2948 / November 12, 2009

INVESTMENT COMPANY ACT OF 1940
Release No. 28996 / November 12, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13683

In the Matter of **S4 Capital, LLC and** **Sharath Sury** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 21C AND 15(b)(6) OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), (f), AND (k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e) and (k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against S4 Capital, LLC ("S4 Capital") and pursuant to Section 8A of the Securities Act, Sections 15(b)(6) and 21C of the Exchange Act, Sections 203(f) and (k) of the Advisers Act, and Section 9(b) of the Investment Company Act against Sharath Sury ("Sury")(collectively, "Respondents").

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II.

After an investigation, the Division of Enforcement alleges that:

Respondents

1. S4 Capital, L.L.C. (formerly known as Chicago Analytic Capital Management, LLC and Valence Capital Group, LLC) is a Delaware Limited Liability Company located in Chicago, Illinois. It has been registered with the Commission as an investment adviser since March 2000.

2. Sharath M. Sury, 37 years old, is a resident of Chicago, Illinois. Sury has been the CEO and majority owner of S4 Capital since 2001. Sury has held Series 3, 7, and 63 licenses since 1995. Sury is currently a registered representative associated with Chicago Analytic Trading Company.

Facts

3. From December 2005 to February 2006, Sury caused an unregistered hedge fund managed by S4 Capital to engage in undisclosed, unhedged, high-risk trading, primarily in Google stock options, which resulted in substantial losses to the fund. During this period, Sury failed to disclose to investors in the hedge fund with whom S4 Capital had investment advisory agreements, that Sury was engaging in risky, unhedged trading that was contrary to the investment strategy described in the hedge fund's private placement memorandum and their personal investment objectives and that the fund was suffering mounting losses. Sury also sent certain investors emails that lulled them into believing that their investments were profitable and failed to disclose the risky trading and related losses. In total, Sury's undisclosed high-risk trading caused the Hedged Equity Fund to lose all of its assets, totaling approximately $12 million, in about two months.

4. From February 2003 through April 2006, S4 Capital actively managed two unregistered hedge funds: the CACM Core Equity Fund, L.P. d/b/a/ Hedged Equity Fund, L.P. ("Hedged Equity Fund") and the CACM Market Neutral Fund, L.P. ("Market Neutral Fund") (collectively the "Funds"). S4 Capital was the general partner and the investment adviser to these Funds, which were limited partnerships. Sury assisted in the drafting of the Funds' offering materials and acted as the primary portfolio manager of the Funds. At the beginning of 2005, the Funds' trader left S4 Capital, and Sury also became the trader for the Funds.

5. In March 2003, Sury solicited Investors A, a husband and wife, to enter into an investment advisory relationship with S4 Capital. Sury created an S4 Capital investor supervision agreement and an investment policy statement for these investors. The investment policy statement stated that the Investors A risk tolerance was low, that they shared a clear aversion to downside risks, and that portfolio losses greater than 10% were generally unacceptable. The investment policy statement further provided that S4 Capital would pursue "a prudent blend of capital preservation, liquidity, stable tax-exempt income generation and modest inflation-adjusted capital preservation" and "consistent acceptable rates of return without a significant or meaningful

deterioration of principal." Sury, through S4 Capital, recommended that the Investors A money be invested in fixed income securities and conservative hedged investments, using "absolute return" strategies that would protect against downside risk and provide liquidity. Based on the investment supervision agreement and policy statement, Investors A invested approximately $40 million with S4 Capital.

6. In the fall of 2005, after experiencing a period of low returns on their original investments with S4 Capital, Investors A informed S4 Capital's President that they wanted to withdraw their money, totaling $51.9 million, from S4 Capital and invest it elsewhere.

7. At the end of November 2005, Sury and S4 Capital's President met with Investors A in an attempt to retain them as S4 Capital clients. During this meeting, Sury gave a PowerPoint presentation to Investors A and provided five investment options. Sury recommended that Investors A invest in what was presented as a "barbell" investment approach. Sury described this investment approach as a continuation of Investors A diversified portfolio, which limited volatility, limited downside loss, increased transparency, and increased liquidity. This investment strategy was to be comprised of a stable source of capital preservation through investments in the bond market and a source of capital growth through investments in hedged equities. For this latter aspect of the proposed strategy, Sury recommended the Hedged Equity Fund.

8. Investors A were also provided with a copy of the Hedged Equity Fund's private placement memorandum, which stated that the fund's investment objective was "to provide investors with participation in equity markets with reduced exposure to the markets overall volatility" and that the fund would "seek superior overall relative rates of returns by limiting downside risks through hedging or reduced equity exposure and actively participating in the upside through increased market exposure." It further stated that the fund's investment approach was "to manage a diversified portfolio of U.S. common stocks, equity index securities and equity options in order to be highly correlated to the broad movements in the U.S. stock market on the upside and less correlated on the downside," that "the investment will be closely monitored on an ongoing basis for continued positive momentum," and that [p]ositions will be eliminated when they no longer exhibit positive characteristics."

9. Sury's oral and written statements to Investors A did not truthfully describe his investment management of the Hedged Equity Fund.

10. Beginning in at least October 2005, Sury, through S4 Capital, used risky and unhedged trading strategies for the Hedged Equity Fund and the Market Neutral Fund, causing them to experience an enormous amount of volatility.

11. In 2005, S4 Capital's Operations and Compliance Officer ("OCO") prepared internal periodic "flash reports" of the Hedged Equity Fund's performance. The OCO distributed these reports several times a week via email to Sury, among others. The flash reports included a "risk metrics" section which provided a comparison of the volatility of the Hedged Equity Fund's performance to the volatility of general market indices, including the S&P 500 index. The November 23, 2005 flash report stated that the Hedged Equity Fund's volatility for the preceding

30 trading days, 60 trading days, and year had been 77.35%, 93.26%, and 59.12%, respectively. In contrast, the S&P 500 index volatility was reported as having been 12.02%, 11.18%, and 10.53%, respectively, for those same time periods.

12. In addition, on October 20, 2005, Sury placed at least 77% of the Market Neutral Fund's equity and approximately 9% of the Hedged Equity Fund's equity in unhedged, Google options that were expiring in just two days. These trades were levered positions which were extremely risky and far from being market neutral. Sury's trades were in effect a wager that Google's third quarter earnings would be higher than analysts' expectations. At the end of the trading day on October 20, 2005, Google announced third quarter revenues of $1.578 billion and earnings per share of $1.32. Analysts had previously forecasted revenues for the quarter of $892 million and earnings per share of $1.25. On October 21, 2009, Sury sold the Google options, realizing a 241% gain for the Funds. While Sury's trading strategy had produced large returns, the strategy was extremely risky and inconsistent with the Funds' stated investment strategies.

13. After completing the October trades in unhedged, Google options, S4 Capital ceased trading for the Hedged Equity Fund. S4 Capital also began closing down the Market Neutral Fund.

14. Sury knew that the Hedged Equity Fund's portfolio was far more volatile than the S&P 500 index. He also knew that, as expressed in Investors A's investment policy statement, portfolio losses greater than 10% were generally unacceptable. Sury nonetheless advised Investors A to invest in the Hedged Equity Fund, the historical volatility of which vastly exceeded a 10% downside risk level, and concealed from Investors A the historical and contemporaneous risks and volatility of the Hedged Equity Fund.

15. At the beginning of December 2005, based on the representations that they received, Investors A transferred approximately $8.25 million of the $51.9 million they had invested with S4 Capital to the Hedged Equity Fund. They also left the remainder of their investment with S4 Capital in bonds, cash, cash equivalents, and non-affiliated, third-party funds.

16. On November 30, 2005, the Hedged Equity Fund had a balance of approximately $3.73 million. Investors A investment in the Hedged Equity Fund thus more than tripled the size of the Fund.

17. Prior to Investors A investment in the Hedged Equity Fund, six trusts had invested approximately $4 million in the Hedged Equity Fund in 2003. These Trusts were all managed by the same trustee, Investor B. Investor B was also an investment advisory client of S4 Capital. Before Investor B made these investments in the Hedged Equity Fund, Sury had created an investment policy statement stating that Investor B's investment objective was to pursue a long-term growth and income strategy, while achieving an expected return of 4-7%. Investor B wanted moderate capital appreciation with capital preservation. Sury also provided Investor B with the Hedged Equity Fund's private placement memorandum, which contained the representations discussed above.

18. Contrary to the representations made in the Hedged Equity Fund's private placement memorandum and Sury's oral presentations to Investors A, Sury, through S4 Capital, continued to cause the Hedged Equity Fund to engage primarily in high-risk stock and options day-trading, including trading in Google stock and options. Sury failed to disclose this extremely risky trading and the fund's mounting losses resulting from his risky trading to Investors A and B.

19. Sury also sent Investors A several emails that falsely reassured them that the Hedged Equity fund's investments were consistent with the Fund's and Investors A investment objectives and/or that their investments were profitable.

20. On December 30, 2005, the Hedged Equity Fund had incurred more than $1.5 million in realized and unrealized trading losses in December. Instead of disclosing these losses, Sury, on December 30, 2005, sent an email to Investors A reiterating that their investment strategy was a "barbell" approach consisting of capital preservation in the bond market and capital growth through hedged equities.

21. By January 11, 2006, Investors A had earned no profits from the Hedged Equity Fund, which remained in a deficit position. Despite the fund's poor performance, Sury sent Investors A another email on January 11, 2006 stating "I am planning to begin hedging your equities exposure . . . Best to take some of our (early) profits off the table."

22. In mid-January 2006, S4 Capital's Chief Compliance Officer met with S4 Capital's President and told him that Sury should immediately stop trading unhedged, Google options in the Hedged Equity Fund because Investors A would never tolerate such losses. S4 Capital's President also confronted Sury about his risky trading. Nevertheless, Sury, through S4 Capital, continued to take increasingly large, unhedged positions in Google options in hopes that Google would report positive fourth quarter earnings.

23. By January 18, 2006, the Hedged Equity Fund had lost nearly $4.8 million. However, on January 18, 2006, Sury sent Investors A another email which stated, among other things, that their investment strategy "continues to be a prudent course."

24. On January 20, 2006, Google's stock experienced a sharp price decline as a result of news that the U.S. Justice Department had sued Google to compel the production of documents and that Yahoo, one of Google's direct competitors, had announced that it had missed analysts' expectations for the fourth quarter of 2005. After receiving this negative news, rather than disclosing the resulting losses, Sury, on January 20, 2006, instead sent Investors A an email stating "Today has seen some extraordinary activity. . . I think there is some merit to begin considering an allocation to equities . . . Indeed, putting on collared hedge positions would be a very prudent move at present, especially if we begin to see better earnings reports in the coming weeks. . . I'm hopeful that you will find the current strategy more rewarding in the long term than the more defensive strategy we used to protect your portfolio in the past 18 months." By the close of trading on Friday, January 20, 2006, Sury's trading caused the Hedged Equity Fund to realize losses of approximately $3,137,640 when a total of 4,418 Google call contracts expired worthless.

25. On January 22, 2005, S4 Capital's President confronted Sury and told him that the trading losses were unacceptable, and demanded to know why Sury placed the majority of the Hedged Equity Fund's assets in Google options. Sury admitted to S4 Capital's President that he was hoping for better than expected fourth quarter earnings for Google and he was trying to mirror his trading in unhedged, Google options in the Market Neutral Fund and Hedged Equity Fund on October 20, 2005 which resulted in a 241% gain for the Funds.

26. On January 23, 2006, the Hedged Equity Fund lost an additional $1,989,095 when Sury sold a total of 3,300 February Google calls purchased between January 18, 2006 and January 20, 2006. The risky trading and these losses were not disclosed to Investors A and B.

27. As a result of Sury's unhedged, high-risk trading strategy, S4 Capital and the Hedged Equity Fund incurred a $4,202,555 margin call on January 25, 2006. By this time, the Hedged Equity Fund had lost approximately $7.2 million due to the significant losses it had suffered and did not have sufficient capital to meet this margin call. As a result, Sury and S4 Capital's President, through S4 Capital, caused the Market Neutral Fund to loan $4,205,000 to the Hedged Equity Fund in order to meet the margin call. Sury and S4 Capital's President caused the Hedged Equity Fund to execute a promissory note for this loan. The note was guaranteed by the assets of the Hedged Equity Fund and S4 Capital. However, at that time, the Hedged Equity Fund and S4 Capital had insufficient assets to make this guarantee, and the Hedged Equity Fund immediately defaulted on the promissory note, which was due the next day.

28. As of January 31, 2006, the Hedged Equity Fund held positions with an aggregate market value of $9,729,115. This $9,729,115 included the $4,205,000 loaned from the Market Neutral Fund. After the close of trading that same day, Google announced that it had missed analysts' expectations and Google's stock price declined sharply thereafter. At the close of trading on January 31, 2006, the Hedged Equity Fund owned $7,855,700 worth of net long Google call options representing nearly 81% of the portfolio's total value. Sury and S4 Capital used over $2 million of the Market Neutral Fund's loan to establish these positions.

29. On February 1, 2006, as the value of Google rapidly declined, Sury began liquidating the Google options held in the Hedged Equity Fund. By February 3, 2006, all of the remaining positions in the Hedged Equity Fund were liquidated. Between February 3, 2006 and February 7, 2006, Sury, through S4 Capital, used all of the available cash from the sale of the Google options positions to repay approximately $3,913,000 to the Market Neutral Fund from the Hedged Equity Fund, and Sury repaid the remainder of the loan from his personal assets.

30. Sury's undisclosed high-risk trading caused the Hedged Equity Fund to lose all of its assets, totaling approximately $12 million, in about two months time. Approximately $11.6 million, or nearly 95%, of these losses were the result of Sury's trades in Google stock and options.

Violations

31. As a result of the conduct described above, S4 Capital and Sury willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder,

which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities.

32. As a result of the conduct described above, S4 Capital willfully violated Sections 206(1) and 206(2) of the Advisers Act, which prohibits any investment adviser from, directly or indirectly, employing any device, scheme or artifice to defraud any client or prospective client and engaging in any transaction, practice or course of business which operates as a fraud or deceit upon any client or prospective client.

33. As a result of the conduct described above, Sury willfully aided and abetted and caused S4 Capital's violations of Sections 206(1) and 206(2) of the Advisers Act.

III.

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

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

B. What, if any, remedial action is appropriate in the public interest against S4 Capital pursuant to Section 203(e) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 203(i) of the Advisers Act and Section 9(d) of the Investment Company Act;

C. What, if any, remedial action is appropriate in the public interest against Sury pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act including, but not limited to, civil penalties pursuant to Section 21B of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act; and

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60996; File No. PCAOB-2009-03)

November 13, 2009

Public Company Accounting Oversight Board; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Postponing the Effective Date of Rules and Forms Related to Annual and Special Reporting by Registered Firms and Succession to the Registration Status of a Predecessor Firm

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on September 30, 2009, the Public Company Accounting Oversight Board (the "Board" or the "PCAOB") filed with the Securities and Exchange Commission (the "SEC" or "Commission") the proposed rule changes described in Items I, II, and III below, which items have been prepared by the Board. The PCAOB has designated the proposed rule change as "constituting a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule" under Section 19(b)(3)(A)(i) of the Securities Exchange of 1934 (as incorporated, by reference, into Section 107(b)(4) of the Act) and Rule 19b-4(f)(1), which renders the proposal effective upon receipt of this filing by the Commission. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rule Change

The Board is filing with the Commission a rule change to postpone, from October 12, 2009, to December 31, 2009, the effective date of PCAOB Rules 2200, Annual Report; 2201, Time for Filing of Annual Report; 2202, Annual Fee; 2203, Special Reports; 2204, Signatures; 2205, Amendments; 2206 Date of Filing; 2207, Assertions of Conflicts with Non-U.S. Laws; 2108, Succeeding to the Registration Status of a Predecessor; 2109, Procedure for Succeeding to the Registration Status of a Predecessor; instructions to PCAOB Form 2, Annual Report Form;

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PCAOB Form 3, Special Report Form; and PCAOB Form 4, Succeeding to the Registration Status of a Predecessor; and related amendments to PCAOB Rules 1001(a)(vii), 1001(n)(ii), 1001(o)(i), 2107(c), 2107(f), 2300(a), 2300(b), 2300(c), 2300(f), 2300(g), 4000, and 4003(c).

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rule. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) Purpose

In the Board's filings under Rule 19b-4 seeking Commission approval of the proposed rules and form instructions identified in Section I above (PCAOB-2008-04 (June 17, 2008) and PCAOB-2008-05 (August 4, 2008)), the Board stated that those proposed rules and form instructions would take effect 60 days after Commission approval. The Commission approved those rules and form instructions in Commission Release Nos. 34-60496 and 34-60497 on August 13, 2009. Accordingly, the rules and form instructions were to take effect on October 12, 2009.

On the date that the rules and form instructions take effect, deadlines will begin to run for registered firms to report certain information to the Board by filing prescribed forms electronically through the Board's Web-based system for processing and publishing those forms. Because of technical issues related to deploying that Web-based system, it now appears that the system will not be sufficiently operational by October 12, 2009 to allow the filing of such forms by registered firms. Accordingly, the Board is delaying the effective date of the rules and form instructions to December 31, 2009 to permit time to resolve the technical issues and deploy the system.

The change in the effective date will have no impact on the timing of the first annual reports on Form 2 that will be required of registered firms pursuant to Rule 2200. Those reports will continue to be due by June 30, 2010, for the twelve-month period ending March 31, 2010, just as they would have been if the rules took effect on October 12, 2009. Similarly, the first annual fee due from firms pursuant to Rule 2202 will continue to be due by July 31, 2010, just as it would have been if the rules took effect on October 12, 2009.

Changing the effective date will, however, postpone to December 31, 2009 the onset of the obligation for registered firms to file special reports on Form 3 to report certain events that occur, and will similarly postpone the option of submitting a Form 4 to succeed to the registration status of a predecessor firm.

(b) Statutory Basis

The statutory basis for the proposed rule is Title I of the Act.

B. Board's Statement on Burden on Competition

The Board does not believe that the proposed rules will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Board's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

The Board did not solicit or receive written comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Securities Exchange of 1934 (as incorporated, by reference, into Section 107(b)(4) of the Act) and Rule 19b-4(f)(1) thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule is consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/pcaob.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number PCAOB 2009-03 on the subject line.

Paper comments:

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

All submissions should refer to File Number PCAOB 2009-03. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web sit (http://www.sec.gov/rules/pcaob/shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule that are filed with the Commission, and all written communications relating to the proposed rule between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing will also be available for inspection and copying at the principal office of the PCAOB. 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. All submissions should refer to File No. PCAOB-2009-03 and should be submitted on or before [insert 21 days from publication in the Federal Register].

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Aguilar
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 60998 / November 13, 2009

INVESTMENT ADVISERS ACT OF 1940
Release No. 2949 / November 13, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13684

In the Matter of **WILLIAM T. DAILEY, III,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against William T. Dailey, III ("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 and Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. William T. Dailey, III, was a trader and the office manager, from 2003 through 2006, in the San Francisco office of Needham & Co., LLC, a New York-based broker-dealer and investment adviser registered with the Commission. Dailey is 41 years old and resides in San Mateo, California.

2. On November 3, 2009, a final judgment was entered by consent against Dailey, permanently enjoining him from future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in the civil action entitled *Securities and Exchange Commission v. Benjamin Jones, et al.*, Civil Action Number 09-CV-4895, in the United States District Court for the Northern District of California. Pursuant to the final judgment, Dailey was ordered to disgorge $20,311 of trading profits and $5,714 of prejudgment interest, and to pay a civil money penalty in the amount of $91,035.

3. The Commission's complaint alleged that Dailey received material nonpublic information regarding an issuer known as Jamdat Mobile, Inc. ("Jamdat"), which he knew or should have known was provided to him in breach of a fiduciary duty to the issuer; that Dailey profited by trading in his own account on the basis of the material nonpublic information that he received; and that Dailey tipped material nonpublic information regarding Jamdat's acquisition to a friend of his, which resulted in further illicit trading in the securities of Jamdat.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 15(b)(6) of the Exchange Act and Section 203(f) of the Advisers Act, that Respondent Dailey be, and hereby is barred from association with any broker, dealer, or investment adviser, with the right to reapply for association after five 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.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 242

[Release No. 34-60997; File No. S7-27-09]

RIN 3235-AK46

Regulation of Non-Public Trading Interest

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rules and amendments to joint-industry plans.

SUMMARY: The Securities and Exchange Commission ("Commission") is proposing to amend the regulatory requirements of the Securities Exchange Act of 1934 ("Exchange Act") that apply to non-public trading interest in National Market System ("NMS") stocks, including so-called "dark pools" of liquidity. First, it is proposing to amend the definition of "bid" or "offer" in Exchange Act quoting requirements to apply expressly to actionable indications of interest ("IOIs") privately transmitted by dark pools and other trading venues to selected market participants. The proposed definition would exclude, however, IOIs for large sizes that are transmitted in the context of a targeted size discovery mechanism. Second, the Commission is proposing amendments to the display obligations of alternative trading systems ("ATSs") in Regulation ATS under the Exchange Act, including a substantial lowering of the trading volume threshold in Regulation ATS that triggers public display obligations for ATSs. Third, the Commission is proposing to amend the joint-industry plans for publicly disseminating consolidated trade data to require real-time disclosure of the identity of dark pools and other ATSs on the reports of their executed trades. The proposals are intended to promote the Exchange Act goals of transparency, fairness, and efficiency.

DATES: Comments should be received on or before [insert date 90 days after date of publication in the Federal Register].

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

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. S7-27-09 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 Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. S7-27-09. 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 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; 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: Actionable IOIs: Theodore S. Venuti, Special Counsel, at (202) 551-5658, Arisa Tinaves, Special Counsel, at (202) 551-5676, Gary M. Rubin, Attorney, at (202) 551-5669; ATS Display Obligations: Brian Trackman, Special Counsel, at (202) 551-5616, Edward Cho, Special Counsel, at (202) 551-5508; Post-Trade Transparency for ATSs: Natasha Cowen, Special Counsel, at (202) 551-5652, Mia Zur, Special Counsel, at (202) 551-5638, Nicholas Shwayri, Law Clerk, at (202) 551-5667, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-7010.

SUPPLEMENTARY INFORMATION:

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I. Introduction

The Commission is proposing to amend the regulatory requirements of the Exchange Act that apply to non-public trading interest in NMS stocks,[1] including so-called "dark pools" of

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[1] Rule 600(b)(47) of Regulation NMS defines "NMS stock" to mean any NMS security other than an option. Rule 600(b)(46) defines "NMS security" to mean any security for which trade reports are made available pursuant to an effective transaction reporting plan. In general, NMS stocks are those that are listed on a national securities exchange.

liquidity. Such trading interest is considered non-public, or "dark," primarily because it is not included in the consolidated quotation data for NMS stocks that is widely disseminated to the public.

Consolidated market data is the primary vehicle for public price transparency in the U.S. equity markets. It includes both: (1) pre-trade transparency – real-time information on the best-priced quotations at which trades may be executed in the future ("consolidated quotation data"); and (2) post-trade transparency – real-time reports of trades as they are executed ("consolidated trade data").[2] The central processors for consolidated market data in NMS stocks collect quotation and trade information from the relevant self-regulatory organizations ("SROs") – the equity exchanges and the Financial Industry Regulatory Authority ("FINRA") – and distribute the information in a consolidated stream pursuant to joint-SRO plans. Rule 603(b) of Regulation NMS requires that consolidated market data for each NMS stock be disseminated through a single plan processor. Consolidated market data is designed to assure that the public has a single source of affordable, accurate, and reliable information on the best quoted prices and last sale prices for each NMS stock.[3]

In general, dark liquidity (that is, trading interest that is not included in the consolidated quotation data) is not a new phenomenon. Market participants that need to trade in large size, such as institutional investors, always have sought ways to minimize their transaction costs by completing their trades without prematurely revealing the full extent of their trading interest to

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2 17 CFR 242.603(b).

3 The consolidated quotation data streams and their policy objectives are fully described in the Commission's Concept Release on Regulation of Market Information Fees and Revenues. Securities Exchange Act Release No. 42208 (December 9, 1999), 64 FR 70613 (December 17, 1999) ("Market Information Concept Release").

the broader market.[4] For many years, the manual trading floors of exchanges were a primary source of dark liquidity in the form of floor traders that "worked" the large orders of their customers, executing each such order in a number of smaller transactions without revealing to counterparties the total size of the order. In addition, broker-dealers acting as over-the-counter ("OTC") market makers and block positioners long have provided liquidity directly to their customers that is not reflected in the consolidated quotation data. Moreover, Rule 604 of Regulation NMS, which imposes limit order display requirements, recognizes the need of large

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4 The Commission previously has noted the interest of, and steps taken by, institutional investors to minimize the price impact of their trading:

> Another type of implicit transaction cost reflected in the price of a security is short-term price volatility caused by temporary imbalances in trading interest. For example, a significant implicit cost for large investors (who often represent the consolidated investments of many individuals) is the price impact that their large trades can have on the market. Indeed, disclosure of these large orders can reduce the likelihood of their being filled. Consequently, large investors often seek ways to interact with order flow and participate in price competition without submitting a limit order that would display the full extent of their trading interest to the market. Among the ways large investors can achieve this objective are: (1) to have their orders represented on the floor of an exchange market; (2) to submit their orders to a market center that offers a limit order book with a reserve size feature; or (3) to use a trading mechanism that permits some form of "hidden" interest to interact with the other side of the market. A market structure that facilitates maximum interaction of trading interest can produce price competition <u>within</u> displayed prices by providing a forum for the representation of undisclosed orders.

Securities Exchange Act Release No. 42450 (February 23, 2000), 65 FR 10577, 10581 (February 28, 2000) (SR-NYSE-99-48) ("Concept Release on Market Fragmentation") (citations omitted) (emphasis in original). The Commission also noted the harm that short-term volatility can cause to investors:

> In theory, short-term price swings that hurt investors on one side of the market can benefit investors on the other side of the market. In practice, professional traders, who have the time and resources to monitor market dynamics closely, are far more likely than investors to be on the profitable side of short-term price swings (for example, by buying early in a short-term price rise and selling early before the price decline).

<u>Id</u>. at 10581 n. 26.

investors to control the public display of their trading interest. Rule 604(b)(4), for example, provides a general exception from the public display requirement for a block size order, unless the customer placing the order requests that the order be displayed.[5] In general, the Commission has sought over the years to promote the public display of trading interest by attempting to provide positive incentives for display, but has never sought to prohibit trading venues from offering dark liquidity services to investors.[6]

The term "dark pool" is not used in the Exchange Act or Commission rules. For purposes of this release, the term refers to ATSs that do not publicly display quotations in the consolidated quotation data. Although dark pools publicly report their executed trades in the consolidated trade data, the trade reports are not required to identify the particular ATS that executed the trade. In contrast, the trade reports of registered exchanges are required to identify the exchange that executed the trade and thereby provide more transparency about the location of liquidity in NMS stocks.[7]

In recent years, an increasing number of dark pools have organized to provide their customers with electronic access to dark liquidity trading services. The number of active dark pools trading NMS stocks has increased from approximately 10 in 2002 to approximately 29 in

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5 Rule 600(b)(9) of Regulation NMS defines "block size" to mean an order of at least 10,000 shares; or for a quantity of stock having a market value of at least $200,000.

6 The Commission's recently proposed amendment to Rule 602 of Regulation NMS to eliminate an exception for the use of "flash orders" reflects this approach. See Securities Exchange Act Release No. 60684 (September 18, 2009), 74 FR 48632 (September 23, 2009). Although flash orders are used to access dark liquidity, the concerns that prompted the Commission's proposal relate to the use of the "flash" mechanism (that is, the dissemination of valuable order information to certain market participants rather than in the consolidated quotation data).

7 See infra note 85 and accompanying text. See also the CTA Plan, Section VI(f) and the Nasdaq UTP Plan, Section VI(c)(3).

2009.[8] For the second quarter of 2009, the trading volume of these dark pools was approximately 7.2% of the total share volume in NMS stocks, with no individual dark pool executing more than 1.3%.[9] By way of comparison, no single registered securities exchange currently executes more than 19% of volume in NMS stocks.[10] Given this dispersal of volume among a large number of trading venues, dark pools with their 7.2% market share collectively represent a significant source of liquidity in NMS stocks.

The particular business models and trading mechanisms of dark pools can vary widely. For example, some dark pools, such as block crossing networks, offer specialized size discovery mechanisms that attempt to bring large buyers and sellers in the same NMS stock together anonymously and to facilitate a trade between them. The average trade size of these block crossing networks can be as high as 50,000 shares.[11] Most dark pools, though they may handle large orders, primarily execute trades with small sizes that are more comparable to the average

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8 Data compiled from Forms ATS submitted to the Commission for 2d quarter 2009. Some trading venues, such as OTC market makers, offer dark liquidity primarily in a principal capacity and do not operate as ATSs. For purposes of this release, these trading venues are not defined as dark pools because they are not ATSs. These trading venues may, however, offer electronic dark liquidity services that are analogous to those offered by dark pools. If subject to the quoting requirements of Rule 602 of Regulation NMS, for example, an OTC market maker would be covered by the proposal to amend the definition of bid or offer to address actionable IOIs.

9 Data compiled from Forms ATS submitted to the Commission for 2d quarter 2009.

10 See, e.g., market volume statistics reported by BATS Exchange, Inc., available at http://www.batstrading.com/market_summary (no single national securities exchange executed more than 19.0% of volume in NMS stocks during 5-day period ending September 21, 2009).

11 See, e.g., http://www.liquidnet.com/about/liquidStats.html (average U.S. execution size in July 2009 was 49,638 shares for manually negotiated trades via Liquidnet's negotiation product); http://www.pipelinetrading.com/AboutPipeline/CompanyInfo.aspx (average trade size of 50,000 shares in Pipeline).

size of trades in the public markets, which was less than 300 shares in August 2009.[12] These dark pools that primarily match smaller orders (though the matched orders may be "child" orders of much larger "parent" orders) execute more than 90% of dark pool trading volume.[13]

The emergence of dark pools as a significant source of liquidity for NMS stocks raises a variety of important policy issues that deserve serious consideration. In this regard, the Commission has undertaken a broad review of equity market structure to assess its performance in recent years and whether market structure rules have kept pace with, among other things, changes in trading technology and practices. To help facilitate its review, the Commission intends to consider in the near future whether to publish a concept release requesting comment and data on a wide range of market structure topics. These likely would include the benefits and drawbacks of dark liquidity in all its forms, including dark pools, the order flow arrangements of OTC market makers, and undisplayed orders on exchanges.

The proposals in this release accordingly do not attempt to address all of the issues regarding dark liquidity. The proposals instead address three issues with respect to dark liquidity that the Commission preliminarily believes warrant attention, are sufficiently discrete, and as to which the Commission has sufficient information to proceed with a proposal.

One such issue arises from the messages, often called IOIs, that some dark pools privately transmit to selected market participants concerning their actionable orders in NMS stocks. As discussed further in section II below, these actionable IOIs are intended to attract immediately executable order flow to the trading venue, and, in this sense, they function quite

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12 See, e.g., http://www.nasdaqtrader.com/trader/aspx?id=marketshare (average size of NASDAQ matched trades in July 2009 was 228 shares); http://nyxdata.com/nysedata/asp/factbook (NYSE Group average trade size in all stocks traded in July 2009 was 267 shares).

13 Data compiled from Forms ATS submitted to Commission for 2d quarter 2009.

similarly to displayed quotations. As a result, dark pools that distribute actionable IOIs are no longer completely dark on a pre-trade basis. Rather, they are "lit" to a select group of market participants and dark with respect to the rest of the public. By privately transmitting valuable order information concerning the best prices for NMS stocks to selected market participants, actionable IOIs create the potential for two-tiered access to information, something that has long been a serious concern of the Commission.[14] It therefore is proposing two initiatives that would address this concern.

First, the Commission is proposing to amend the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS to apply explicitly to actionable IOIs. This definition of bid or offer is a key element that determines the public quoting requirements of exchanges and OTC market makers under Rule 602 of Regulation NMS, as well as ATSs under Rule 301(b) of Regulation ATS. In this respect, the revised definition would apply equally to all types of trading venues and help promote fair competition among them. Importantly, however, the proposed definition of bid or offer would recognize the need for targeted size discovery mechanisms that can enable investors to trade more efficiently in sizes much larger than the average size of trades in the public markets.[15] Specifically, the proposed amendment to the definition would exclude any actionable IOIs "for a quantity of NMS stock having a market value of at least $200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000" ("size-discovery IOIs").[16]

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14 See infra note 59 and accompanying text.

15 See supra note 12 (average size of trades in public markets is less than 300 shares). The market value of a 300 share order in a $30 stock is $9000.

16 For purposes of this release, the term "size discovery IOIs" means IOIs that qualify for the proposed exclusion for certain IOIs with large size. The term "actionable IOIs" means any actionable IOI other than size discovery IOIs.

As a second initiative to address actionable IOIs, the Commission is proposing to lower substantially the trading volume threshold in Rule 301(b) of Regulation ATS that triggers the obligation for ATSs to display their best-priced orders in the consolidated quotation data. Currently, an ATS is not required to include its best-priced orders for an NMS stock in the consolidated quotation data (even if it widely disseminates such orders) when its trading volume in that NMS stock is less than 5%.[17] Similarly, many, if not all, dark pools that transmit actionable IOIs would not be required to include this actionable order information in the consolidated quotation data if the Regulation ATS display threshold remains at 5%. The Commission is proposing to lower the volume threshold to 0.25% to help assure that the public, through the consolidated quotation data, has access to valuable order (including actionable IOI) information about the best prices and sizes for NMS stocks that trade on an ATS.

The practical result of the proposed amendment to the definition of bid or offer and the proposed lowering of the ATS volume threshold would be that ATSs could not privately display actionable IOIs only to select market participants and thereby create two-tiered access to information on the best available prices for NMS stocks. In addition, by lowering the trading volume threshold, more ATS quotes would be made available to the public by requiring their inclusion in the consolidated quotation data. As discussed below, the Commission preliminarily believes that this result would enhance price transparency and promote fairer and more efficient markets.

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17 Those ATSs that operate as electronic communication networks ("ECNs") and qualify for the ECN display alternative under Rule 602(b)(5)(ii) voluntarily have chosen to include their best-priced orders in the consolidated quotation data even when their volume in an NMS stock is less than 5%. The proposed amendments to Regulation ATS would not affect the display practices of these ECNs.

Finally, the Commission is proposing an initiative to improve the post-trade transparency of dark pools and other ATSs. As ATSs that trade in the OTC market, dark pools must be members of FINRA, and they are required to report their trades to FINRA for inclusion in the consolidated trade data. These trade reports do not, however, identify the particular venue that executed the trade, unlike the trade reports of registered exchanges.[18] To address this information gap, the Commission is proposing to amend the joint-SRO plans for publicly disseminating consolidated trade data to require real-time disclosure of the identity of ATSs on the reports of their executed trades. The proposal is designed to improve the quality of information about sources of liquidity in NMS stocks, as well as to increase public confidence in the integrity of the U.S. equity markets.[19]

II. Actionable IOIs

A. Concerns About Actionable IOIs

In recent years, a number of dark pools have begun to transmit IOIs to selected market participants that convey substantial information about their available trading interest.[20] These

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18 See infra note 85 and accompanying text. ATSs are broker-dealers that have chosen to comply with Regulation ATS and thus are exempt from the statutory definition of "exchange." 17 CFR 240.3a1-1(a)(2).

19 See, e.g., Securities Exchange Act Release No. 30569 (April 10, 1992), 57 FR 13396, 13398-13399 (April 16, 1992) (discussing benefits of transparency to the operation of fair and efficient capital markets).

20 Data compiled from Forms ATS submitted to the Commission for 2d quarter 2009 suggest that approximately 11 of 29 active dark pools in NMS stocks use some form of IOI. See also Peter Chapman and Nina Mehta, 2008 Review: IOIs Expand and Do More Heavy Lifting, Traders Magazine (December 2008) ("The year just passed witnessed the transformation of the indication of interest. Long a plain vanilla communication tool between the sellside and the buyside, the IOI is being reinvented to meet the requirements of a new era of trading."); John Hintz, Institutions and Sell Side Alike Grapple with Impact of IOIs, Securities Industry News, September 8, 2008 ("The dozens of dark pools that have emerged in recent years have each sought to offer unique features to draw order flow and increase fill rates. But some of the platforms' "special sauce" may make them less than fully dark.").

messages are not included in the consolidated quotation data, although, like displayed quotations, they can be significant inducements for the routing of orders to a particular trading venue. Indeed, some exchanges, when they do not have available trading interest to execute orders at the best displayed prices, give participants a choice of routing their orders to undisplayed venues in response to IOIs rather than to public markets in response to the best displayed quotations.[21]

Although these IOIs may not explicitly specify the price and size of available trading interest at the dark pool, the practical context in which they are transmitted renders them "actionable" – that is, the messages effectively alert the recipient that the dark pool currently has trading interest in a particular symbol, side (buy or sell), size (minimum of a round lot of trading interest), and price (equal to or better than the national best bid for buying interest and the national best offer for selling interest).

For example, a dark pool may send an IOI to a group of market participants communicating an interest in buying a specific NMS stock. Given that Rule 611 of Regulation NMS generally prevents trading centers, including dark pools, from executing orders at prices inferior to the national best bid or offer ("NBBO"), the IOI recipient reasonably can assume that the price associated with the IOI is the NBBO or better. Moreover, the IOI may be part of a course of conduct in which the recipient has responded with orders to the sender and repeatedly

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21 See, e.g., NYSE Arca, "Client Notice: NYSE Arca to Provide Indication of Interest (IOI) Routing" (March 12, 2008) (routing service for "non-displayed liquidity pools"); Rob Curran, NYSE, Nasdaq Expanding Roles as 'Dark Pools' Converge, Dow Jones News Service (June 13, 2008) ("Only if the dark-pool partners give an indication they may have a better price on the security will Nasdaq route an order there."); Nina Mehta, Arca Beats Nasdaq to Dark Pools, Traders Magazine Online News, March 14, 2008 ("Now, after a marketable order checks Arca's book for liquidity, it passes through what [Arca executive] calls a 'cloud' of electronic indications from as many as 29 dark pools (not all are online yet). The order executes against indications pooled in the cloud before being routed to protected quotes on other markets. Customers that execute against the cloud are guaranteed NBBO-or-better executions.").

received executions at the NBBO or better with a size of at least one round lot. With this information (both explicit and implicit), the recipient of the IOI can reasonably conclude that sending a contra-side marketable order[22] responding to the IOI will result in an execution if the dark pool trading interest has not already been executed against or cancelled. In this respect, actionable IOIs are functionally quite similar to displayed quotations at the NBBO.

The order information communicated by actionable IOIs can be extremely valuable. Actionable IOIs with prices (whether explicit or implicit) better than the NBBO would effectively narrow the quoted spread for an NMS stock, if included in the consolidated quotation data. For example, if the NBBO for an NMS stock were \$20.10 and \$20.14, an actionable IOI to buy with a price of \$20.12 would, if included in the consolidated quotation data, create a new NBBO of \$20.12 and \$20.14 and thereby reduce the quoted spread by 50%. Reducing quoted spreads is important not only for those that trade with the displayed quotations, but also for other investors, including those whose orders are routed to OTC market makers for executions that often are derived from NBBO prices.[23] In addition, actionable IOIs with prices (whether explicit or implicit) equal to the NBBO could substantially improve the quoted depth at the best prices for an NMS stock. For example, an investor may wish to sell 500 shares of a stock when the size of the national best bid may be only 100 shares. The existence of multiple dark pools that contemporaneously had transmitted actionable IOIs to buy the stock would represent a substantial increase in the available size at NBBO prices or better.

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22 A "marketable" order is priced so that it is immediately executable at the best displayed quotations (that is, a buy order priced at the national best offer or higher and a sell order priced at the national best bid or lower).

23 See, e.g., Concept Release on Market Fragmentation, supra note 4, at 10582-10583 (discussing broker-dealer internalization and noting that "a market maker with access to directed order flow often may merely match the displayed prices of other market centers and leave the displayed interest unsatisfied").

The public, however, does not have access to this valuable information concerning the best prices and sizes for NMS stocks. Rather, dark pools transmit this information only to selected market participants. In this regard, actionable IOIs can create a two-tiered level of access to information about the best prices and sizes for NMS stocks that undermines the Exchange Act objectives for a national market system.[24] The consolidated quotation data is intended to provide a single source of information on the best prices for a listed security across all markets, rather than force the public to obtain data from many different exchanges and other markets to learn the best prices.[25] This objective is not met when dark pools or other trading venues disseminate information that is functionally quite similar to quotations, yet is not included in the consolidated quotation data.

The Commission also is concerned that the private use of actionable IOIs may discourage the public display of trading interest and reduce quote competition among markets. The Commission long has emphasized the need to encourage displayed liquidity in the form of publicly displayed limit orders.[26] Such orders establish the current "market" for a stock and thereby provide a critical reference point for investors. Actionable IOIs, however, often will be executed by dark pools at prices that match the best displayed prices for a stock at another

24 See infra note 59 and accompanying text.

25 See 17 CFR 242.603(b) (providing for the distribution of all consolidated information for an individual NMS stock through a single plan processor).

26 See, e.g., Securities Exchange Release No. 51808 (June 9, 2005), 70 FR 37496, 37527 (June 29, 2005) ("NMS Release") ("The Commission believes, however, that the long-term strength of the NMS as a whole is best promoted by fostering greater depth and liquidity, and it follows from this that the Commission should examine the extent to which it can encourage the limit orders that provide this depth and liquidity to the market at the best prices."); Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290, 48293 (September 12, 1996) ("Order Handling Rules Release") ("[T]he display of customer limit orders advances the national market system goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution, and disintermediation.").

market. In this respect, actionable IOIs at NBBO matching prices potentially deprive those who publicly display their interest at the best price from receiving a speedy execution at that price. The opportunity to obtain the fastest possible execution at a price is the primary incentive for the display of trading interest.[27] Particularly if actionable IOIs continued to expand in trading volume, they could significantly undermine the incentives to display limit orders and to quote competitively, thereby detracting from the efficiency and fairness of the national market system.

Moreover, for market participants that wish to supply liquidity in the form of non-marketable resting orders (such as those that match or improve NBBO prices), actionable IOIs provide a tool to achieve this result without displaying quotations publicly. The availability of these private messages as an alternative means to attract order flow may reduce the incentives of market participants to quote publicly. More generally, actionable IOIs divert a certain amount of order flow that otherwise might be routed directly to execute against displayed quotations in other markets.[28] Given the importance of displayed quotations for market efficiency, the Commission is particularly concerned about additional marketable order flow that may be diverted from the public quoting markets and that could further reduce the incentives for the public display of quotations.

B. Description of Proposal

To address these concerns, the Commission is proposing to amend the Exchange Act quoting requirements to apply expressly to actionable IOIs. In particular, it is proposing to amend the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS. "Bid" and "offer" are key terms that determine the scope of the two primary rules that specify the types of

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27 See NMS Release, supra note 26, at 37505.

28 See supra note 21 and accompanying text.

trading interest that must be included in the consolidated quotation data: Rule 602 of Regulation NMS and Rule 301(b)(3) of Regulation ATS.

Rule 602 of Regulation NMS specifies the public quoting requirements of national securities exchanges, national securities associations (currently, FINRA is the only national securities association that is subject to Rule 602), exchange members, and OTC market makers. In general, Rule 602 requires exchange members and certain OTC market makers to provide their best-priced bids and offers to their respective exchanges or FINRA.[29] The exchanges and FINRA, in turn, are required to make their best bids and offers available in the consolidated quotation data.[30]

Rule 600(b)(8) of Regulation NMS currently defines "bid" or "offer" to mean "the bid price or the offer price communicated by a member of a national securities exchange or member of a national securities association to any broker or dealer, or to any customer, at which it is willing to buy or sell one or more round lots of an NMS security, as either principal or agent, <u>but shall not include indications of interest</u>."[31] This exclusion of IOIs was part of the definition of bid or offer when it was originally drafted in 1978 for inclusion in the predecessor of Rule 602.[32]

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29 Under the definition of "subject security" in Rule 600(b)(73)(ii)(A) of Regulation NMS, an OTC market maker is not required to provide its best bids and offers for an NMS stock if the executed volume of the firm during the most recent calendar quarter comprised one percent or less of the aggregate trading volume for such NMS stock.

30 17 CFR 242.603(b).

31 17 CFR 242.600(b)(8) (emphasis added).

32 Securities Exchange Act Release No. 14415 (January 26, 1978), 43 FR 4342 (February 1, 1978) ("The terms "bid" or "offer" shall mean the bid price of the offer price most recently communicated by an exchange member or third market maker to any broker or dealer, or to any customer, at which he is willing to buy or sell a particular amount of a reported security, as either principal or agent, but shall not include indications of interest.").

In the adopting release, the term "indication of interest" was not defined, discussed, or expressly limited to a non-actionable communication of trading interest.

Rule 301(b)(3) of Regulation ATS specifies the order display and access requirements of ATSs.[33] When an ATS exceeds a 5% trading volume threshold in an NMS stock, the ATS is required to provide its best-priced orders to an exchange or association for inclusion in the consolidated quotation data made available under Rule 602. The term "order" is defined in Rule 300(e) of Regulation ATS to mean "any firm indication of a willingness to buy or sell a security, as either principal or agent, <u>including any bid or offer quotation</u>, market order, limit order, or other priced order."[34] This definition of "order" therefore includes, but is not limited to, "bid or offer quotations." Although Regulation ATS does not define the term "bid or offer quotation," the Commission considers it to have the same meaning as the terms "bid" or "offer" in Rule 600(b)(8) of Regulation NMS.[35]

When Regulation ATS was adopted in 1998, the Commission addressed the issue of whether IOIs were covered by the term "order" in the context of whether an IOI was "firm" or "non-firm." It noted that "[w]hether or not an indication of interest is 'firm' will depend on what actually takes place between a buyer or seller. The label put on an order – 'firm' or 'non-firm' – is not dispositive."[36] The Commission further stated that "a system that displays <u>bona fide</u>, non-firm indications of interest – including, but not limited to, indications of interest to buy or sell a

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33 The requirements for ATS order display and access are discussed in section III below.

34 17 CFR 242.300(e) (emphasis added).

35 Rule 600(b)(62) of Regulation NMS defines "quotation" to mean "a bid or an offer."

36 Securities Exchange Act Release No. 40760 (December 8, 1998), 63 FR 70844, 70850 (December 22, 1998) ("Regulation ATS Adopting Release"). The discussion in the Regulation ATS Adopting Release specifically referenced the definition of "order" in Rule 3b-16(c) under the Exchange Act, which is relevant for purposes of the meaning of "exchange." Rule 3b-16 was adopted at the same time as Regulation ATS, and their definitions of "order" are the same.

particular security without either prices or quantities associated with those indications – will not be displaying 'orders' . . .. Nevertheless, the price or size of an indication of interest may be either explicit or may be inferred from the facts and circumstances accompanying the indication."[37] The Regulation ATS Adopting Release also noted that the definition of order was "intended to be broader than the terms bid and offer in [the predecessor of Rule 602]."[38]

The Commission preliminarily believes that the quoting requirements of both Rule 602 and Regulation ATS should clearly cover actionable IOIs. It therefore is proposing to amend the definition of "bid" or "offer" in Rule 600(b)(8) by expressly limiting its exclusion of IOIs to those "that are not actionable." For example, an IOI would be considered actionable under the proposal if it explicitly or implicitly conveys all of the following information about available trading interest at the IOI sender: (1) symbol; (2) side (buy or sell); (3) a price that is equal to or better than the NBBO (the national best bid for buy orders and the national best offer for sell orders); and (4) a size that is at least equal to one round lot. In determining whether or not an IOI conveys this information, all of the facts and circumstances surrounding the IOI should be considered, including the course of dealing between the IOI sender and the IOI recipient.[39]

Under the proposal, when a quoting obligation under Rule 602 or Rule 301(b)(3) is triggered by the sending of an actionable IOI (i.e., sending an actionable IOI would be the communicating or displaying of a bid or an offer), the IOI sender would be considered a quoting venue and subject to the quoting requirements that generally apply to that type of venue, whether it be an exchange, an OTC market maker, or an ATS. These requirements would include, for example, restrictions on the display of locking or crossing quotations under Rule 610(d) of

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37 Id.

38 Id.

39 See supra note 36 and accompanying text.

Regulation NMS. In addition, the IOI sender would be required to reflect accurate information about the underlying order or other trading interest in the consolidated quotation data. This required order information would include the specific limit price and size of the underlying order or other trading interest.[40] The IOI sender also would be required to update the information as necessary, for example, to reflect executions or cancellations of the underlying order. Of course, customers of the dark pool would remain free, as they are entitled to do with quoting venues today, to control the release of their buying or selling interest.[41] Customers could not, however, consent to the dissemination of information sufficient for the transmission of an actionable IOI, yet withhold this information from the consolidated quotation data that is made available to the public.[42]

The Commission recognizes that some trading venues, such as block crossing networks, may use actionable IOIs as part of a trading mechanism that offers significant size discovery benefits (that is, finding contra-side trading interest for large size without affecting prices). These benefits may be particularly valuable for institutional investors that need to trade efficiently in sizes much larger than those that are typically available in the public quoting markets. These size discovery mechanisms could be rendered unworkable, however, if their

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40 See, e.g., 17 CFR 242.301(b)(3)(ii) (requiring ATSs to provide the best prices and sizes of orders at the highest buy price and the lowest sell price for such NMS stock).

41 Rule 604 of Regulation NMS, for example, explicitly recognizes the ability of customers to control whether their limit orders are displayed to the public. Rule 604(b)(2) provides an exception from the limit order display requirement for orders that are placed by customers who expressly request that the order not be displayed. Rule 604(b)(4) provides an exception for all block size orders unless the customer requests that the order be displayed.

42 In addition, the Commission notes that existing Rule 301(b)(10) of Regulation ATS, 17 CFR 242.301(b)(10), requires an ATS to establish adequate safeguards and procedures to protect subscribers' confidential trading information. To meet this requirement, an ATS that markets itself as a dark pool, yet sends IOIs to third parties regarding subscriber orders, should adequately explain its use of IOIs to its subscribers.

narrowly targeted IOIs for large size were required to be included in the consolidated quotation data. Accordingly, the Commission is proposing a further amendment to the current definition of "bid" or "offer" in Rule 600(b)(8) to exclude any IOIs "for a quantity of NMS stock having a market value of at least $200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000."

The purpose of this proposed exception for a targeted size discovery mechanism is to provide an opportunity for block crossing networks and other trading venues to offer new ways for investors that need to trade in large size to find contra-side trading interest of equally large size. The $200,000 figure is taken from the definition of "block size" in Rule 600(b)(9) of Regulation NMS, which covers orders of at least 10,000 shares <u>or</u> for a quantity of stock having a market value of $200,000. The Commission does not believe, however, that the 10,000 share alternative in the block size definition would be appropriate for the proposed size discovery exclusion from the definition of bid or offer, particularly with respect to low-priced stocks. For example, the market value of an IOI for 10,000 shares of a stock priced at $3 per share is only $30,000. To assure that the proposed size discovery exclusion would be limited to truly large size orders, the Commission is proposing to limit the exception to IOIs with a market value of at least $200,000.

C. Request for Comments

The Commission seeks comment and data on all aspects of the proposed amendment of the definition of bid or offer in Rule 600(b)(8) to apply expressly to actionable IOIs. Would the proposal promote the transparency, fairness, and efficiency of the national market system? Would it promote fair competition among trading venues in NMS stocks? Do commenters believe that the Commission has provided sufficient information about the attributes of an actionable IOI for trading venues to comply? Should the rule text include an express definition of "actionable IOI," and, if so, what should it be? For example, should rule text incorporate the elements discussed above (symbol, side, price, and size), as well as a facts and circumstances analysis? Would an express definition be sufficient to address the full range of the policy concerns the Commission identifies in this release and prevent circumvention by market participants? Do actionable IOIs offer significant benefits for market participants that could not be realized if they were defined as bids or offers for purposes of Rule 602 of Regulation NMS and Rule 301(b) of Regulation ATS? If so, could similar benefits be achieved through other means? What is the typical size of an actionable IOI? How many large orders use actionable IOIs? What is the amount of order flow that is diverted from displayed quotations due to actionable IOIs? Please quantify and provide supporting data if possible.

Comment also is requested on the proposed size discovery exclusion from the definition of bid or offer. Would the proposed exclusion promote more efficient trading for investors that need to trade in large size? Is the exclusion narrowly drafted to cover those trading mechanisms that offer valuable size discovery benefits without inappropriately excluding trading interest concerning the best prices and sizes for NMS stocks from the consolidated quotation data? Comment also is requested on whether market value is the appropriate criterion for size, and whether $200,000 is the appropriate figure. Should this figure be higher or lower? Please explain why. For example, is the $200,000 figure appropriate for high-priced stocks? Should the exclusion include a size criterion based on number of shares? If yes, should it be 10,000 shares, as in Rule 600(b)(9), or a larger or smaller number of shares? Finally, comment is requested on whether other criteria for size, such as percentage of average daily share volume in a security, would be more appropriate.

III. ATS Display Obligations

The Commission is also proposing certain amendments to Regulation ATS.[43] In conjunction with the Commission's proposed amendments to the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS, the proposed amendments to Regulation ATS would seek to further integrate the best-priced orders available on ATSs into the national market system by revising the order display requirements in Rule 301(b)(3) of Regulation ATS.[44] Specifically, the Commission is proposing to amend Rule 301(b)(3)(i)(B) of Regulation ATS[45] to reduce the average daily trading volume threshold, that would trigger the order display and execution access requirements for an ATS, from 5% to 0.25%. The Commission is also proposing to amend Rule 301(b)(3)(ii) of Regulation ATS[46] to clarify that an ATS must publicly display and provide access to its best-priced orders in NMS stocks when such orders are displayed to more than one person (other than ATS employees), regardless of whether such persons are subscribers of the ATS. Finally, the Commission is proposing to amend Rule 301(b)(3) to parallel the proposed size discovery exclusion from the definition of "bid" or "offer" discussed in section II above.

A. Lowering the Threshold for Display Requirement

Rule 301(b)(3) of Regulation ATS imposes certain order display and execution access obligations on ATSs. Currently, the obligations apply to any ATS that "(A) displays subscriber orders to any person (other than alternative trading system employees); and (B) during at least 4 of the preceding 6 calendar months, had an average trading volume of 5 percent or more of the aggregate average daily share volume for [an] NMS stock as reported by an effective transaction

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43 17 CFR 242.300 et seq.

44 17 CFR 242.301(b)(3).

45 17 CFR 242.301(b)(3)(i)(B).

46 17 CFR 242.301(b)(3)(ii).

reporting plan."[47] If an ATS meets these criteria, it is required to comply with Rule 301(b)(3)(ii),[48] which requires the ATS to provide to a national securities exchange or national securities association (each of which is a "self-regulatory organization" or "SRO") the prices and sizes of the orders at the highest buy price and the lowest sell price for that NMS stock, displayed to more than one subscriber of the ATS, for inclusion in the quotation data made available by the SRO to vendors. An ATS that meets the volume threshold also is required to comply with Rule 301(b)(3)(iii), which sets forth certain access standards regarding the orders that the ATS is required to provide to an SRO pursuant to Rule 301(b)(3)(ii).

The Commission is proposing to amend Rule 301(b)(3)(i)(B) by reducing the average daily trading volume threshold from 5% to 0.25%. Thus, under the proposed amendment, the display and access requirements of Rules 301(b)(3)(ii) and 301(b)(3)(iii), respectively, would apply if the ATS's average daily volume in an NMS stock were 0.25% or more during at least four of the preceding six calendar months. Average daily trading volume would continue to be based on volumes reported by an effective transaction reporting plan.

The Commission preliminarily believes that lowering the volume threshold would further the goals of the national market system by reducing the potential for two-tiered markets and improving the quality of quotation data made available to the public. As discussed above, the Commission is proposing to amend the definitions of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS in a manner that would, among other things, make these sections consistent with the Commission's policy statements in adopting Regulation ATS that actionable IOIs are orders for purposes of that regulation.[49]

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47 17 CFR 242.301(b)(3)(i).

48 17 CFR 242.301(b)(3)(ii).

49 See supra note 36 and accompanying text.

The Commission believes that broker-dealers operating ATSs should be subject to quoting requirements that broadly parallel those applicable to other market participants. Currently, the order display and execution access requirements in Regulation ATS do not apply to an ATS unless, among other things, the ATS has an average daily trading volume in an NMS stock of 5% or more. Few if any dark pool ATSs exceed the 5% threshold for any NMS stocks although, as explained above,[50] ATSs collectively account for a significant share of trading volume. Many dark pool ATSs communicate order information via actionable IOIs that could, if appropriately integrated, contribute to the overall efficiency and quality of the national market system. Without any attendant change to Regulation ATS to lower the 5% threshold, the proposed amendments to the definitions of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS would have less effect, because most ATSs could remain under the 5% threshold and thus continue to communicate actionable IOIs only to selected market participants. Therefore, in conjunction with the proposed amendments to Rule 600(b)(8), the Commission is proposing to substantially lower the threshold at which an ATS incurs an obligation under Regulation ATS to provide orders to an SRO for inclusion in the public quote stream. The Commission preliminarily believes that such amendment would be consistent with the mandate set forth in Section 11A of the Exchange Act[51] to promote a national market system.

Congress in 1975 endorsed the development of a national market system and granted the Commission broad authority to implement it.[52] Chief among the objectives of the national market system are coordinating markets, reducing fragmentation, and limiting the possibility of tiered markets where the best trading opportunities are available only to selected market

50 See supra notes 9 and 10 and accompanying text.

51 15 U.S.C. 78k-1.

52 See Pub. L. 94-29, 89 Stat. 97 (1975) (adopting Section 11A of the Exchange Act).

participants.[53] As the Commission has long recognized, proper coordination of markets requires transparency and access across the national market system.[54] Market participants must be able to know where the best trading opportunities exist, and have the ability to execute orders in response to those opportunities. The Commission has taken a number of actions designed to further these goals,[55] such as by providing, through Regulation ATS, a regulatory framework that promotes competition among and innovation by exchange and non-exchange trading centers while attempting to minimize detrimental market fragmentation. As the Commission observed in 1997, the failure "to fully coordinate trading on alternative trading systems into national market systems mechanisms has impaired the quality and pricing efficiency of secondary equity markets. . . . Although these systems are available to some institutions, orders on these systems frequently are not available to the general investing public."[56] The Commission noted that such

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53 See 15 U.S.C. 78k-1(a)(1)(D) ("The linking of all markets for qualified securities through communication and data procession facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders"). See also Securities Exchange Act Release No. 39884 (April 21, 1998), 63 FR 23504, 23514 (April 29, 1998) ("Regulation ATS Proposing Release"); Securities Exchange Act Release No. 38672 (May 23, 1997), 62 FR 30485, 30492 (June 4, 1997) ("Concept Release") (citing inter alia SEC, STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS (February 2, 1972), 37 FR 5286 (March 14, 1972)); Securities Exchange Act Release No. 36310 (September 29, 1995), 60 FR 52792 (October 10, 1995).

54 See, e.g., Regulation ATS Proposing Release, supra note 53, 63 FR at 23511.

55 See, e.g., Rules 610 and 611 of Regulation NMS, 17 CFR 242.610 and 242.611; Order Handling Rules Release, supra note 26 and accompanying text. See also H.R. Rep. 94-123, 94th Cong., 1st Sess. 50 (1975) (concluding that "Investors must be assured that they are participants in a system which maximizes the opportunities for the most willing seller to meet the most willing buyer").

56 Concept Release, supra note 53, 63 FR at 30492. See also Regulation ATS Proposing Release, supra note 53, 63 FR at 23514.

"hidden markets" – where superior quotations might be available to a subset of market participants – impeded the goals of the national market system.[57]

Later, when adopting Regulation ATS in 1998, the Commission stated that "it is inconsistent with congressional goals for a national market system if the best trading opportunities are made accessible only to those market participants who, due to their size or sophistication, can avail themselves of prices in alternative trading systems. The vast majority of investors may not be aware that better prices are disseminated to alternative trading system subscribers and many do not qualify for direct access to these systems and do not have the ability to route their orders, directly or indirectly, to such systems. As a result, many customers, both institutional and retail, do not always obtain the benefit of the better prices entered into an alternative trading system."[58] The Commission further stated that, "in light of the significant trading volume on some alternative trading systems, integration of institutional and non-market maker broker-dealer orders into the national market system is essential to prevent the development of a two-tiered market."[59] Beyond the general benefits of such integration, the Commission specifically noted that "prices displayed only on alternative trading systems are

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57 See Regulation ATS Proposing Release, supra note 53, 63 FR at 23514-15 ("The use of these systems to facilitate transactions in securities at prices not incorporated into the [national market system] has resulted in fragmented and incomplete dissemination of quotation information. Recent evidence suggests that the failure of the current regulatory approach to fully integrate trading on alternative trading systems into [the national market system] mechanisms has impaired the quality and pricing efficiency of secondary equity markets, particularly in light of the explosive growth in trading volume on such alternative trading systems").

58 Regulation ATS Adopting Release, supra note 36, 63 FR at 70865.

59 Id. at 70866.

immediately known to key market players who can adjust their trading to take advantage of their information advantage."[60]

While initially proposing a 10% threshold,[61] the Commission ultimately adopted a 5% threshold. As noted in the Regulation ATS Adopting Release: "The Commission believes that lowering the threshold to five percent will provide more benefits to investors, promote additional market integration, and further discourage two-tier markets. At the same time, the Commission believes that those alternative trading systems with less than five percent of the volume would not add sufficiently to transparency to justify the costs associated with linking to a market."[62] The Commission continues to have the same concerns about fragmentation, two-tiered markets, and lack of transparency potentially caused by ATSs as it did when adopting Regulation ATS. However, as explained below, it now preliminarily believes that the 5% threshold for triggering ATS display obligations is too high, and that developments in technology, communications, and market structure warrant a substantial reduction of the ATS display threshold, to 0.25%.

Since the Commission adopted Regulation ATS, the equity markets have evolved significantly and trading activity has become substantially less concentrated. The market shares of major national securities exchanges have declined over the last several years.[63] More recently adopted national market system rules require robust intermarket linkages and protection of best-

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60 Id. at 70869. See also Order Handling Rules Release, supra note 26, 61 FR at 48308 ("[T]he ECN amendment is intended to integrate into the public quote the prices of market makers and specialists that are now widely disseminated to ECN subscribers but are not available to the rest of the market").

61 See Regulation ATS Proposing Release, supra note 53, 63 FR at 23515.

62 Regulation ATS Adopting Release, supra note 36, 63 FR at 70867.

63 See supra notes 9 and 10 and accompanying text.

priced quotations.[64] As noted above,[65] a large number of ATSs operating as dark pools have commenced operations and collectively represent a significant source of liquidity for NMS stocks. Many dark pool ATSs send actionable IOIs regarding subscriber orders held in their systems. Such actionable IOIs typically represent orders that are at or inside the NBBO, which – if incorporated into the public quote stream – could substantially benefit the national market system by, among other things, providing additional liquidity and promoting vigorous price competition between orders and between markets.

Because the number of trading centers has increased and the concentration of trading activity has become more dispersed, even smaller trading centers can now, collectively, have a substantial impact on price discovery for the overall market. For this reason, the Commission preliminarily believes that, to maintain a fair and efficient national market system, the majority of information about orders in NMS stocks communicated by ATSs to selected market participants – whether via actionable IOIs or otherwise – should participate in the public price discovery process. To accomplish this goal, the Commission is proposing to substantially lower the trading volume threshold in Rule 301(b)(3) of Regulation ATS. At the same time, consistent with the goals it articulated in adopting Regulation ATS,[66] the Commission continues to believe that competition is important to a successful national market system, and that ATSs help promote

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64 See, e.g., Rules 610 and 611 of Regulation NMS, 17 CFR 242.610 and 242.611; NMS Release, supra note 26, 70 FR at 37501-37503 (summary of basis for requirements).

65 See supra notes 8-10 and accompanying text.

66 See Regulation ATS Adopting Release, supra note 36, 63 FR at 70846-47 ("The final rules seek to establish a regulatory framework that makes sense both for current and future securities markets. This regulatory framework should encourage market innovation while ensuring basic investor protections. . . . The Commission believes the framework it is adopting meets the varying needs and structures of market participants and is flexible enough to accommodate the business objectives of, and the benefits provided by, alternative trading systems").

competition among trading centers. Accordingly, rather than proposing to reduce the threshold to 0% and, thereby, effectively requiring that any orders communicated by an ATS to more than one person be made available to the market as a whole, the Commission is proposing a new threshold of 0.25%.

Regulation ATS was designed to balance the benefits of reducing barriers to entry for non-exchange trading venues with the need for appropriate regulation and coordination among exchange and non-exchange trading venues.[67] The proposed display threshold of 0.25% is designed to keep barriers to entry for new ATSs low so as to promote competition, while reducing the amount of important price information that is selectively displayed outside the public quote stream. A new ATS that has not yet reached the 0.25% threshold in an NMS stock would, under the proposed amendments, be permitted to communicate orders in NMS stocks – whether via actionable IOIs or otherwise – to selected market participants. Such an ATS would be able to commence operations without, at least initially, incurring linkage and other costs associated with the requirement to provide order display and execution access. Although the Commission preliminarily believes that these costs are not unduly burdensome, the Commission is sensitive to these costs and preliminarily believes that it is not appropriate at this time to impose such costs on new ATSs that display subscriber orders outside the public quote stream, whether by communicating actionable IOIs or otherwise.[68]

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67 See Regulation ATS Adopting Release, supra note 36, 63 FR at 70847 ("The Commission believes the framework it is adopting meets the varying needs and structures of market participants and is flexible enough to accommodate the business objectives of, and the benefits provided by, alternative trading systems").

68 If the proposed changes to Rule 301(b)(3) are adopted, a new ATS could engage in limited display of orders in any NMS stock until it reached an average daily trading volume of 0.25% or more in that NMS stock over four of the preceding six months. The Commission preliminarily believes that this proposed threshold should provide a new ATS entrant sufficient opportunity to initiate and develop its business. A new ATS also

Although the Commission preliminarily believes that most established ATSs that communicate actionable IOIs would be covered by the proposed trading volume threshold,[69] it also preliminarily believes that the proposed amendments to Rule 301(b)(3)(ii) of Regulation ATS would not impose significant costs or inappropriate compliance burdens on such ATSs. As discussed below,[70] for those ATSs that would become subject to Regulation ATS's order display and execution access requirements because of the lowering of the display threshold, and that would comply with that obligation by providing their best-priced orders to an SRO for inclusion in the public quote stream, the Commission preliminarily believes that the costs of linking to an SRO are not substantial. The communications and order-routing systems necessary to comply with Regulation ATS's order display and execution access requirements have improved significantly since they were originally adopted. The Commission believes that robust and extremely fast linkages that were not available at that time are now widely offered on commercially reasonable terms. It also appears that the market for these services is highly competitive, further reducing their cost. The Commission notes that for ATSs currently operating as ECNs, even those with relatively small market shares, already incur the costs

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could structure its business to avoid any display of orders, and thus any impact of the proposed amendments. Consequently, the Commission does not anticipate that the proposed amendments would lessen competition among or innovation by securities markets.

69 Based on information provided to the Commission by dark pool ATSs on their quarterly Forms R-31, many such ATSs are above 0.25% of total national volume in all NMS stocks. If an ATS has over 0.25% of total national volume in all NMS stocks, it likely exceeds 0.25% in many individual NMS stocks – and thus would become subject to Regulation ATS's display and execution access requirements with respect to such NMS stocks, if the 0.25% threshold were to be adopted by the Commission.

70 See infra in section VI.B.

associated with providing their best-priced orders to an SRO for inclusion in the public quote stream.[71]

Any ATS would be able to avoid any direct impact from the proposed amendments by ceasing to send actionable IOIs to more than one person. Such an ATS would not incur any costs to link to an SRO for the purpose of providing its best-priced orders to an SRO for inclusion in the public quote stream. The Commission understands that some ATSs already operate on a completely dark basis, which suggests that this may be a viable business strategy for additional ATSs.[72]

The proposed amendments are designed to create a more level playing field with respect to order display and execution access for all market participants that receive and attempt to execute orders, including exchanges, ATSs, and OTC market makers. By amending Rule 301(b)(3) to make the order display and execution access requirements of ATSs more closely

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[71] Some ECNs display or have in the past displayed their orders in FINRA's Alternative Display Facility ("ADF"). Market participants that wish to trade against an ECN order displayed on the ADF must route a contra-side order to the ECN, as the ADF itself does not provide execution functionality. Other ECNs display or have in the past displayed their orders on national securities exchanges that provide an "order delivery" functionality. When an order arrives at the exchange seeking to execute against an ECN order that is displayed on the exchange, the exchange will "deliver" the contra-side order to the ECN for execution. This order delivery functionality is designed to eliminate the possibility of a double execution of the ECN order (once against an order sent to the exchange and once against an order sent directly to the ECN). To be competitive and comply with relevant regulatory requirements, including Regulation NMS, the exchange and ECN trading systems must be closely integrated and have very high reliability and speed. The prevalence of these order display and routing arrangements employed by ECNs suggests that it would not be inappropriately burdensome for other ATSs to undertake similar order display and routing arrangements to include their trading interest in the consolidated quotation data.

[72] Certain ATSs generate executions by communicating actionable IOIs to selected market participants and thereby benefit from the current regulatory structure. The Commission acknowledges that the proposed amendments could impact such ATSs. However, as explained in this Release (see infra section VI.B), the Commission preliminarily believes that the potential benefits to the broader market of the proposed changes to Rule 301(b)(3) would justify these impacts.

parallel those of other market participants, the Commission preliminarily believes that the national market system would be fairer, more transparent, and more competitive – to the benefit of all investors.

B. Elimination of "in the alternative trading system" limitation

In its current form, the display requirement of Regulation ATS applies only with respect to orders that are displayed to more than one person in the alternative trading system.[73] As the Commission noted in the Regulation ATS Adopting Release, the term "person in the alternative trading system" means a subscriber of the ATS.[74] The Commission noted that this language would permit ATSs that operated a negotiation feature from incurring any order display obligations pursuant to Regulation ATS.[75]

The Commission proposes to amend Rule 301(b)(3)(ii) by eliminating the phrase "in the alternative trading system" and replacing it with the phrase "(other than alternative trading system employees)." The purpose of eliminating the phrase "in the alternative trading system" would be to make an ATS that meets the volume threshold subject to the display obligation whenever it displays an order in an NMS stock to more than one person, regardless of whether

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73 See 17 CFR 240.301(b)(3)(ii) ("[s]uch alternative trading system shall provide to a national securities exchange or national securities association the prices and sizes of orders at the highest buy price and the lowest sell price for such NMS stock, displayed to more than one person in the alternative trading system, for inclusion in the quotation data made available by the national securities exchange or national securities association").

74 See Regulation ATS Adopting Release, supra note 36, 63 FR at 70866 ("alternative trading systems are not required to provide to the public quote stream orders displayed to only one other alternative trading system subscriber"); id. at 70867 ("Rule 301(b)(3) only requires alternative trading systems to publicly disseminate the best priced orders that are displayed to other alternative trading subscribers").

75 See id. at 70866. Using a negotiation feature, two subscribers of an ATS would communicate with each other using the facilities of the ATS in an attempt to reach agreement on the terms of a transaction. The negotiation could result in one subscriber communicating a firm order to another subscriber, which the latter could accept or reject.

those persons are subscribers of the ATS. When the Commission adopted Regulation ATS in 1998, trading technology and business strategies had not yet evolved to the point where communicating order information to anyone other than a subscriber of an ATS was feasible or even desirable. Given the state of the market in 1998, the Commission did not consider imposing, and thus did not adopt, a display obligation with respect to order information communicated to non-subscribers.

More recent technological developments require the Commission to revisit this issue. As markets have become highly automated and systems for sending, receiving, and processing large numbers of electronic messages have grown more robust and more widely available, many market participants – including some ATSs – now communicate actionable IOIs to attract potential counterparties for subscriber orders that they hold.[76] In many cases, the recipients of those IOIs are not subscribers of the ATS and thus are not "in" the ATS. In its current form, however, Rule 301(b)(3) does not cover this type of display, even if the ATS exceeds the current 5% threshold.

The development and implementation of new technology – particularly the ability of third-party vendors to provide fast and robust order-routing services to a wide number of venues on commercially attractive terms – support extending Regulation ATS's display requirements to instances where orders are displayed to more than one person, regardless of whether such persons are subscribers of the ATS. Whether or not a recipient of such order information is deemed to be "in" the ATS, communication of such information to a limited subgroup of market

76 The recipient of such information can respond by sending a firm order back to the sender with the goal of interacting with the contra-side order held by the sender.

participants has the potential to create a two-tiered market.[77] Thus, the Commission preliminarily believes that the phrase "in the alternative trading system" unduly restricts the order display and execution access obligations of ATSs, and that the proposed amendment to Rule 301(b)(3)(ii) is appropriate to further the objectives of a national market system.

While the Commission is proposing to delete the phrase "in the alternative trading system" from Rule 301(b)(3)(ii), it is proposing to replace it with the phrase "(other than alternative trading system employees)." The ability of ATS employees to see such order information should not affect whether the ATS is required to provide its best-priced orders to an SRO for inclusion in the public quote stream. Existing Rule 301(b)(3)(i)(A) already contains the language "(other than alternative trading system employees)." By inserting the same phrase in Rule 301(b)(3)(ii), the Commission would clarify that no display obligations are triggered because ATS employees can see subscribers' order information.

C. Size Discovery Exclusion

The Commission proposes to revise Rule 301(b)(3)(ii) of Regulation ATS to add an exclusion for certain large orders to make it consistent with the proposed amendments to the definition of "bid" or "offer" discussed in section II above. Rule 301(b)(3)(ii) currently states that an ATS is required to provide to an SRO the prices and sizes of the orders at the highest buy price and the lowest sell price for any NMS stock for inclusion in the public quote stream that are, among other things, displayed to more than one person in the ATS. The Commission proposes to amend Rule 301(b)(e)(ii) to exclude "orders having a market value of at least

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77 However, under the proposal, a negotiation system that allowed one subscriber to communicate an order to a second subscriber in an attempt to reach agreement on the terms of a transaction would continue to be exempt from any order display or execution access requirements under Regulation ATS, because the system is not displaying subscriber orders to more than one person.

$200,000 that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000."

With respect to such "size discovery orders,"[78] this proposed amendment to Rule 301(b)(3)(ii) would make the exception from the order display and execution access requirements applicable to ATSs consistent with the proposed exception in Rule 602 applicable to exchanges and responsible brokers and dealers. If Rule 301(b)(3)(ii) were not amended in this manner, the proposed exception to display requirements for size discovery IOIs in Rule 602 would not apply to ATSs. Rule 300(e) of Regulation ATS[79] defines the term "order" for purposes of Regulation ATS as including "any bid or offer quotation" which, if the Commission adopts this proposal, would no longer include size discovery IOIs. However, Rule 300(e) also defines the term "order" to include any "other priced order." Because a size discovery order could be an "other priced order," a size discovery order could be subject to the order display and execution access requirements of Rule 301(b)(3)(ii), regardless of any change to the definition of "bid" or "offer" in Rule 602. Therefore, the Commission is proposing to amend Rule 301(b)(3)(ii) to explicitly provide that "orders having a market value of at least $200,000 that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000" would not be subject to Regulation ATS's order display and

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78 The Commission notes that the proposed exclusion from Rule 301(b)(3)(ii) would apply to "orders" meeting certain criteria rather than to "indications of interest," which are the subject of the proposed exception to Rule 600(b)(8) of Regulation NMS discussed above. Because the term "order" is defined broadly in Regulation ATS and incorporated into multiple aspects of the regulation (i.e., recordkeeping and reporting requirements), the Commission preliminarily believes that an effort to distinguish and exclude size discovery IOIs from the definition of "order" under Regulation ATS would have additional and unintended effects on Regulation ATS.

79 17 CFR 242.300(e).

execution access requirements.[80] For the same reasons discussed in section II above,[81] the Commission preliminarily believes that the proposed amendment to Rule 301(b)(3)(ii) would appropriately balance preventing two-tiered markets and encouraging the public display of limit orders with affording certain large orders some opportunity for size discovery without having to be displayed in the public quote stream.

D. Request for Comment

The Commission requests the views of commenters on all aspects of the proposed amendments to Regulation ATS described above. The Commission also requests particular comment on the following:

1. Is 0.25% of aggregate average daily share volume in an NMS stock an appropriate threshold to trigger the order display and execution access requirements of Regulation ATS? Why or why not? Should the Commission adopt a higher or lower threshold? If so, what should that threshold be and why? Should the Commission leave the threshold at 5%? Would a threshold of 0.25% achieve the desired balance of not creating a barrier to entry for new ATSs while capturing most established ATSs that communication actionable IOIs? Are there other considerations and goals the Commission should take into account in establishing a new threshold?

80 Because the Commission's objective in the present proposal relates only to order display and execution access required by Rule 301(b)(3)(ii), no change to the definition in Rule 300(e) is being proposed. Therefore, other requirements relating to orders in Regulation ATS – including fair access; capacity, integrity, and security; recordkeeping; reporting; and the confidential treatment of trading information (see 17 CFR 242.301(b)(5), (b)(6), (b)(8), (b)(9), and (b)(10), respectively – would continue to apply with respect to all orders, whatever their size. In addition, executions of all orders, whatever their size, would continue to count toward an ATS's trading volume threshold for purposes of Rule 301(b)(3).

81 See supra section II.

2. Should the Commission adopt a threshold based on additional or different criteria other than trading volume (e.g., adjusting the trading volume threshold based on the liquidity of an NMS stock)? If the Commission were to do so, how should that threshold be determined and calculated? For example, what would be the appropriate time period for a liquidity-based threshold?

3. Is it consistent with the Commission's goals to permit very low volume ATSs to display orders to more than one person outside the public quote stream (by communicating actionable IOIs or otherwise) as would be the case with a display threshold of 0.25%, or should the display threshold be 0%? Are such IOIs typically used for more or less liquid NMS stocks? Should the types of NMS stocks that are typically associated with IOI usage affect the setting of the display threshold? If so, how?

4. Would lowering the average daily trading volume threshold to 0.25% promote price transparency and price discovery in the national market system? Why or why not? Are there other rule amendments the Commission could adopt that would achieve the Commission's goals?

5. Should the order display requirements of Rule 301(b)(3) include a size discovery exclusion for large orders? Is a principal amount of $200,000 an appropriate value to define large orders for this purpose? Should the Commission adopt a higher or lower threshold? If so, what should that threshold be and why? Are there other or additional criteria, such as number of shares, on which the exclusion should be based? If so, what are those criteria?

6. Is the amendment to Rule 301(b)(3)(ii) eliminating the phrase "in the alternative trading system" appropriate? Should the application of the order display requirements of Rule 301(b)(3)(ii) remain limited to orders that are displayed only to subscribers of an ATS? If so, why?

7. What would be the most likely method of compliance by ATSs were the Commission to adopt the proposed amendments to Rule 301(b)(3)? Do you believe that ATSs that currently send actionable IOIs would choose to comply with the proposed amendments to Regulation ATS by submitting subscriber orders to an SRO for inclusion in the public quote stream or by going completely dark (i.e., not disclosing any information about subscriber orders, whether via IOIs or otherwise)? What percentage of ATSs (whether by number or by the percentage of ATS trading volume that they represent) do you estimate would choose each option? Are there other options not discussed here that ATSs might pursue? Are there other policy implications that the Commission should consider regarding the likely responses by ATSs if the Commission were to adopt the proposed amendments?

8. Do you believe that subscribers of ATSs would change how they use ATSs if the Commission were to adopt the proposed amendments to Regulation ATS? If so, how?

9. How would the proposed amendments affect ATS revenues and the ability of ATSs to offer new products and services?

10. How would the proposed amendments affect internalization and payment-for-order-flow arrangements? Would the proposed amendments provide greater incentives to initiate internalization programs in lieu of developing a new ATS?

11. Would the proposed amendments increase or decrease trading costs for institutional investors? If so, please describe and quantify.

12. What would be the effects, if any, on the price discovery process for NMS stocks, their overall liquidity, or other trading characteristics if more ATSs went completely dark?

13. What costs would an ATS incur as a result of the proposed amendments to Rule 301(b)(3)? If an ATS that communicates actionable IOIs chose to comply with amended Rule

301(b)(3) by providing orders to an SRO for inclusion in the public quote stream, what would be the costs of the attendant linkage and order-routing systems (on both an initial and ongoing basis) and their related costs (e.g., compliance costs)? Do you agree with the Commission's preliminary assessment that fast and robust linkage and order-routing systems are widely available to market participants on commercially reasonable terms?

14. Would the proposed amendments to Rule 301(b)(3) have any impact (positive or negative) beyond those described in this release? Would the proposed amendments raise any additional issues that the Commission should consider?

IV. Post-Trade Transparency for ATSs

A. Background

1. Joint-SRO Arrangements for Disseminating Market Information

Section 11A(a)(2) of the Exchange Act, adopted by the Securities Acts Amendments of 1975 ("1975 Amendments"),[82] directs the Commission, having due regard for the public interest, the protection of investors and the maintenance of fair and orderly markets, to use its authority under the Exchange Act to facilitate the establishment of a national market system for securities in accordance with the Congressional findings and objectives set forth in Section 11A(a)(1) of the Exchange Act. Among those findings and objectives is "the availability to brokers, dealers, and investors of information with respect to quotations for and transactions in securities."[83]

Using this authority, the Commission has required the SROs to act jointly pursuant to various national market system plans in disseminating consolidated market information.[84] Under

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82 Pub. L. 94-29, 89 Stat. 97 (1975).

83 Section 11A(a)(1)(C)(iii) of the Exchange Act, 15 U.S.C. 78k-1(a)(1)(C)(iii).

84 See, e.g., 17 CFR 242.601. This rule requires exchanges to file a transaction reporting plan concerning transactions in listed equity securities executed through their facilities

this regulatory framework, the SROs have developed and funded, and presently operate, the systems that disseminate a highly-reliable, real-time stream of consolidated market information throughout the United States and the world.

The joint-industry plans that provide for the dissemination of last sale information for equity securities are the Consolidated Tape Association Plan ("CTA Plan") and the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation, and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privileges Basis ("Nasdaq UTP Plan") (collectively "the Plans").[85] These plans govern the arrangements for disseminating consolidated trade information. Among other things, the plans require the individual SROs to provide trade information for an NMS stock to a securities information processor ("SIP"), which then consolidates the information into a single stream for dissemination to the public. In this way, the public has access to a highly reliable source of information that is consolidated from all the market centers that trade a particular security.[86]

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and imposes a parallel requirement on associations for transactions effected otherwise than on a national securities exchange.

85 The CTA Plan is available at http://www.nyxdata.com/cta and the Nasdaq UTP Plan is available at http://www.utpdata.com. These plans are transaction reporting plans as well as National Market System Plans and were submitted by the plan participants for notice, comment, and approval by the Commission. The CTA Plan was originally declared effective pursuant to Section 17(a) of the Act and Rule 17a-15 thereunder. See Securities Exchange Act Release No. 10787 (May 10, 1974), 39 FR 17799 (May 20, 1974). It was subsequently approved, as amended, under Section 11A of the Act. See Securities Exchange Act Release No. 16589 (February 19, 1980), 45 FR 12377 (February 26, 1980). The Nasdaq UTP Plan was approved pursuant to Section 11A(a)(3)(B). See Securities Exchange Act Release No. 28146 (June 26. 1990), 55 FR 27917 (July 6, 1990).

86 For a more detailed description of the Plans, see Market Information Concept Release, supra note 3, 64 FR at 70616.

The CTA Plan provides for the dissemination of trade information for any CTA "Eligible Security" which is defined as any common stock, long-term warrant, preferred stock, or right admitted to dealings on the New York Stock Exchange LLC ("NYSE"), NYSE Amex LLC ("NYSE Amex") or the "regional exchanges."[87] The CTA Plan is administered by the Consolidated Tape Association ("CTA"), which consists of a representative from each of the twelve U.S. equities markets.[88]

The Nasdaq UTP Plan was approved on a pilot basis in 1990;[89] it became operational in 1994.[90] The Nasdaq UTP Plan governs the collection, processing, and dissemination on a consolidated basis of quotation information and transaction reports in Eligible Securities for each of its Participants.[91] Eligible Securities under the Nasdaq UTP Plan means any Nasdaq Global Market or Nasdaq Capital Market security ("Nasdaq securities") as defined in Nasdaq Rule 4200, but does not include any security that is defined as an "Eligible Security" within Section VII of

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87 Nasdaq securities are expressly excluded from this definition. See CTA Plan, Sections I(p) and (q), and VII. The Consolidated Quotation Plan provides for the consolidation of quotations from the markets trading the securities covered by the CTA Plan.

88 The participants are: BATS Exchange, Inc.; Chicago Board Options Exchange, Inc.; Chicago Stock Exchange, Inc.; Financial Industry Regulatory Authority, Inc.; International Securities Exchange, LLC; The NASDAQ Stock Market LLC; NASDAQ OMX BX, Inc.; NASDAQ OMX PHLX, Inc.; National Stock Exchange, Inc.; New York Stock Exchange LLC; NYSE Amex LLC; and NYSE Arca, Inc. (collectively, the "Participants").

89 See supra note 85.

90 See Securities Exchange Act Release No. 34371 (July 13, 1994), 59 FR 37103 (July 20, 1994). Before 1994, the Commission had to grant unlisted trading privileges ("UTP") to an exchange in order for the exchange to trade an over-the-counter ("OTC") security. Before the Nasdaq UTP Plan was approved, the Commission approved a limited pilot for exchanges to trade OTC securities. See Securities Exchange Act Release No. 22412 (September 16, 1985), 50 FR 38640 (September 24, 1985). In 1994, the Exchange Act was amended to permit exchanges to trade OTC securities on a UTP basis without Commission action.

91 See Nasdaq UTP Plan, Section II.

the CTA Plan.[92] This consolidated information provides investors with the current quotation and last sale information in Nasdaq securities. It enables investors to ascertain from one data source the current prices in all the markets trading Nasdaq securities. The Nasdaq UTP Plan serves as the transaction reporting plan for its Participants and is a prerequisite for their trading of Nasdaq securities.[93] The Nasdaq UTP Plan is administered by the participating exchanges and association, and applies to all of the markets that trade equity securities.[94] Amendments submitted by SROs to the Plans are subject to Commission review under Rule 608 of Regulation NMS.[95] Further, the Commission may itself amend National Market System plans, pursuant to Rule 608(b)(2) of Regulation NMS.

2. Alternative Trading Systems and Their Arrangements for Disseminating Market Information

Rules applicable to ATSs are set forth in Regulation ATS.[96] ATSs can choose whether to register as national securities exchanges or to register as broker-dealers and comply with additional requirements under Regulation ATS, depending on their activities and trading volume.[97] ATSs that register as broker-dealers[98] are required to be SRO members.[99] Because ATSs effect transactions in the OTC market, they must be members of FINRA.[100]

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92 See Nasdaq UTP Plan, Section III (B).

93 See 17 CFR 242.608; See also Securities Exchange Act Release No. 55647 (April 19, 2007), 72 FR 20891 (April 26, 2007).

94 See supra note 7.

95 See 17 CFR 242.608.

96 See 17 CFR 242.300 et seq.

97 See 17 CFR 242.301.

98 See Section 15(b) of the Act, 15 U.S.C. 78o(b).

99 See Section 15(b)(8) of the Act, 15 U.S.C. 78o(b)(8).

100 Id.

Rule 601(b) of Regulation NMS under the Exchange Act, which governs the dissemination of transaction reports and last sale information in national market system securities, requires SRO members to transmit the information required by the transaction reporting plans to the SRO.[101] OTC trades, including trades executed by ATSs, are reported to the consolidated trade streams through one of the trade reporting facilities ("TRFs") operated by FINRA on behalf of exchanges,[102] or through FINRA's ADF.[103] The published trade reports identify the trades as OTC trades; they do not identify the particular ATS or other broker-dealer that reported the trade.[104]

B. Proposed Amendments to the Plans

The Commission has long believed that one of the most important functions it can perform for investors is to ensure that they have access to the information they need to protect and further their own interests.[105] The Commission has consistently supported making timely and accurate reports of transactions available to the public.[106] A transparent market is a market

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101 See 17 CFR 242.601(b).

102 See FINRA Rules 6300 et seq. FINRA has established the following TRFs (each in conjunction with the pertinent Exchange): the FINRA/NASDAQ TRF and the FINRA/NYSE TRF.

103 See FINRA Rules 6200 et seq. The ADF is both a trade reporting and quotation display and collection facility for purposes of transactions in NMS stocks effected otherwise than on an exchange.

104 Members reporting trades to FINRA attach their unique Market Participant Symbols ("MPIDs") for reporting a trade to a TRF or the ADF, but the MPID is not disseminated publicly on trade reports. Trades reported to one of the two FINRA TRFs are transmitted to the SIPs for CTA or Nasdaq UTP (and disseminated to the public) with a market center identifier of FINRA and a sub-indicator for the relevant exchange TRF (i.e., NYSE or NASDAQ).

105 See, e.g., Market Information Concept Release, supra note 3, at 70614.

106 See, e.g., Securities Exchange Act Release No. 16589 (February 19, 1980), 45 FR 12377 (February 26, 1980) (amending the rule governing the collection and dissemination of transaction reports and last sale data).

in which investors and their brokers have information about the current buying and selling interest in a security, as well as information about the price and size of recent transactions and where those transactions have taken place.[107] In particular, the Commission has long been an advocate of post-trade transparency and has encouraged the markets to enhance the information made available to the public regarding transactions effected on exchanges and in the OTC market.[108] As the Commission has stated in the past, transparency allows all market participants to assess overall supply and demand, substantially counteracts the effects of fragmentation that necessarily characterize a decentralized market structure, without forcing all executions into one market, and can reduce the "information gap" between investors with differing degrees of sophistication.[109] Nationwide disclosure of market information is necessary to assure the efficient pricing of securities, to maximize the depth and liquidity of the securities markets and to provide investors with the opportunity to receive the best possible execution of their orders.[110]

Since the adoption of Regulation ATS, the equity markets have evolved and, among other things, trading activity has become less concentrated. The share of trading volume at certain major national securities exchanges has declined over the last several years.[111] ATSs, including those that are ECNs and those that are dark pools, have gained a growing share of equity trading

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107 See, e.g., Securities Exchange Act Release No. 50700 (November 18, 2004), 69 FR 71256, 71271 (December 8, 2004).

108 See, e.g., Securities Exchange Act Release No. 30569 (April 10, 1992), 57 FR 13396 (April 16, 1992) (stating, among other things, that real-time publicly disseminated trade reporting is crucial to the efficient and fair operation of capital markets).

109 See id.

110 See, e.g., SEC, STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS (February 2, 1972), 37 FR 5286, 5287 (March 14, 1972).

111 See supra notes 9-10 and accompanying text.

in the past several years.[112] Currently, approximately 38 percent of trading volume in NMS stocks is reported as OTC (which includes ATS trades).[113] The lack of information concerning the ATS on which trades are executed makes it difficult, if not impossible, for the public to assess ATS trading in real-time, and to reliably identify the volume of executions in particular stocks on individual ATSs.

The Commission preliminarily believes that the current level of post-trade transparency for ATSs is inadequate. Requiring ATS trades to carry a specific identifier that would be disseminated publicly would equalize the trade reporting requirements for exchanges and ATSs, both of which operate systems that bring together orders of multiple buyers and sellers on an agency basis. Accordingly, the Commission is proposing to amend the Plans to require the disclosure of the identity of individual ATSs on trade reports in the public data stream, the same way exchange trades are identified. Requiring the public disclosure of the individual ATS that executed a trade should enable market participants to better assess in real-time where executions in particular securities are occurring among various ATSs in the over-the-counter market. In addition, the proposal should allow more reliable trading volume statistics to be calculated for individual ATSs. The Commission preliminarily believes this should enhance the ability of broker-dealers and their customers to more effectively find liquidity and achieve best execution in the over-the-counter market.

However, the Commission is sensitive to the need of investors executing large size trades to control the information flow concerning their transactions, and preliminarily believes that the

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112 See Securities Exchange Act Release No. 59248 (January 14, 2009), 74 FR 4357, 4361 (January 26, 2009); see also Regulation ATS Adopting Release, supra note 36, at 70844.

113 See, e.g., market volume statistics available at http://www.batstrading.com/market_summary (OTC volume in NMS stocks was 37.7% during 5-day period ending September 21, 2009)

disclosure of the identity of the ATS that has executed a particular large size trade could potentially cause undue information leakage about that trading. Identification of an ATS that focuses on such block trading, for example, could signal to the market that the entity trading may plan to execute more trades in the same securities, with the risk that other market participants may attempt to take advantage of this information, to the detriment of the entity engaged in those large trades. The Commission preliminarily believes that the benefits of not disclosing the identity of ATSs that execute large size trades justify not providing such post-trade information about large size trades. The Commission also preliminarily believes that the exception for large size trades strikes the appropriate balance between the need of investors executing large size trades to minimize significant information leakage and the right of the investing public to have this identifying post-trade information. Therefore, the Commission is not proposing to require the identification of ATSs on trade reports in the public data stream for large size trades.[114]

Specifically, the Commission is proposing to revise the definition in the CTA Plan of Last Sale Price Information, to add language at the end of the first paragraph of Section VI(f) (Market Identifiers) of the CTA Plan, and to revise the second and third sentences of Section VIII(a) (Responsibility of Exchange Participants). Together, these changes would amend the CTA Plan to require that all last sale prices collected by FINRA from each ATS be accompanied by an identifier unique to the ATS and distributed by the SIP, unless the trade has a market value of at least $200,000. Such trades would continue to be reported as OTC trades without an ATS identifier.

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114 As with the other proposed amendments discussed above in the release, the Commission is proposing to use the $200,000 figure to define large size trades. It is a figure that is well recognized as constituting a large size order. The Commission is concerned that with these large size trades there is more potential for information leakage. For a more detailed discussion of large size trades and the $200,000 figure, <u>see</u> section II.

The Commission also is proposing to amend the Nasdaq UTP Plan to achieve the same result. Specifically, the Commission is proposing to revise the definition of "Transaction Reports" in Section III (U), the language in Section VI(C)(3) regarding processor dissemination of information via transaction reports, and Section VIII(B) regarding Transaction Reports. Together, these changes would amend the Nasdaq UTP Plan to require that all last sale prices collected by FINRA from each ATS be accompanied by an identifier unique to the ATS and distributed by the SIP, unless the trade has a market value of at least $200,000. Such trades would continue to be reported as OTC trades without an ATS identifier.

Currently, as discussed above, the identity of the ATSs is not reported to the public data stream. Recognizing the changes that have taken place in the marketplace and the increased share of equity trading by ATSs in the last number of years, the Commission preliminarily believes that requiring the disclosure of the identity of ATSs on their trade reports in the public data stream should be beneficial to investors. The proposed amendments would augment available trade information, provide important information about trading volumes of ATSs, including dark pools, as well as information on which ATSs may have liquidity in particular stocks. The Commission also preliminarily believes that the resulting improved transparency would help ensure that publicly available prices fully reflect overall supply and demand, equip the investing public with tools to make better investment decisions, increase the perception of fairness that is necessary for the healthy functioning of the national market system, and, as a result, enhance public confidence in the securities markets.[115]

C. Request for Comment on Proposed Plan Amendments

115 See supra notes 107-109 and accompanying text.

The Commission invites interested persons to submit written comments on any aspect of the proposed Plan amendments. The Commission seeks comment on whether there are alternative approaches to improving ATS post-trade transparency that the Commission should consider that would achieve the Commission's stated goals. The Commission specifically seeks comment on whether the amendment of the Plans is the best way to address the matter. If there are alternative approaches, such as requiring the TRFs to make the identity of ATSs that submit trade reports available to the public as part of their proprietary data streams, please discuss your suggested approach, its feasibility, and how it would achieve the Commission's goals. In addition, the Commission seeks comment on the timing and level of detail that ATSs should be required to provide about their trading activity. Would summary information, such as end-of-day volume statistics be preferable to real-time, trade-by-trade disclosure? If so, please explain your reasoning. Would real-time identification of ATS trades cause inappropriate information leakage concerning customer orders or result in other unintended consequences? What modifications could the Commission make to its proposal to address any such concerns? Will the proposed change affect trading on exchanges, where no large trade exception applies? The Commission also seeks comment on whether the proposed exception to the ATS trade reporting requirement for large size trades is justified and would help minimize concerns about information leakage. If a large size trade exception is not appropriate, please explain why you believe such an exception is not necessary. Further, is the proposed threshold the appropriate one, or should it be higher or lower? Should the Commission consider using a threshold other than a dollar threshold, such as a certain number of shares? How should the Commission establish such a threshold; for example, should it use other existing thresholds? If the Commission adopts the Plan amendments with the exemption for large size trades, should the

Commission require that the information with respect to which ATS effected the large size trades be made public at the end of the day (or at other time intervals), rather than in real-time as would occur if this were included in the consolidated data stream? In addition, comment is requested on the effect of the proposed post-trade disclosure on investors, ATSs, vendors and others that may be affected by the proposed amendments, as well as the effect on the market place and any competitive effect the proposed Plan changes may have.

V. Paperwork Reduction Act

A. Actionable IOIs

The proposed amendment of Rule 600(b)(8) of Regulation NMS does not contain any "collection of information requirements" within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[116] Rule 600 of Regulation NMS contains all of the defined terms used in Regulation NMS. The proposed amendment of Rule 600(b)(8) would revise the definition of "bid" or "offer" by expressly limiting its exclusion of IOIs to those "that are not actionable and indications of interest for a quantity of NMS stock having a market value of at least $200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000." The practical result of the amendment would be that actionable IOIs that do not qualify for the size discovery exclusion would be "bids" or "offers."

While the amendment to Rule 600(b)(8) does not contain any collection of information requirements within the meaning of the PRA, the proposed change in the definition of "bid" or "offer" could affect the collection of information burdens under Rule 602 of Regulation NMS.[117]

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116 44 U.S.C. 3501, et seq.

117 The proposed amendment to Rule 600(b)(8) of Regulation NMS also may affect the obligations imposed by Rule 301(b)(3) of Regulation ATS on ATSs that meet the specified trading volume threshold. Rule 301(b)(3) does not, however, currently contain a collection of information requirement as defined by the PRA because it currently

"Bid" and "offer" are key terms that determine the scope of Rule 602 of Regulation NMS. In general, Rule 602 requires exchange members and OTC market makers to provide their best-priced bids and offers to their respective exchanges and FINRA. The exchanges and FINRA, in turn, are required to make their best bids and offers available in the consolidated quotation data. The Commission does not believe that the proposed amendment to Rule 600(b)(8) would require any new or additional collection of information under Rule 602. Exchange members and certain OTC market makers would continue to be required to provide their best-priced bids and offers to their respective exchanges and FINRA.[118] The proposed amendment to Rule 600(b)(8) could increase the number of "bids" or "offers" that exchange members and OTC market makers would be required to review to determine their best-priced bids and offers. It is the Commission's understanding that all exchange members and OTC market makers have systems and procedures in place to make this determination today. As a result, the Commission believes that any burden increase in determining their best-priced bids and offers due to the proposed inclusion of actionable IOIs in the definition of "bid" or "offer" would not substantively or materially change existing collection burdens.[119] The Commission encourages comment on all aspects of this issue. In addition, the Commission encourages specific comment on:

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affects fewer than ten entities. However, the proposal to lower the trading volume threshold contained in Rule 301(b)(3)(i)(B) could affect the number of entities subject to Rule 301(b)(3) so that the amended rule would contain a collection of information. The PRA burden associated with the proposed amendment to, and amendments affecting the application of, Rule 301(b)(3)(i)(B) are discussed below in section V.B.

118 Under the definition of "subject security" in Rule 600(b)(73)(ii)(A) of Regulation NMS, an OTC market maker is not required to provide its best bids and offers for an NMS stock if the executed volume of the firm during the most recent calendar quarter comprised one percent or less of the aggregate trading volume for such NMS stock.

119 The information collection contained in Rule 602, entitled "Dissemination of Quotations – Rule 11Ac1-1," the precursor to Rule 602, has been assigned control number 3235-0461. The Commission, however, will be updating the overall burden estimate for this

1. To what extent, if at all, would the proposed amendment to Rule 600(b)(8) increase the number of bids or offers that exchange members and OTC market makers would be required to review and report to their respective exchanges and FINRA for inclusion in the consolidated quotation data? Please provide data and specific quantifications.

2. To what extent, if at all, would system changes or increases in system capacities be necessary to exchange members or OTC market makers to comply with the requirements of Rule 602, if the Commission were to adopt the proposed amendments to Rule 600(b)(8)?

B. ATS Display Obligations

Certain provisions of the proposed amendments to Regulation ATS rules contain "collection of information requirements" within the meaning of the PRA.[120] The Commission has submitted the information to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. 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 title of this collection is "Rule 301, Form ATS and Form ATS-R" (OMB Control Number 3235-0509).

1. Summary of Collection of Information

Rule 301(b)(3) of Regulation ATS governs order display and execution access for ATSs. Currently, the rule provides that an ATS incurs order display and execution access obligations if it displays subscriber orders in an NMS stock to more than one person in the ATS and the ATS has 5% or more of the average daily trading volume in such NMS stock, as reported by an effective transaction reporting plan. An ATS meeting these criteria must provide to an SRO the

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collection of information to account for an increase in the number of self-regulatory organizations subject to the Rule.

120 44 U.S.C. 3501 et seq.

prices and sizes of the orders at the highest buy price and the lowest sell price for such NMS stock for inclusion in the public quote stream.

The proposed amendment to Rule 301(b)(3)(i)(B) of Regulation ATS would broaden the applicability of these order display and execution access requirements by reducing the trading volume threshold from 5% of the aggregate average daily share volume to 0.25%. The proposed amendment to Rule 301(b)(3)(ii) would clarify that the order display and execution access requirements apply when a subscriber order is displayed to more than one person (other than ATS employees), regardless of whether such persons are subscribers of the ATS. The proposed amendments to Rule 301(b)(3)(i)(A) and (ii) would provide an exception to the order display and execution access requirements for orders that have a market value of at least $200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000.

The proposed amendments would not impact Form ATS or Form ATS-R. ATSs would continue to evaluate and submit the same information on these forms. Accordingly, the proposed amendments, if adopted, would not result in any revision to those collections of information. However, the proposed amendments could result in more ATSs being required to establish connections to SROs in order to display their best-priced orders. Each such ATS also could be required to expand or modify its systems capacity, internal controls, and compliance policies and procedures to provide orders to an SRO in a manner consistent with the SRO's rules and enable market participants to access such orders for execution. These requirements would constitute a "collection of information" that would be subject to the PRA.

The current collection of information, "Rule 301, Form ATS and Form ATS-R" (OMB Control Number 3235-0509), does not contain a collection of information with respect to Rule

301(b)(3) of Regulation ATS. When adopted, Rule 301(b)(3) did not contain a collection of information because fewer than ten entities were affected by Rule 301(b)(3).[121] In addition, under the current 5% volume threshold, it remains the case that fewer than ten ATSs are required to send best-priced orders to an SRO for inclusion in the consolidated public quote system.[122]

Since the adoption of Regulation ATS, the number of ATSs has grown significantly, and the national market system and the nature of order interaction have evolved considerably. Currently, there are numerous dark pool ATSs, many of which use actionable IOIs as a means to attract order flow. The proposed amendment to Rule 600(b)(8) of Regulation NMS to include actionable IOIs within the definition of "bid" or "offer" and the proposed lowering of the trading volume threshold in Rule 301(b)(3) from 5% to 0.25% might impose collection of information requirements on ten or more ATSs. For this reason, the Commission has prepared an estimate of the associated compliance burdens on ATSs for purposes of the PRA, as further detailed below.

The Commission preliminarily believes that the proposed amendment to Rule 301(b)(3) of Regulation ATS would not, if adopted, substantively or materially change collection burdens for SROs under the requirements of Rule 602 of Regulation NMS.[123] Under the proposal, order information that is communicated by ATSs to more than one person outside the public quote stream (whether via actionable IOIs or otherwise) could be required to be incorporated into the public quote stream. As described above, to do so an ATS would send the order information to an SRO, and that SRO would then be responsible under Rule 602 for incorporating the

121 See supra note 117.

122 This information is based on discussions of Commission staff with certain potential ATS respondents and other market participants.

123 See supra notes 117 and 118 and accompanying text.

information into the consolidated public quote stream.[124] The Commission preliminarily believes, however, that the additional burden on the SRO of including such ATS orders with the large volume of quotations that the SRO already includes in the public quote stream under Rule 602 would not be substantive or material. The Commission encourages comment on this point.

2. Proposed Use of Information

Rule 301(b)(3) of Regulation ATS requires an ATS to provide to an SRO the prices and sizes of the orders at the highest buy price and the lowest sell price in an NMS stock upon the satisfaction of certain threshold conditions under Rules 301(b)(3)(i)(A) and (B). If the Commission adopts the proposed amendments to Rule 301(b)(3), more than ten entities could become subject to the requirement to provide this order information to an SRO. Such information would be used by the SRO to determine the SRO's best bid, best offer, and aggregate quotation sizes. The SRO must make that information public, pursuant to Rule 602 of Regulation NMS.[125] This information is used, among other ways, by market participants to understand the market and to inform their trading decisions. The Commission also may use this information as part of its general market oversight and regulatory functions.

3. Respondents

There are approximately 73 ATSs that are subject to Regulation ATS. Of these, approximately 11 are dark pool ATSs that use actionable IOIs. Approximately one other ATS that is not an ECN displays subscriber orders in NMS stocks on a limited basis in some other fashion.[126] Therefore, the Commission preliminarily believes that up to 12 ATS respondents

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124 See id.

125 17 CFR 242.602.

126 The Commission notes that there are presently four ATSs operating as ECNs, as defined in Rule 600(b)(23) of Regulation NMS, 17 CFR 242.600(b)(23). These ATSs already display customer orders in the public quote stream and permit market participants to

could be impacted by the proposed amendments to Rule 301(b)(3).[127] The remaining 61 ATSs likely would not be impacted for PRA purposes by the proposed amendments, because they: (a) do not display subscriber orders in NMS stocks to more than one person (whether by communicating actionable IOIs or otherwise), (b) are ECNs and already publicly display subscriber orders, or (c) do not effect transactions in NMS stocks.[128] The Commission seeks comment on the number of ATSs that could be impacted by the proposed changes and the nature of such impacts.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

The proposed amendments to Rule 301(b)(3) of Regulation ATS would, if adopted, increase the collection of information burdens only with respect to those ATSs with sufficient volume in an NMS stock (0.25% or more of the aggregate average daily share volume) that choose to communicate actionable IOIs or that otherwise display order information to more than one person. An ATS crossing the 0.25% threshold would be required to provide its best-priced orders to an SRO for inclusion in the public quote stream. As stated previously, ATSs that are completely dark (i.e., that do not display any subscriber order information, whether by communicating actionable IOIs or otherwise) would not be impacted by the proposed amendments to Rule 301(b)(3).

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access such orders. Accordingly, these systems would not have new burdens under Rule 301(b)(3), as the Commission is proposing to amend it.

127 The Commission notes that, of these 12 potential respondents, any could choose to avoid Regulation ATS's order display and execution access requirements by choosing not to display subscriber orders to more than one person (or by displaying to more than one person only size discovery orders). Nevertheless, as set forth above, the Commission preliminarily believes that the proposed changes to Rule 301(b)(3) constitute a "collection of information" under the PRA. The proposed amendments also could impact new ATSs or existing ATSs that expand their business activities.

128 The Commission obtains information on the securities that are traded by ATSs from the Forms ATS filed with the Commission by ATSs.

The Commission preliminarily believes that including actionable IOIs as bids or offers under Rule 600(b)(8) of Regulation NMS and reducing the average daily trading volume threshold in Rule 301(b)(3) of Regulation ATS from 5% to 0.25% could increase the order display and execution access obligations of ATSs that transmit actionable IOIs or otherwise display order information to selected market participants. These obligations could entail the initial burdens of re-programming their current systems to monitor the ATS's percentage of trading in NMS stocks, establishing linkages to an SRO for the purpose of submitting orders to the SRO for public display and of providing access to market participants wishing to trade against such orders, and expanding systems capacity and internal controls, including establishing or modifying applicable compliance policies and procedures, to carry out these functions in a manner consistent with the SRO's rules.[129] The Commission preliminarily believes that such obligations could include ATS staff time to build new systems or re-program current systems, as well as ongoing ATS staff time to maintain such systems and carry out their associated functions.

The Commission preliminarily estimates that the one-time, initial annualized expense for potential ATS respondents to establish connectivity to an SRO would be approximately

129 Currently, under Rule 301(b)(3) of Regulation ATS, an ATS that displays subscriber orders to any person (other than ATS employees) and has an average daily trading volume of 5% or more of the aggregate daily share volume for an NMS stock is required to provide to an SRO the best priced orders for such NMS stock for inclusion in the public quote stream. Thus, ATSs are already required to monitor trading levels in NMS stocks and have policies and procedures in place to do so. As a result of the proposed amendments to Rule 301(b)(3), which would lower the average daily trading volume threshold from 5% to 0.25% and provide for an exception to the display obligation for orders that have a market value of at least $200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000, ATSs could be required to re-program their respective systems that monitor trading levels in NMS stocks to reflect this change in the average daily trading volume threshold.

$3,900,000.[130] In addition, the Commission preliminarily estimates that the one-time, initial annualized burdens for all potential ATS respondents to comply with the proposed amendments to Rule 301(b)(3) would be approximately 17,880 burden hours.[131] This figure is based on the estimated number of hours for initial internal development and implementation by an ATS to re-program its system, expand system capacity, and adjust internal controls, including costs to establish or modify applicable compliance policies and procedures.

The Commission also has estimated the ongoing expenses of complying with the proposed amendments to Rule 301(b)(3), which could include, among other things, maintaining connectivity with an SRO, monitoring daily trade activity, and ensuring compliance. The Commission preliminarily estimates that the ongoing annualized expense for all potential ATS respondents to maintain connectivity to an SRO would be approximately $3,600,000.[132] In

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130 This figure is the total initial, one-time annualized expense to establish electronic connections with an SRO for all potential ATS respondents and is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated expense from the following: (($25,000 relating to hardware- and software-related expenses) + ($25,000 monthly ongoing costs to maintain the connection x 12 months)) x (12 potential ATS respondents) = $3,900,000.

131 This figure is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated one-time burdens from the following: [((Sr. Programmer at 320 hours) + (Compliance Manager at 20 hours) + (Compliance Attorney at 20 hours) + (Programmer Analyst at 20 hours) + (Sr. Systems Analyst at 30 hours)) x (2 months) + ((Sr. Programmer at 2 hours) + (Compliance Manager at 6 hours) + (Compliance Attorney at 4 hours) + (Compliance Clerk at 40 hours) + (Sr. Systems Analyst at 2 hours) + (Director of Compliance at 5 hours) + (Sr. Computer Operator at 8 hours)) x (10 months)] x (12 potential ATS respondents) = 17,880 burden hours.

132 This figure is the total ongoing annualized expense to maintain electronic connections with an SRO for all potential ATS respondents and is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated expense from the following: (($25,000 monthly ongoing costs to maintain the connection x 12 months)) x (12 potential ATS respondents) = $3,600,000.

addition, the Commission preliminarily estimates that the ongoing annualized burdens for all potential ATS respondents to comply with the proposed amendments to Rule 301(b)(3) would be approximately 9,648 burden hours.[133] This figure includes the estimated number of internal professional staff hours for running compliance policies and procedures (including monitoring daily trading activity), ongoing system maintenance and development, and personnel costs associated with maintaining connectivity to an SRO.

The Commission is also proposing a change to Rule 301(b)(3)(ii) that would add an exception to the display and execution access requirements for orders that have a market value of at least $200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000. The Commission preliminarily believes that no ATS would incur any increased burdens because of the proposed exception. An ATS would incur either the same burdens (because it communicated no orders that met the terms of the proposed exception) or fewer burdens (because some or all of the orders that it communicated met the terms of the proposed exception, thus reducing the number of orders under the proposed amendments to Rule 301(b)(3) that the ATS would otherwise have to provide to an SRO for inclusion in the public quote stream). Some ATSs that might avail themselves of the proposed exception already have in place the functionality to communicate size discovery orders, have average execution sizes above $200,000, and have developed strategies to identify market participants that are reasonably believed to represent current contra-side trading interest

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133 This figure is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated ongoing burdens from the following: ((Sr. Programmer at 2 hours) + (Compliance Manager at 6 hours) + (Compliance Attorney at 4 hours) + (Compliance Clerk at 40 hours) + (Sr. Systems Analyst at 2 hours) + (Director of Compliance at 5 hours) + (Sr. Computer Operator at 8 hours)) x (12 months) x (12 potential ATS respondents) = 9,648 burden hours.

of at least $200,000.[134] Thus, the Commission preliminarily believes that such ATSs would not incur any costs if the Commission were to adopt the proposed exception.

The Commission seeks comment on the reporting and recordkeeping collection of information burdens associated with the proposed amendments. In particular:

1. How many ATSs would incur collection of information burdens if the proposed amendments to Regulation ATS were adopted by the Commission?

2. Would ATSs respond to the proposed amendments by linking to an SRO for the purpose of displaying their best-price orders in the public quote stream or by going completely dark? If the former, what would the initial and ongoing PRA burdens be of linking to an SRO to provide such orders and to offer execution access to those orders consistent with the SRO's rules?

3. What are the burdens, both initial and annual, that an ATS would incur for programming, establishing connectivity to an SRO, expanding systems capacity, and establishing compliance programs if the Commission were to adopt the proposed amendments? Would there be additional burdens associated with the collection of information under these proposed amendments?

4. What additional burdens, both initial and annual, if any, would an ATS incur related to the proposed exception for size discovery orders?

5. Retention Period of Recordkeeping Requirements

An ATS would be required to retain records and information pertaining to its operations, including information that would have to be disclosed under the proposed amendments to Rule

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134 The Commission obtains information about ATSs' trading methods from the Forms ATS submitted to it by ATSs.

301(b)(3), pursuant to, and for the periods specified in, Regulation ATS.[135] In addition, the broker-dealer operating an ATS is subject to the recordkeeping requirements specified in Section 17 of the Exchange Act and the rules and regulations thereunder.[136]

6. Collection of Information is Mandatory

Any collection of information pursuant to the proposed amendments to Rule 301(b)(3) would be a mandatory collection of information.

7. Responses to Collection of Information Will Not Be Kept Confidential

The collection of information resulting from the proposed amendments to Rule 301(b)(3) would not be confidential and would be publicly available.

8. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;

2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

3. Enhance the quality, utility, and clarity of the information to be collected; and

4. Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

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135 See, e.g., 17 CFR 242.302; 17 CFR 242.303.

136 See 15 U.S.C. 78q; 17 CFR 240.17a-1 et seq.

C. Post-Trade Transparency for ATSs

Certain provisions of the proposed amendments to the CTA Plan and the Nasdaq UTP Plan would result in a new "collection of information requirement" within the meaning of the PRA.[137] The Commission is therefore submitting this proposal to the Office of Management and Budget ("OMB") for review in accordance with 44 U.S.C. 3507 and 5 CFR 1320.11. The title for the collection of information requirements is the "CTA Plan and the Nasdaq UTP Plan, 'Post-trade Transparency for ATSs.'" Compliance with the collection of information requirements would be mandatory. 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. OMB has not yet assigned a control number to the new collection requirements in the proposed amendments to the CTA Plan and Nasdaq UTP Plan.

1. Summary

The CTA Plan and the Nasdaq UTP Plan are the joint-industry plans that provide for the dissemination of last sale information for equity securities and set forth the arrangements for dissemination of consolidated trade information. Currently, trades executed in the OTC market, including trades executed by ATSs, are reported to the consolidated trade streams through one of the TRFs operated by FINRA on behalf of the exchanges or to the ADF. As ATSs effect transactions in the OTC market, they must be FINRA members and the trade reports currently identify their trades as OTC trades. The ATS that executed the trade, however, is not currently identified in the public data streams.

The proposed amendments to the CTA Plan and the Nasdaq UTP Plan would require the disclosure of the identity of those ATSs subject to Regulation ATS on trade reports in the public

137 44 U.S.C. 3501 et seq.

data steam. Specifically, the proposed amendments to the CTA Plan and the Nasdaq UTP Plan would require that all last sale prices collected by FINRA from each ATS subject to Regulation ATS be accompanied by an identifier unique to the ATS and be transmitted to the SIP, unless the trade is a large size trade with a market value of at least $200,000.

The proposed Plan amendments by redefining terms in the Plans, indirectly would require ATSs to include a unique identifier when transmitting last sale price data to FINRA. All ATSs currently report their transactions to FINRA, under FINRA rules, using an MPID, but the Commission understands some ATSs currently use the MPID of their sponsoring broker-dealer. As a result, some ATSs may need to obtain a unique MPID from FINRA, which FINRA provides at no cost.[138] Those ATSs would need to re-program their systems to substitute the new MPID for their sponsoring broker-dealer's MPID when transmitting last sale price data to FINRA. The Commission believes that the proposed amendments to the CTA Plan and the Nasdaq UTP Plan with respect to the ATSs would result in a "collection of information," but would not trigger a burden outside the ordinary and customary business of the ATS for purposes of the PRA.

The proposed Plan amendments would require FINRA to transmit to the SIPs a unique identifier from each ATS subject to Regulation ATS, unless the trade is a large size trade (a trade with a market value of at least $200,000). Currently, FINRA receives the MPID information from the ATSs as required by FINRA rules. FINRA, however, currently removes the MPID from the trade reports before submitting them to the SIPs. Under the proposed Plan amendments, FINRA would need to re-program its systems to transmit the MPIDs for ATS trades to the SIPs, except for large size trades with market value of at least $200,000. The

138 ATSs can obtain an additional MPID from FINRA. See FINRA Rules 6160 and 6170.

Commission believes that the proposed amendments to the CTA Plan and the Nasdaq UTP Plan with respect to FINRA would result in a "collection of information," as well as a minor burden for purposes of the PRA.

The proposed Plan amendments would require the SIPs, for the CTA Plan and the Nasdaq UTP Plan, to disseminate information provided to them by FINRA. Under the proposed Plan amendments, the SIPs would need to re-program their systems to enable them to accept as well as transmit trade reports with the additional data element, the MPID, for those ATS transactions that have a market value of less than $200,000. The Commission believes that the proposed amendments to the CTA Plan and the Nasdaq UTP Plan with respect to the SIPs would result in a minor burden for purposes of the PRA.

The Commission encourages comment on all of these points.

2. Proposed Use of Information

The proposed amendments to the CTA Plan and the Nasdaq UTP Plan would require that all last sale prices collected by FINRA from each ATS subject to Regulation ATS be accompanied by an identifier unique to the ATS and be transmitted to the SIP, unless the trade is a large size trade with a market value of at least $200,000. If the Commission adopts the proposed amendments to the Plans, some ATSs would now be required to get a unique identifier, rather than use the identifier of their sponsoring broker-dealer. Such information should enable the public to determine more accurately the volume of executions occurring on any particular ATS, as well as on ATSs in general. The SIPs must make this information public, pursuant to the CTA Plan and Nasdaq UTP Plan. This information is used, among other ways, by market participants to understand the market and to inform their trading decisions. The Commission also may use this information as part of its general market oversight and regulatory functions.

3. Respondents

There are approximately 73 ATSs that are subject to Regulation ATS. Of these, approximately 30 are dark pool ATSs. The Commission understands that some of these ATSs disseminate market data using the identifier of their sponsoring broker-dealer while others already use a unique identifier for their trades. Those using their sponsoring broker-dealer's identifier would have to acquire another identifier and incur a one-time systems cost to change the identifier that gets affixed to their trade reports. The ATSs using a unique identifier would not be affected for PRA purposes by the proposed Plan amendments, because they currently use a unique identifier. All last sale prices for OTC transactions are collected by FINRA and then transmitted to the SIP. The Commission seeks comment on the number of ATSs that could be affected by the proposed changes and the nature of such effects on the ATSs, FINRA, and the SIP.

4. Total Initial and Annual Reporting and Recordkeeping Burdens

The proposed amendments to the CTA Plan and Nasdaq UTP Plan would, if adopted, to varying degrees, increase the collection of information burdens for ATSs, FINRA, and the SIPs.

a. Burden on ATSs

The Commission understands that all ATSs currently report their transactions to FINRA pursuant to FINRA's rules using an MPID, with some ATSs reporting their transactions using an MPID of their sponsoring broker-dealer, while other ATSs use a unique MPID. The Plan changes would require that each ATS have a unique MPID. Therefore, some ATSs would have to acquire an MPID from FINRA. The Commission preliminarily believes that ATSs that already use a unique MPID would not incur additional collection of information burdens related to the transmission of unique MPIDs. Those ATSs that currently use an MPID of their sponsoring broker-dealer may incur a de minimis cost in re-programming their systems to substitute the new MPID for the one currently used in transmitting their transactions to FINRA.

The Commission preliminarily believes that this collection of information would not involve any substantive or material change in the burden that already exists as part of the ATSs' ordinary and customary activities in providing MPID information to FINRA in the normal course of business, pursuant to FINRA's rules.[139]

b. Burden on FINRA

Currently, when FINRA reports transactions to the SIPs, the MPID is dropped from every transaction report and an identifier is appended indicating the trade was executed OTC. Under the proposed amendments, each ATS trade report would carry a unique ATS indicator, in addition to the OTC indicator, unless the trade is a large size trade. FINRA, upon the receipt of an ATS trade report with a unique indicator would retransmit the trade report to the SIP, after excluding the ATS identifier from trade reports for large size trades. FINRA would have to re-program its systems to allow for the trade report message to carry the unique identifier for each ATS and to exclude the identifier for large size trades from the transmission to the SIPs.

The Commission preliminarily estimates that the one-time, initial annualized expense for FINRA for development, including re-programming and testing of the systems would be approximately $1,175,000.[140]

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139 See 5 CFR 1320.3(b)(2) ("The time, effort, and financial resources necessary to comply with a collection of information that would be incurred by persons in the normal course of their activities ... would be excluded from the 'burden' if the agency demonstrates that the reporting, recordkeeping, or disclosure activities needed to comply are usual and customary.").

140 This figure is the total initial, one-time annualized expense to add unique ATS identifiers to trade report messages transmitted to the SIPs. This figure includes the development and testing expenses of the FINRA/NASDAQ TRF, FINRA/NYSE TRF, and the ADF, to

The Commission preliminarily estimates that the one-time, initial annualized burden for FINRA development, including re-programming and testing of the systems to comply with the proposed amendments to the Plans would be approximately 100 burden hours.[141]

The Commission preliminarily believes that the ongoing annualized expense for FINRA would not result in a burden for purposes of the PRA, as FINRA currently transmits trade report messages to the SIPs in the normal course of business.[142]

c. Burden on the SIPs

Currently, the SIPs do not receive an MPID from FINRA for the ATS trades. FINRA removes the MPID and an identifier is appended indicating the trade was executed OTC. Under the proposed Plan amendments, the SIPs would receive from FINRA a trade report identifying the specific ATS on which a trade was executed, unless the trade is a large size trade. The SIPs would need to re-program their systems to allow for the trade report message that carries the unique identifier for each ATS to be received by the SIPs and then later allow for the transmission of the information to the vendors.

The Commission preliminarily estimates that the one-time, initial annualized burden for the Securities Industry Automation Corporation ("SIAC"), which serves as a SIP for the CTA Participants, to comply with the proposed Plan amendments would be approximately 320 burden

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which ATS trades are reported. The figure is based on discussions of Commission staff with FINRA staff.

141 This figure is based on discussions of Commission staff with FINRA staff. This figure includes the FINRA development and testing. The Commission derived the total estimated one-time burden from the following: [(Programmer Analyst at 25 hours) x 2 + (Computer Operator at 25 hours) x 2] = 100 burden hours.

142 See supra notes 104 and 139.

hours.[143] This figure is based on the estimated number of hours for SIAC to provide planning, development, implementation, testing, and quality assurance.

The Commission further preliminarily estimates that the one-time, initial annualized burden for the Nasdaq SIP, which serves as a SIP for the UTP Participants, to comply with the proposed Plan amendments would be approximately 800 burden hours.[144] This figure is based on the estimated number of hours for the Nasdaq SIP to develop and test the software and work with the UTP participants and vendors regarding the enhancement.

The Commission preliminarily believes that the ongoing annualized expense for the SIPs would not result in a burden for purposes of the PRA, as SIPs currently transmit trade report messages in the normal course of business.[145]

The Commission seeks comment on the reporting and recordkeeping collection of information burdens associated with the proposed amendments. In particular:

1. Would ATSs incur any collection of information burdens if the proposed Plan amendments were adopted by the Commission? How many ATSs would be required to obtain a new MPID under the proposed Plan amendments? What would be the costs, if any, to an ATS required to obtain a new MPID to substitute the new MPID for the one it currently uses in transmitting last sale price data to FINRA?

2. What are the burdens, both initial and annual, that FINRA (including the two TRFs and the FINRA ADF) and the SIPs would incur for programming, expanding systems capacity, and establishing compliance programs if the Commission were to adopt the proposed

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143 This figure is based on discussions of Commission staff with SIAC.

144 This figure is based on discussions of Commission staff with Nasdaq SIP.

145 See supra note 86 and accompanying text; see also note 139.

amendments? Would there be additional burdens associated with the collection of information under these proposed Plan amendments?

5. Retention Period of Recordkeeping Requirements

The proposed amendments to the Plans do not contain any new record retention requirements. As an SRO subject to Rule 17a-1 under the Exchange Act, FINRA is required to retain records of the collection of information for a period of not less than five years, the first two years in an easily accessible place.[146]

As registered broker-dealers, all ATSs that would be subject to the proposed amendments are currently required to retain records in accordance with Rule 17a-4 of the Exchange Act.[147]

6. Collection of Information is Mandatory

Any collection of information pursuant to the proposed amendments to the CTA Plan and the Nasdaq UTP Plan would be a mandatory collection of information.

7. Responses to Collection of Information Will Not Be Kept Confidential

The collection of information resulting from the proposed amendments to the CTA Plan and the Nasdaq UTP Plan would not be confidential and would be publicly available.

8. Request for Comment

Pursuant to 44 U.S.C. 3505(c)(2)(B), the Commission solicits comment to:

1. Evaluate whether the proposed collection of information is necessary for the performance of the functions of the agency, including whether the information shall have practical utility;

2. Evaluate the accuracy of the agency's estimate of the burden of the proposed collection of information;

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146 17 CFR 240.17a-1.

147 17 CFR 240.17a-4.

3. Enhance the quality, utility, and clarity of the information to be collected; and

4. Minimize the burden of collection of information on those who are to respond, including through the use of automated collection techniques or other forms of information technology.

Persons wishing to submit comments on the collection of information requirements should direct them to the following persons: (1) Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, OMB, Room 3208, New Executive Office Building, Washington, DC 20503; and (2) Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090 with reference to File No. S7-27-09. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication, so a comment to OMB is best assured of having its full effect if OMB receives it within 30 days of publication. The Commission has submitted the proposed collection of information to OMB for approval. Requests for the materials submitted to OMB by the Commission with regard to this collection of information should be in writing, refer to File No. S7-27-09, and be submitted to the Securities and Exchange Commission, Records Management, Office of Filings and Information Services, 100 F Street, NE, Washington, DC 20549.

VI. Consideration of Costs and Benefits

A. Actionable IOIs

The Commission is sensitive to the costs and benefits associated with the proposed amendment to the definition of "bid" and "offer" in Rule 600(b)(8) of Regulation NMS to apply expressly to certain actionable IOIs. We request comment on the costs and benefits associated with the proposed amendment. The Commission has identified certain costs and benefits of the proposal and requests comment on all aspects of its preliminary cost-benefit analysis, including identification and assessments of any costs and benefits not discussed in this analysis. The Commission also seeks comments on the accuracy of any of the benefits identified and also welcomes comments on the accuracy of any of the costs estimates. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information or statistics regarding any such costs or benefits.

1. Benefits

The Commission preliminarily believes that the proposed amendment would benefit market participants by increasing transparency and reducing the potential for a two-tiered market. The Commission also preliminarily believes that the proposed amendment would help encourage displayed liquidity in the form of publicly displayed limit orders.

As discussed above, a number of dark pools transmit IOIs to selected market participants that convey substantial information about their available trading interest.[148] These messages are not included in the consolidated quotation data, although, like displayed quotations, they can be significant inducements for the routing of orders to a particular trading venue. Indeed, some exchanges, when they do not have available trading interest to execute orders at the best displayed prices, give participants a choice of routing their orders to undisplayed venues in response to IOIs rather than to public markets in response to the best displayed quotations.[149]

Although these IOIs may not explicitly specify the price and size of available trading interest at the dark pool, the practical context in which they are transmitted may render them "actionable." For example, an IOI would be actionable if it effectively alerted the recipient that the dark pool currently has trading interest in a particular symbol, side (buy or sell), size

148 See supra note 20.

149 See supra note 21.

(minimum of a round lot of trading interest), and price (equal to or better than the national best bid for buying interest and the national best offer for selling interest).

This might occur if a dark pool sent an IOI to a group of market participants communicating an interest in buying a specific NMS stock. Given that Rule 611 of Regulation NMS generally prevents trading centers, including dark pools, from executing orders at prices inferior to the national best bid or offer ("NBBO"), the IOI recipient reasonably can assume that the price associated with the IOI is the NBBO or better. Moreover, the IOI may be part of a course of conduct in which the recipient has responded with orders to the sender and repeatedly received executions at the NBBO or better with a size of at least one round lot. With this information (both explicit and implicit), the recipient of the IOI can reasonably conclude that sending a contra-side marketable order responding to the IOI will result in an execution if the dark pool trading interest has not already been executed against or cancelled. In this respect, actionable IOIs are functionally quite similar to displayed quotations at the NBBO.

The order information communicated by actionable IOIs can be extremely valuable. Actionable IOIs with implicit prices better than the NBBO effectively narrow the quoted spread for an NMS stock. For example, if the NBBO for an NMS stock were \$20.10 and \$20.14, an actionable IOI to buy with an implicit price of \$20.12 would, if included in the consolidated quotation data, create a new NBBO of \$20.12 and \$20.14 and thereby reduce the quoted spread by 50%. Reducing quoted spreads is important not only for those that trade with the displayed quotations, but also for other investors including those whose orders are routed to OTC market makers for executions that often are derived from NBBO prices. In addition, actionable IOIs with implicit prices equal to the NBBO can substantially improve the quoted depth at the best prices for an NMS stock. For example, an investor may wish to sell 500 shares of a stock when the size of the national best bid may be only 100 shares. The existence of multiple dark pools that contemporaneously had transmitted actionable IOIs to buy the stock would represent a substantial increase in the available size at NBBO prices or better.

The public, however, does not have access to this valuable information concerning the best prices for NMS stocks. Rather, dark pools transmit this information only to selected market participants. In this regard, actionable IOIs can create a two-tiered level of access to information about the best prices for NMS stocks that is contrary to the Exchange Act objectives for a national market system.[150] The consolidated quotation data is intended to provide a single source of information on the best prices for a listed security across all markets, rather than force the public to obtain data from many different exchanges and other markets to learn the best prices. This objective is not met if dark pools or other trading venues disseminate pricing information that is functionally quite similar to quotations, yet is not required to be included in the consolidated quotation data. The proposal is designed to promote transparency by requiring that the valuable pricing information provided to selected market participants through actionable IOIs is also made available to the public in the consolidated quotation data.

The Commission also is concerned that the private use of actionable IOIs may discourage the public display of trading interest and harm quote competition among markets. The Commission long has emphasized the need to encourage displayed liquidity in the form of publicly displayed limit orders.[151] Such orders establish the current "market" for a stock and thereby provide a critical reference point for investors. Actionable IOIs, however, often will be executed by dark pools at prices that match the best displayed prices for a stock at another market. In this respect, actionable IOIs at NBBO matching prices potentially deprive those who

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[150] See supra note 59.

[151] See supra note 26.

publicly display their interest at the best price from receiving a speedy execution at that price. The opportunity to obtain the fastest possible execution at a price is the primary incentive for the display of trading interest.[152] Particularly if actionable IOIs continue to expand in trading volume, they could significantly undermine the incentives to display limit orders and to quote competitively, and thereby detract from the efficiency and fairness of the national market system.

Moreover, for market participants that wish to supply liquidity in the form of non-marketable resting orders (such as those that match or improve NBBO prices), actionable IOIs provide a tool to achieve this result without displaying quotations publicly. The availability of these private messages as an alternative means to attract order flow may reduce the incentives of market participants to quote publicly. More generally, actionable IOIs divert a certain amount of order flow that otherwise might be routed directly to execute against displayed quotations in other markets. Given the importance of displayed quotations for market efficiency, the Commission is particularly concerned about additional marketable order flow that may be diverted from the public quoting markets and that could further reduce the incentives for the public display of quotations. The proposal is designed to promote the display of public quotations by eliminating a practice that diverts order flow to private markets and by requiring that actionable IOIs be included in the consolidated quotation data.

By excepting IOIs with a market value of at least $200,000 that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000, the proposal is also tailored to maintain the significant size discovery benefits offered by some trading venues such as block crossing networks. In particular, market participants such as institutional investors would be able to find contra-side trading interest for large size without

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152 See supra note 27.

causing price impact. In addition, the proposed exception for a targeted size discovery mechanism would provide an opportunity for block crossing networks and other trading venues to offer innovative ways for investors that need to trade in large size to find contra-side trading interest of equally large size.

The Commission seeks comment on the anticipated benefits of the proposed amendment. Would the proposal promote the transparency, fairness, and efficiency of the national market system? Would it promote fair competition among trading venues in NMS stocks? Do commenters believe that the Commission has provided sufficient information about the attributes of an actionable IOI for trading venues to comply with the proposed definition? What is the typical size of an actionable IOI? How many large orders use actionable IOIs? What is the amount of order flow that is diverted from displayed quotations due to actionable IOIs? Please quantify and provide supporting data if possible.

Comment also is requested on the proposed size discovery exclusion from the definition of bid or offer. Would the proposed exclusion promote more efficient trading for investors that need to trade in large size? Is the exclusion narrowly drafted to cover those trading mechanisms that offer valuable size discovery benefits without inappropriately excluding trading interest concerning the best prices and sizes for NMS stocks from the consolidated quotation data? Comment also is requested on whether market value is the appropriate criterion for size, and whether $200,000 is the appropriate figure. Should this figure be higher or lower? Please explain why. For example, is the $200,000 figure appropriate for high-priced stocks? Should the exclusion include a size criterion based on number of shares? If yes, should it be 10,000 shares, as in Rule 600(b)(9), or a larger or smaller number of shares? Finally, comment is requested on whether other criteria for size, such as percentage of average daily share volume in a security, would be more appropriate.

2. Costs

The Commission preliminarily anticipates that market participants could incur certain costs if the proposed amendment is adopted. The change in the definition of "bid" and "offer" would affect compliance with Rule 602 of Regulation NMS.[153] "Bid" and "offer" are key terms that determine the scope of Rule 602 of Regulation NMS. In general, Rule 602 requires exchange members and certain OTC market makers to provide their best-priced bids and offers to their respective exchanges and FINRA.[154] The exchanges and FINRA, in turn, are required to make their best bids and offers available in the consolidated quotation data. The Commission does not believe that the amendment to Rule 600(b)(8) would create significant new compliance burdens under Rule 602. Exchange members and OTC market makers would continue to be required to provide their best-priced bids and offers to their respective exchanges and FINRA. The proposed amendment to Rule 600(b)(8) may increase the number of "bids" and "offers" that exchange members and OTC market makers must review to determine their best-priced bids and offers. It is the Commission's understanding that all exchange members and OTC market makers have systems and procedures in place to make this determination today. As a result, the

153 The proposed amendment to Rule 600(b)(8) of Regulation NMS also may affect the obligations imposed by Rule 301(b)(3) of Regulation ATS on ATSs that meet the specified trading volume threshold. Given the current threshold of 5%, the Commission does not believe that the proposed amendment of Rule 600(b)(8) would substantially affect the quoting requirements of ATSs. The proposal to lower the volume threshold contained in Rule 301(b)(3), however, could affect this view. The costs associated with the proposed amendment to Rule 301(b)(3) are discussed below.

154 Under the definition of "subject security" in Rule 600(b)(73)(ii)(A) of Regulation NMS, an OTC market maker is not required to provide its best bids and offers for an NMS stock if the executed volume of the firm during the most recent calendar quarter comprised one percent or less of the aggregate trading volume for such NMS stock.

Commission believes that any increased burden in determining their best-priced bids and offers due to the inclusion of actionable IOIs in the definition of "bid" and "offer" would not be significant.

The Commission is aware that actionable IOIs may offer benefits to certain market participants. For example, some market participants choose to trade in dark pools in an effort to minimize the effect of their trading on quoted prices. The use of actionable IOIs to attract order flow may increase the amount of volume executed in dark pools and thereby further the trading strategies of these market participants. If actionable IOIs were included in the consolidated quotation data, these types of trading strategies would not be possible because the actionable IOIs themselves would be included in publicly quoted prices. In addition, some market participants may be willing to allow dark pools to transmit information about their actionable orders to selected recipients, but not be willing to provide this information in the consolidated quotation data that is widely disseminated to the public. If adopted, the proposal could cause these market participants to choose not to transmit this information to anyone and thereby reduce available pricing information for an NMS stock (albeit, information that was only privately available).

These potential costs of reduced trading in dark liquidity venues and reduced availability of liquidity information would be mitigated by the availability of the size discovery exception. The Commission recognizes that some trading venues, such as block crossing networks, may use actionable IOIs as part of a trading mechanism that offers significant size discovery benefits. These benefits may be particularly valuable for institutional investors that need to trade efficiently in sizes much larger than those that are typically available in the public quoting markets. These size discovery mechanisms could be rendered unworkable, however, if their IOIs for large size were required to be included in the consolidated quotation data. Accordingly, the Commission's proposed amendment would exclude certain IOIs with a market value of $200,000 or more communicated to those reasonably believed to represent equivalent contra-side trading interest from the current definition of "bid" and "offer" in Rule 600(b)(8). This would maintain the significant size discovery benefits offered by certain trading venues. Also, the Commission expects that the compliance costs to restrict communication to large size contra-side trading interest would be minimal because trading venues that offer size discovery mechanisms currently have systems in place to achieve this objective. In particular, these systems typically incorporate minimum trade size functionalities, as well as mechanisms to help assure that the valuable, actionable information concerning a participant's trading interest is transmitted only to those with whom there is a reasonable opportunity for obtaining an execution in large size.

In addition, the Commission expects that the negative effects of requiring actionable IOIs to be included in the consolidated quotation data would be mitigated by the ability of market participants to adapt their trading strategies to the new rules. Higher incentives to display liquidity and alternative forms of competition for order flow also could mitigate any negative effect of the proposal. Customers of dark pools would remain free, as they are entitled to do with quoting venues today, to control the release of their order information.[155] Customers could not, however, consent to the dissemination of order information sufficient for the transmission of an actionable IOI under $200,000, yet withhold information about their orders from the consolidated quotation data that is made available to the public.

[155] See supra note 41 and accompanying text.

The Commission generally requests comment on any direct or indirect costs of the proposed amendment and asks commenters to quantify those costs, where possible. In addition, the Commission requests specific comments on the following questions:

1. What are some of the trading strategies that employ actionable IOIs? Is the use of such actionable IOIs in the best interest of these traders and how would the inability to use those actionable IOIs impact traders, markets, or investors more generally? Could similar benefits be achieved through other means?

2. How are market participants likely to change their behavior if actionable IOIs must be included in the consolidated quotation data? What are the likely effects of these changes? For example, would a significant percentage of dark pools that currently use actionable IOIs go completely dark? What would be the effects on traders, markets, and investors were that to occur?

3. How would the proposal affect competition between trading venues?

4. Would the size discovery exception maintain the existing opportunities of block crossing networks and other trading venues to offer benefits to market participants that need to trade in large size? Do these venues currently have systems in place that would enable them to comply at minimal cost with the terms of the exception?

5. To what extent, if at all, would the proposed amendment to Rule 600(b)(8) increase the number of bids or offers that exchange members and OTC market makers would be required to review and report to their respective exchanges and FINRA for inclusion in the consolidated quotation data?

6. To what extent, if at all, would system changes or increases in system capacities be necessary for exchange members or OTC market makers to comply with the requirements of Rule 602, if the Commission were to adopt the proposed amendments to Rule 600(b)(8)?

B. ATS Display Obligations

The Commission is sensitive to the costs and benefits associated with the proposed amendments to Rule 301(b)(3) of Regulation ATS. The Commission requests comment on the costs and benefits associated with these proposed amendments. The Commission has identified certain costs and benefits of the proposal and requests comment on all aspects of its preliminary cost-benefit analysis, including identification and assessments of any costs and benefits not discussed in this analysis. The Commission also seeks comments on the accuracy of any of the benefits identified and also welcomes comments on the accuracy of any of the cost estimates. Finally, the Commission encourages commenters to identify, discuss, analyze, and supply relevant data, information, or statistics regarding any such costs or benefits.

1. Benefits

The emergence of dark pools as a significant source of liquidity for NMS stocks raises a variety of important policy issues that deserve consideration. Some dark pools transmit actionable IOIs to selected market participants for the purpose of attracting contra-side order flow to the ATS.[156] Such actionable IOIs function quite similarly to displayed quotations and, as a result, dark pools that distribute such actionable IOIs are no longer truly dark; rather they are "lit" to a select group of market participants but dark with respect to the rest of the public. The

[156] See supra section II (describing the use of actionable IOIs).

Commission preliminarily believes that this practice is creating a two-tiered market and an inequitable distribution of price information.[157]

It has been a longstanding Commission concern to avoid two-tiered markets, whereby certain market participants have access to information or order flow that others do not.[158] The public quote stream is intended to provide a single source of information on the best prices for NMS stocks across all markets, rather than force the public to obtain data from many different exchanges and other trading venues to learn the best prices.[159] This objective is not being met if dark pools or other markets disseminate pricing information that is functionally quite similar to quotations, yet is not required to be included in the public quote stream.[160]

Congress in 1975 endorsed the development of a national market system and granted the Commission broad authority to implement it.[161] Chief among the objectives of the national market system are coordinating markets, reducing fragmentation, and limiting the possibility of tiered markets where the best trading opportunities are available only to selected market participants.[162] As the Commission has long recognized, proper coordination of markets requires

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157 See id.

158 See supra section II (describing the purpose of the consolidated quotation data stream).

159 See id.

160 See id.

161 See Pub. L. 94-29, 89 Stat. 97 (1975) (adopting Section 11A of the Exchange Act).

162 See 15 U.S.C. 78k-1(a)(1)(D) ("The linking of all markets for qualified securities through communication and data procession facilities will foster efficiency, enhance competition, increase the information available to brokers, dealers, and investors, facilitate the offsetting of investors' orders, and contribute to best execution of such orders.") See also Regulation ATS Proposing Release and Concept Release (citing inter alia SEC, STATEMENT OF THE SECURITIES AND EXCHANGE COMMISSION ON THE FUTURE STRUCTURE OF THE SECURITIES MARKETS (February 2, 1972), 37 FR 5286 (March 14, 1972)); Securities Exchange Act Release No. 36310 (September 29, 1995), 60 FR 52792 (October 10, 1995).

transparency and access across the national market system.[163] Market participants must be able to know where the best trading opportunities exist and have the ability to execute orders in response to those opportunities. The Commission has taken a number of actions designed to further these goals,[164] including by providing, through Regulation ATS, a regulatory framework that permits competition among and innovation by exchange and non-exchange trading centers while attempting to minimize detrimental market fragmentation. As the Commission observed in 1997, the failure "to fully coordinate trading on alternative trading systems into national market systems mechanisms has impaired the quality and pricing efficiency of secondary equity markets. . . . Although these systems are available to some institutions, orders on these systems frequently are not available to the general investing public."[165] The Commission noted that such "hidden markets" – where superior quotations might be available to a subset of market participants – impeded the goals of the national market system.[166]

The proposed amendments to Rule 301(b)(3), together with the proposed changes to Rule 600(b)(8) of Regulation NMS, seek to inhibit the development of "hidden" or partially lit markets that result in a tiered market structure, and thus strengthen the national market system for the benefit of public investors. By more fully coordinating trading on ATSs into the national

163 See, e.g., Regulation ATS Proposing Release, supra note 53, 63 FR at 23511.

164 See supra note 55.

165 Concept Release, supra note 53, 63 FR at 30492. See also Regulation ATS Proposing Release, supra note 53, 63 FR at 23514.

166 See Regulation ATS Proposing Release, 63 FR at 23514-15 ("The use of these systems to facilitate transactions in securities at prices not incorporated into the [national market system] has resulted in fragmented and incomplete dissemination of quotation information. Recent evidence suggests that the failure of the current regulatory approach to fully integrate trading on alternative trading systems into [the national market system] mechanisms has impaired the quality and pricing efficiency of secondary equity markets, particularly in light of the explosive growth in trading volume on such alternative trading systems").

market system, the proposed amendments are designed to improve pricing efficiency and execution quality in NMS stocks.

As described above, the Commission is proposing to amend Rule 301(b)(3)(i)(B) of Regulation ATS[167] to reduce the average daily trading volume threshold that would trigger display obligations for an ATS from 5% to 0.25%. The Commission is also proposing to amend Rule 301(b)(3)(ii) of Regulation ATS[168] to clarify that an ATS must publicly display and provide execution access to its best-priced orders in NMS stocks when such orders are displayed to more than one person (other than ATS employees), regardless of whether such persons are subscribers of the ATS. In addition, the Commission is proposing to amend Rule 301(b)(3)(ii) to mirror the proposed exception in the definition of "bid" or "offer" in Rule 600(b)(8) for orders having a market value of at least $200,000 and which are communicated only to market participants who are reasonably believed to represent current contra-side trading interest of at least $200,000. Together with the proposal to amend the definition of "bid" or "offer" in Rule 600(b)(8) to explicitly include actionable IOIs, these proposed amendments to Rule 301(b)(3) of Regulation ATS are designed to increase the opportunity for all market participants to discover and interact with the best-priced orders, while offering certain large orders the opportunity for size discovery.

The Commission believes that broker-dealers operating ATSs should be subject to quoting requirements that broadly parallel those applicable to other market participants. Currently, the order display and execution access requirements in Regulation ATS do not apply unless an ATS has an average daily trading volume threshold in an NMS stock of 5% or more. Few if any ATSs exceed the 5% threshold for any NMS stocks although, as explained above,[169]

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167 17 CFR 242.301(b)(3)(i)(B).

168 17 CFR 242.301(b)(3)(ii).

169 See supra notes 9 and 10 and accompanying text.

ATSs collectively account for a significant share of trading volume. Many dark pool ATSs communicate order information via actionable IOIs that could, if appropriately integrated, contribute to the overall efficiency and quality of the national market system. Without any attendant change to Regulation ATS to lower the 5% threshold, the proposed amendments to the definitions of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS would have less effect, because most ATSs could continue to communicate actionable IOIs only to selected market participants. Therefore, in conjunction with the proposed amendments to Rule 600(b)(8), the Commission is proposing to substantially lower the threshold at which an ATS incurs an obligation under Regulation ATS to provide orders to an SRO for inclusion in the public quote stream. The Commission preliminarily believes that such amendment would be consistent with the mandate set forth in Section 11A of the Exchange Act[170] to promote a national market system.

The Commission also preliminarily believes that, by expanding the pool of orders that would be required to be incorporated into the consolidated public quote stream, the proposed amendments to Rule 301(b)(3) would have the potential in many cases to narrow the NBBO or to increase the quoted size at the existing NBBO.[171] As noted above, requiring that actionable IOIs be incorporated into the public quote stream is particularly important now given their increasing prevalence.[172] Thus, although 0.25% is only a small portion of average daily trading volume, actionable IOIs sent by even small ATSs, when aggregated, may represent a significant percentage of the orders that would set the price of, or increase the size available at, the

170 15 U.S.C. 78k-1.

171 See supra section II.

172 Id.

NBBO.[173] The Commission preliminarily believes that making most such orders visible and available to the market as a whole could represent a substantial benefit to investors. Furthermore, incorporating the best-priced orders from all but the smallest ATSs into the public quote stream would increase the value of the public quote stream.

The Commission is also proposing to amend Rule 301(b)(3) to include an exception from the order display and execution access requirements for certain large orders, which would mirror the proposed exception with respect to the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS. This exception would apply to orders with a market value of $200,000 or more that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000. Pursuant to the proposed exception, an ATS could display these large orders to potential counterparties reasonably believed to represent contra-side trading interest of at least $200,000 without triggering the order display and execution access requirements of Rule 301(b)(3).

As noted earlier, the Commission recognizes that some trading venues, such as block crossing networks, may use actionable IOIs as part of a trading mechanism that offers significant size discovery benefits.[174] These benefits may be particularly valuable for institutional investors that need to trade efficiently in sizes much larger than those that are typically available in the public quoting markets.[175] These size discovery mechanisms could be rendered unworkable, however, if their narrowly targeted IOIs for large size were required to be included in the public

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173 See id (noting dark pools in the aggregate account for 7.2% of aggregate trading volume in the NMS).

174 See supra Section VI.A.1.

175 See id.

quote stream.[176] The Commission preliminarily believes that the proposed exception would facilitate greater opportunity for ATS subscribers to discover size without generating adverse market impact.

2. Costs

The Commission preliminarily anticipates that ATSs could incur certain costs if the proposed amendments were adopted. Under the proposed amendments, ATSs that display orders in NMS stocks (except for orders that have a market value of at least $200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000) to more than one person, whether by communicating actionable IOIs or otherwise, and meet the proposed average daily trading volume threshold of 0.25% would be subject to the order display and execution access requirements of Rule 301(b)(3) of Regulation ATS.[177]

The Commission does not preliminarily expect that the costs of monitoring daily trade volume associated with the proposed amendments to Rule 301(b)(3) would be significant. Each ATS is already required to monitor its trading volumes. However, ATSs might incur some costs to adjust their current monitoring programs to take account of the proposed reduction in the display threshold from 5% to 0.25%. In addition, as described above, the proposed amendments might impose certain costs, both initial and ongoing, on dark pool ATSs that currently transmit

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176 See id.

177 The Commission is not proposing to amend Rule 301(b)(3)(iii) of Regulation ATS. For an ATS that is required to display orders pursuant to Rule 301(b)(3)(ii), Rule 301(b)(3)(iii) requires such ATS to provide to any broker-dealer that has access to the SRO to which the ATS provides the prices and sizes of its best-priced orders the ability to effect a transaction with such orders that is: (a) equivalent to the ability of such broker-dealer to effect a transaction with other orders displayed on the SRO; and (b) at the price of the highest priced buy order or lowest priced sell order displayed for the lesser of the cumulative size of such priced orders entered therein at such price, or the size of the execution sought by such broker-dealer. See 17 CFR 242.301(b)(3)(iii).

actionable IOIs and could be required to change their business models. Likewise, the proposed amendments could impose costs, both initial and ongoing, on any ATS that is currently displaying, or might in the future decide to display, order information and that might, if the Commission adopts the proposed amendments, decide instead to operate as a completely dark ATS. The Commission notes that each ATS could avoid any such costs by not displaying orders at all, or by selectively displaying only large orders that qualify for the proposed exception.

For an ATS that is impacted by the proposed amendment to Rule 301(b)(3), initial adjustment costs could include system re-programming to monitor the ATS's percentage of trading in NMS stocks,[178] establishing linkages to an SRO for the purpose of submitting orders to the SRO for public display and of providing access to market participants wishing to trade against such orders, and expanding systems capacity and internal controls, including establishing or modifying applicable compliance policies and procedures, to carry out these functions in a manner consistent with the SRO's rules. The Commission preliminarily believes that such adjustment costs could include ATS staff time to build new systems or re-program current systems, as well as ongoing ATS staff time to maintain such systems and carry out their associated functions.

178 Currently, under Rule 301(b)(3) of Regulation ATS, an ATS that displays subscriber orders to any person (other than ATS employees) and has 5% or more of the aggregate daily share volume for an NMS stock is required to provide to an SRO its best-priced orders for such NMS stock for inclusion into the public quote stream. Thus, ATSs are already required to monitor trading levels in NMS stocks. As a result of the proposed amendments to Rule 301(b)(3), which would lower the average daily trading volume threshold from 5% to 0.25%, ATSs could be required to re-program their respective systems that monitor trading levels in NMS stocks to reflect the lower threshold. Based on discussions of Commission staff with certain potential ATS respondents and other market participants, the Commission preliminarily believes that costs of such re-programming would not be significant, although it requests comment on that point.

For purposes of the PRA, the Commission preliminarily estimated that the initial annualized expense for all potential ATS respondents to establish connectivity to an SRO would be approximately $3,900,000.[179] In addition, the Commission preliminarily estimated that the initial annualized expense to comply with the proposed amendments to Rule 301(b)(3) would be approximately $3,815,520.[180] This figure is based on the estimated number of hours and hourly costs[181] for initial internal development and implementation by an ATS to re-program the system, expand the system capacity, and adjust internal controls, including costs to establish or modify applicable compliance policies and procedures for an initial implementation period of two months, plus the estimated costs associated with running compliance policies and procedures (including monitoring daily trading activity), ongoing system maintenance and development, and estimated internal costs associated with maintaining connectivity to an SRO, and ensuring compliance for a period of ten months, multiplied by 12 (the Commission's estimate of the number of potentially impacted ATSs).

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179 See supra note 130.

180 This figure is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated initial annualized expense from the following: [((Sr. Programmer (320 hours) at $292 per hour) + (Compliance Manager (20 hours) at $258 per hour) + (Compliance Attorney (20 hours) at $270 per hour) + (Programmer Analyst (20 hours) at $193 per hour) + (Sr. Systems Analyst (30 hours) at $244 per hour)) x (2 months) + ((Sr. Programmer (2 hours) at $292 per hour) + (Compliance Manager (6 hours) at $258 per hour) + (Compliance Attorney (4 hours) at $270 per hour) + (Compliance Clerk (40 hours) at $63 per hour) + (Sr. Systems Analyst (2 hours) at $244 per hour) + (Director of Compliance (5 hours) at $388 per hour) + (Sr. Computer Operator (8 hours) at $75 per hour)) x (10 months)] x (12 potential ATS respondents) = $3,815,520.

181 Hourly figures are from SIFMA's Management & Professional Earnings in the Securities Industry 2008 and SIFMA's Office Salaries in the Securities Industry 2008, modified by Commission staff to account for an 1800-hour work-year and multiplied by 5.35 or 2.93, as appropriate, to account for bonuses, firm size, employee benefits, and overhead.

The Commission also preliminarily estimated the ongoing expenses of complying with the proposed amendments to Rule 301(b)(3), which could include, among other things, maintaining connectivity with an SRO, monitoring daily trade activity, and ensuring compliance. For purposes of the PRA, the Commission preliminarily estimated that the ongoing annualized expense for all potential ATS respondents to maintain connectivity to an SRO would be approximately $3,600,000.[182] In addition, the Commission preliminarily estimated that the ongoing annualized expense for all potential ATS respondents to comply with the proposed amendments to Rule 301(b)(3) would be approximately $1,261,440.[183] This figure is based on the estimated number of hours and hourly costs[184] for running compliance policies and procedures (including monitoring daily trading activity), ongoing system maintenance and development, and estimated internal costs associated with maintaining connectivity to an SRO, and ensuring compliance for a period of 12 months, multiplied by 12 (the Commission's estimate of the number of potentially impacted ATSs).

The Commission is also proposing a change to Rule 301(b)(3)(ii) that would add an exception to the order display and execution access requirements for orders that have a market value of at least $200,000 and are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000. The Commission preliminarily

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182 See supra note 132.

183 This figure is based on discussions of Commission staff with certain potential ATS respondents and other market participants. The Commission derived the total estimated ongoing burdens from the following: ((Sr. Programmer (2 hours) at $292 per hour) + (Compliance Manager (6 hours) at $258 per hour) + (Compliance Attorney (4 hours) at $270 per hour) + (Compliance Clerk (40 hours) at $63 per hour) + (Sr. Systems Analyst (2 hours) at $244 per hour) + (Director of Compliance (5 hours) at $388 per hour) + (Sr. Computer Operator (8 hours) at $75 per hour)) x (12 months) x (12 potential ATS respondents) = $1,261,440.

184 See supra note 181.

believes that an ATS would not incur any costs relating to order display and execution access because of the proposed exception. An ATS would incur either the same costs as it would otherwise (because it communicated no orders that met the terms of the proposed exception) or fewer costs (because some or all of the orders that it communicated met the terms of the proposed exception, thus reducing the number of orders that would otherwise have to be publicly disseminated under the proposed amendments to Rule 301(b)(3)). Each ATS is already required under Rule 301(b)(3) to monitor its order flow; the Commission preliminarily believes that tracking which orders qualify for the proposed exception would require no additional costs beyond those otherwise required, although it requests comment on that point.

The proposed amendments to Rule 301(b)(3) of Regulation ATS are designed to balance the benefits of technology and flexible regulation with the need for appropriate coordination among trading centers. The Commission understands that linkage costs have fallen substantially since it adopted Regulation ATS. Nevertheless, the Commission is sensitive to the costs of its regulation and the proposed amendments on current and new ATSs, as well as the potential effect on their development. The Commission preliminarily believes that reducing the average daily trading volume threshold to 0.25% would provide an appropriate level under which ATSs could display subscriber orders to more than one person (whether by sending actionable IOIs or otherwise) without imposing substantial costs associated with linking to an SRO.

Consistent with the reasons enunciated in the Regulation ATS Adopting Release for establishing the 5% threshold and as discussed in this release, the Commission preliminarily believes that proposing a reduction of the ATS display threshold to 0.25% is warranted at this time. The Commission also preliminarily believes that the goals and objectives of lowering the threshold justify the costs associated with linking to an SRO. For ATSs that would be subject to the order display and execution requirements if the Commission were to adopt the 0.25% threshold, the Commission preliminarily believes that the current costs of linking to an SRO are not significant.[185] Communications and order-routing systems have improved significantly since Regulation ATS was originally adopted. Robust and extremely fast linkages that were not available at that time are now widely offered on commercially reasonable terms, and the market for these services is highly competitive, further reducing their cost.[186]

In addition, the Commission preliminarily believes that the proposed amendments to Rule 301(b)(3) of Regulation ATS would not, if adopted, impose any substantive or material costs on SROs under the requirements of Rule 602 of Regulation NMS. Under the proposal, order information that is communicated by ATSs to more than one person outside the public quote stream (whether via actionable IOIs or otherwise) could be required to be incorporated into the public quote stream. As described above, to accomplish this, the ATS would be required to send the order information to an SRO, and that SRO would be responsible under Rule 602 for the incorporation of the information in the consolidated public quote stream. The Commission preliminarily believes that any costs associated with including such ATS orders with the large volume of quotations that SROs already include in the public quote stream under Rule 602 would not be material.

As noted previously, an ATS that sends actionable IOIs or otherwise displays subscriber orders to more than one person (other than ATS employees) and exceeds the proposed 0.25% threshold for an NMS stock could avoid the direct costs of linking to an SRO by going completely dark. The Commission recognizes that such a choice could be viewed as a potential

185 This information is based on discussions of Commission staff with certain potential ATS respondents and other market participants.

186 See id.

cost of the proposed amendments. An ATS that, under the existing 5% threshold, generates contra-side interest for its subscriber orders by communicating actionable IOIs might – if it ceased to do so – effect fewer executions, which could lead to a loss of revenue and market share for the ATS. The Commission is sensitive to this potential cost, but preliminarily believes that it would be mitigated by the proposed exception for size discovery orders and justified by the overall benefits of the proposal to the national market system.

The proposed amendment to Rule 301(b)(3) could also impose costs on ATS subscribers that currently receive executions arising from ATSs' use of actionable IOIs. If the proposal is adopted, such subscribers might incur costs to re-evaluate their order execution strategies. For example, if a subscriber currently uses an ATS that communicates actionable IOIs, and the ATS is above the proposed display threshold of 0.25% in one or more NMS stocks, the subscriber would have to evaluate whether it is better served by having its orders in displayed markets or in completely dark pools. The strategies that they adopt in response to the proposal might not be as profitable as those they are employing currently. In addition, market participants that currently receive actionable IOIs might no longer have access to such trading opportunities and could incur costs to adapt their strategies if the number of IOIs that they receive decreases.

Nevertheless, the Commission preliminarily believes that the costs to such subscribers and to recipients of actionable IOIs would be justified by the benefits to the national market system as a whole. For the reasons discussed in this release, the Commission preliminarily believes that the proposal would reduce the possibility of a tiered market structure and provide better access for all investors to the best-priced orders in NMS stocks. This outcome would benefit all market participants.

The Commission requests comment on the costs and benefits of the proposed amendments to Rule 301(b)(3) of Regulation ATS discussed above, as well as any costs and benefits not already described which could result from them. The Commission also requests data to quantify any potential costs or benefits. In addition, the Commission requests specific comment on the following questions:

1. Currently, ATSs can display orders in NMS stocks to more than one person without triggering the order display and execution access requirements in Rule 301(b)(3) if they do not exceed the 5% threshold. Under the proposed amendments to Rule 301(b)(3), many ATSs would lose the ability to display orders in this manner, and would have to either publicly display those orders or go completely dark. What are the costs and benefits of eliminating the ability of ATSs to communicate actionable IOIs to only a limited group?

2. Would the proposed amendments likely result in an increase in the number of ATSs that submit their best-priced orders to an SRO for inclusion in the public quote stream? Why or why not? What benefits would result from more ATSs submitting their best-priced orders in NMS stocks to an SRO for inclusion in the public quote stream? Can those benefits be quantified? If so, how? What are the potential adverse effects?

3. If ATSs respond to the proposed amendments by going completely dark, what costs or benefits would result for: (a) those ATSs, (b) market participants that currently receive actionable IOIs from those ATSs, and (c) the national market system as a whole?

4. For ATSs that would choose to respond to the proposed amendments by submitting their best-priced orders in NMS stocks to an SRO for inclusion in the public quote stream, what are the costs of establishing the necessary linkages to an SRO? To what extent do those ATSs already have the capability to submit orders to an SRO? Could existing systems and

communications infrastructure be adapted for that purpose and, if so, at what cost? Please describe and quantify in terms of both initial and ongoing costs.

5. What would be the costs and benefits of setting the display threshold at 0.25%? Would this change achieve the Commission's goals of increasing price competition in the national market system? Why or why not? Would there be greater benefits to the market as a whole by eliminating the threshold altogether (i.e., setting the threshold at 0%) and thereby requiring any ATS that displays a subscriber order to more than one person to include that order in the public quote stream?

6. What costs would be imposed on new ATSs if the Commission were to adopt the proposed 0.25% threshold or to eliminate it entirely? Would a low or no threshold create a barrier to entry for new ATSs? Why or why not?

7. Under the proposed amendments, an ATS could continue to communicate customer orders in NMS stocks outside the public quote stream if those orders had a market value of at least $200,000 and were displayed only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000. What would be the benefits of allowing such display by ATSs of these orders? Would the execution quality of such orders decline if they instead had to be placed (either in full or in smaller pieces) in displayed markets or completely dark pools? What are the costs to the market of allowing such orders to be displayed by ATSs without requiring their inclusion in the public quote stream?

C. Post-Trade Transparency for ATSs

The Commission is sensitive to the costs and benefits associated with the proposed Plan amendments. The Commission has identified certain costs and benefits of the proposed Plan amendments and requests comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis. The Commission seeks comment and data on the value of the benefits identified. The Commission also requests those commenters to provide data so the Commission can improve the cost estimates, including identification of statistics relied on by commenters to reach conclusions on cost estimates.

1. Benefits

The proposed Plan amendments would require the disclosure of the identity of ATSs on their trade reports in the public data stream to improve post-trade transparency. The proposed Plan amendments would require that all ATSs subject to Regulation ATS use a unique identifier, and would require that the identity of the ATS that executed a trade be included in the public data stream. The Commission believes this proposal to improve post-trade transparency would enhance public confidence in the securities markets by providing accurate information regarding the volume of transactions effected by ATSs as trading venues. This disclosure of information would provide the marketplace with a more complete and accurate picture of trading activity in ATSs thereby improving the quality and pricing efficiency of the equity markets. The Commission preliminarily believes that such information would help investors to assess trading volume of ATSs (including ECNs and dark pools) and to evaluate which ATSs may have liquidity in particular stocks, enabling orders to be more efficiently routed to trading venues. ATSs with more liquidity may receive additional orders from investors. The proposed Plan amendments are intended to address the Commission's long held belief that transparency promotes efficient securities markets.[187]

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[187] The Commission has held the view that transparency not only allows all market participants to assess overall supply and demand, but also counteracts the effects of fragmentation without forcing all executions into one market. In particular, transparency

Commenters should provide specific data and analysis to support any comments they submit with respect to these benefit estimates.

2. Costs

The Commission believes that ATSs would not incur significant costs in connection with the proposed Plan amendments in addition to those already created by the requirements of Rule 601 of the Exchange Act.[188] Currently FINRA rules require each trade to include an MPID. The Commission understands that some ATSs report their transactions using an MPID of their sponsoring broker-dealer, while other ATSs use a unique MPID. The Plan changes would require that each ATS have a unique MPID, necessitating some ATSs to acquire an MPID from FINRA. ATSs can obtain an additional MPID from FINRA at no cost.[189] Those ATSs that currently use an MPID of their sponsoring broker-dealer could incur a de minimis cost in re-programming their systems to substitute the new MPID for the one currently used in transmitting their transactions to FINRA.

FINRA, upon receipt of this unique indicator would retransmit the trade report to the SIP, after excluding the ATS identifier from trade reports for large size trades. For purposes of the PRA, the Commission preliminarily estimated that the initial annualized expense for the FINRA/NASDAQ TRF, FINRA/NYSE TRF, and the ADF would be approximately

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reduces the information gap between investors with differing degrees of sophistication because all investors can monitor the quality of executions they receive. Additionally, the Commission has held the view that transparency reduces the likelihood of transactions at non-competitive prices and provides more immediate and useful information for investigating questionable conduct. See supra note 108.

188 See supra, note 84.

189 See FINRA Rules 6160 and 6170.

$1,175,000.[190] In addition, the Commission preliminarily estimated that the initial annualized expense for FINRA internal development and testing would be approximately $13,400.[191] Therefore, the grand total of the one-time, initial annualized expense for FINRA's development, re-programming, and testing of the systems to comply with the proposed Plan amendments would be approximately $1,188,400. The Commission preliminarily believes that the ongoing annualized expense for FINRA would be de minimis, as FINRA currently transmits trade report messages to the SIPs in the normal course of business.

The SIPs (SIAC and Nasdaq SIP) would need to modify their trade report message to carry the unique identifier for each ATS. Currently, when transactions are reported to the SIP by FINRA, the MPID is dropped and an identifier is appended indicating the trade was executed OTC. Under the proposed Plan amendments, each ATS trade report would carry an ATS indicator, in addition to the OTC indicator, unless the trade is a large size trade. The Commission preliminarily estimated that the initial annualized expense for SIAC and Nasdaq SIP would be approximately $175,000.[192] The Commission preliminarily believes that the ongoing annualized expense for the SIPs would be de minimis, as the SIPs currently transmit

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190 This figure is the total initial, one-time annualized expense to add unique ATS identifiers to trade report messages transmitted to SIPs. This figure includes the development and testing expenses of the FINRA/NASDAQ TRF, FINRA/NYSE TRF, and the ADF, to which ATS trades are reported. The figure is based on discussions of Commission staff with FINRA staff. See supra section V.C.4.b.

191 This figure is based on discussion of Commission staff with FINRA staff. This figure includes FINRA internal development and testing. The Commission derived the total estimated one-time burdens from the following: [(Programmer Analyst at 25 hours) x 2 at $193 per hour] + [(Computer Operator at 25 hours) x 2 at $75 per hour] = $13, 400. See supra section V.C.4.b.

192 This figure is the total initial, one-time annualized expense to provide planning, development, implementation, testing, and quality assurance for the SIPs. The figure is based on discussions of Commission staff with SIAC and Nasdaq SIP staff. See supra section V.C.4.c.

trade report messages in the normal course of business. The Commission notes that the proposed Plan amendments could affect order routing as investors may choose to change their routing strategies based on the additional disclosure under the proposed amendments of the ATS where the trade was executed.

The Commission generally requests comment on all aspects of these cost estimates for the proposed amendments to the Plans. Commenters should provide specific data and analysis to support any comments they submit with respect to these cost estimates.

VII. Consideration of Burden on Competition, and Promotion of Efficiency, Competition and Capital Formation

Section 3(f) of the Exchange Act[193] requires the Commission, whenever it engages in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation. In addition, Section 23(a)(2) of the Exchange Act[194] requires the Commission, when making rules under the Exchange Act, to consider the impact of such rules on competition. Section 23(a)(2) also 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. As discussed below, the Commission's preliminary view is that the proposed amendments should promote efficiency and competition. It preliminarily believes that the proposals would have minimal impact, if any, on promotion of capital formation.

A. Actionable IOIs

The proposed amendment to the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS would expressly limit its exclusion of IOIs to those "that are not actionable"

193 15 U.S.C. 78c(f).

194 15 U.S.C. 78w(a)(2).

and those that are actionable but involve a market value of at least $200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000. The definition of bid or offer is a key element in determining the public quoting requirements of exchanges and OTC market makers. As discussed above, the proposed amendments are designed to help promote fair competition by providing a definition of "bid" or "offer" that would apply to all types of trading venues and, thereby, treat actionable IOIs similarly in those venues. The proposal is further designed to promote competition and enhance efficiency by including all actionable IOIs in the consolidated quotation stream, thereby eliminating the potential that IOIs create for two-tiered access to information on the best prices for NMS stocks. Given that actionable IOIs provide explicit or implicit information regarding symbol, side (buy or sell), size and price, there is little practical reason to treat actionable IOIs differently from displayed quotations at the NBBO.

Currently, dark pools' IOIs often are executed at prices that match the best displayed prices for a stock at another market, potentially depriving those who publicly display their interest at the best price from receiving a speedy execution at that price. The opportunity to obtain the fastest possible execution at a price is the primary incentive for the display of trading interest.[195] If adopted, the proposal could encourage the public display of trading interest and promote quote competition among markets by eliminating a practice that diverts order flow to private markets. Increasing the volume of order flow routed to public quoting markets could reward market participants for displaying their trading interest, thus leading to an increase in the display of trading interest. Such a result would be consistent with the Commission's emphasis

195 See NMS Release, supra note 26.

on the need to encourage displayed liquidity – a critical reference point for investors.[196] Moreover, increasing the volume of order flow directed to public quotations could increase the incentives for markets to compete by displaying the quotations that would attract such order flow. The proposal thereby could promote competition for the displayed liquidity that is vital to the fairness and efficiency of the market for NMS stocks. Encouraging the use of displayed limit orders could help improve the price discovery process, and in turn, contribute to increased liquidity and depth in the market.[197]

Further, the proposed amendment to the current definition of "bid" or "offer" would exclude any IOIs "for a quantity of NMS stock having a market value of at least $200,000 that are communicated only to those who are reasonably believe to represent current contra-side trading interest of at least $200,000." This exception is designed to benefit investors trading in large sizes by allowing them to trade more efficiently than they could if these quotes were required to be included in the public quotation stream. As discussed above, some trading venues may use actionable IOIs as part of a trading mechanism that locates contra-side trading interest for large size orders without causing price impact on the markets. It also could promote competition by enabling trading venues to continue to offer existing size discovery mechanisms, as well as leaving room for trading venues to innovate and offer additional types of size discovery mechanisms.

Based on the analysis above, the Commission preliminarily believes that the proposed amendment to the definition of "bid" or "offer" in Rule 600(b)(8) to apply expressly to

196 See supra note 26.

197 See Order Handling Rules Release, supra note 26, at 48293 ("[T]he display of customer limit orders advances the national market system goal of the public availability of quotation information, as well as fair competition, market efficiency, best execution, and disintermediation.").

actionable IOIs would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission also believes, as discussed above, that the proposed amendment would promote efficiency and competition, and would have minimal impact, if any, on promotion of capital formation.

The Commission requests comment on all aspects of this analysis and, in particular, on whether the proposed amendment would place a burden on competition, as well as the effect of the proposal on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

B. ATS Display Obligations

As discussed above, the proposed amendments to Rule 301(b)(3) are intended to reduce the potential for two-tiered markets and further integrate the best-priced orders available on ATSs into the national market system. By revising the order display and execution access requirements in Rule 301(b)(3) to reflect proposed revisions to the definition of "bid" or "offer" in Rule 600(b)(8) of Regulation NMS, the Commission aims to foster greater price transparency, more vigorous competition, and stronger, more integrated markets.[198]

ATSs that currently use actionable IOIs could respond to the proposed amendments to Regulation ATS by displaying some of these orders in the public quote stream. The proposed amendments to Rule 301(b)(3) are designed to incorporate more order information into the public quote stream and promote quote competition. Actionable IOIs communicated by ATSs to selected market participants often provide important pricing information and could improve the NBBO or add to the size available at the NBBO if they were included in the public quote stream. Both of these impacts could improve the pricing efficiency and overall execution quality

198 See supra section II.

available in the national market system. Requiring more such IOIs to be integrated into the public quote stream also could further competition among orders and among markets.

ATSs that currently use actionable IOIs could respond to the proposed amendments to Regulation ATS by going completely dark. This outcome could reduce the potential benefits to efficiency and quote competition. Nevertheless, this response would reduce the likelihood of two-tiered markets, where some market participants have information about and access to the best-priced orders that others do not. In addition, such a response would reduce the fraction of order flow that is diverted from market participants that publicly display their interest.

Moreover, the Commission preliminarily believes that the proposed amendments to Rule 301(b)(3) would strike an appropriate balance between encouraging competition among market centers and the need for appropriate coordination among them. The Commission's proposal to lower the trading volume threshold in Rule 301(b)(3) from 5% to 0.25% is designed to recognize significant changes in market structure and practice among market participants that have occurred since Regulation ATS was adopted, while at the same time not lowering the volume threshold to a level that would create an inappropriate barrier to entry for new ATSs.

The Commission also preliminarily believes that, by keeping barriers to entry reasonably low for new ATSs and strengthening the national market system, the proposed amendments to Rule 301(b)(3) would promote competition. A significant number of ATSs have been launched since the Commission adopted Regulation ATS in 1998. Competition between ATSs and exchanges, and between ATSs, has yielded numerous benefits for investors and the national market system as a whole, including faster and more robust trading technology, new trading strategies, and lower transaction costs, which in turn support highly liquid markets with wide investor participation. The Commission thus believes that reasonably low barriers to entry for ATSs has generally helped to promote competition and efficiency.

For these reasons, the Commission preliminarily believes that the changes to Rule 301(b) would likely have a positive impact on competition and efficiency, would have minimal impact, if any, on promotion of capital formation, and would not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission generally requests comment on the competitive effects of the proposed amendments to Rule 301(b)(3) on any market participant. The Commission also requests comment on what impact the proposed amendments to Rule 301(b)(3) would have on competition, efficiency, and capital formation. The Commission requests comment on all aspects of this analysis and, in particular, on whether the proposed amendments to Rule 301(b)(3) would place a burden on competition, as well as the effect of the proposal on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views, if possible.

C. Post-Trade Transparency for ATSs

The Commission's preliminary view is that the proposed amendments to post-trade transparency requirements for ATSs should promote efficiency and competition. The Commission believes that the proposed amendments to the Plans would improve post-trade transparency as Plan Participants would be required to include identifying information, specifying the trading center that executed the trade in the consolidated data stream disseminated to the public. This information should lead to more efficient order routing, as investors would know on which ATS a particular security has been traded. This improved post-trade transparency should promote competition among trading venues as the public would be better able to assess where trading volume is being executed. Furthermore, such uniform and reliable reporting practices may promote efficiency by facilitating the flow of information among ATSs, broker-dealers, exchanges, investors, and other market participants. As discussed, the Commission preliminarily believes that this change would bring the trade reporting requirements for ATSs in line with the trade reporting requirements for exchanges. Requiring the public disclosure of which ATS executed a trade should enable the public to determine more accurately the volume of executions occurring on any particular ATS, as well as on ATSs in general. The Commission expects that investors would direct orders to ATSs that provided liquidity in a particular issue. Greater transparency should also enhance the ability of investors to receive best execution for their orders. Transparency should result in more efficient routing of orders to venues with liquidity. The Commission preliminarily believes that some ATSs could receive additional trading interest when investors are able to identify that the ATS has liquidity in a particular stock.

The Commission preliminarily believes the proposed Plan amendments would promote efficiency and competition and would have minimal impact, if any, on promotion of capital formation. In addition, the Commission preliminarily believes that the proposed Plan amendments would not impose any burden on competition not necessary or appropriate in the furtherance of the purposes of the Exchange Act.

The Commission requests comment on all aspects of this analysis and, in particular, on whether the proposed amendments would place a burden on competition, as well as the effect of the proposal on efficiency, competition, and capital formation. Commenters are requested to provide empirical data and other factual support for their views if possible.

VIII. Consideration of Impact on the Economy

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[199] the Commission 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.

The Commission requests comment on the potential impact of the proposed rule amendments on the economy on an annual basis, on the costs or prices for consumers or individual industries, and on competition, investment or innovation. Commenters are requested to provide empirical data and other factual support for their view to the extent possible.

IX. Regulatory Flexibility Act

The Regulatory Flexibility Act ("RFA")[200] requires Federal agencies, in promulgating rules, to consider the impact of those rules on small entities. Section 603(a)[201] of the Administrative Procedure Act,[202] as amended by the RFA, generally requires the Commission to undertake a regulatory flexibility analysis of all proposed rules, or proposed rule amendments, to determine the impact of such rulemaking on "small entities."[203] Section 605(b) of the RFA states

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199 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).

200 5 U.S.C. 601 et seq.

201 5 U.S.C. 603(a).

202 5 U.S.C. 551 et seq.

203 Although Section 601(b) of the RFA defines the term "small entity," the statute permits agencies to formulate their own definitions. The Commission has adopted definitions for the term small entity for the purposes of Commission rulemaking in accordance with the

that this requirement shall not apply to any proposed rule or proposed rule amendment, which if adopted, would not "have a significant economic impact on a substantial number of small entities."[204]

A. Actionable IOIs

Pursuant to Rule 605(b) of the RFA, the Commission certifies that the proposed amendment of Rule 600(b)(8) of Regulation NMS, if adopted, would not have a significant economic impact on a substantial number of small entities. The proposed amendment of Rule 600(b)(8) of Regulation NMS would revise the definition of "bid" or "offer" by expressly limiting its exclusion of IOIs to those "that are not actionable and indications of interest for a quantity of NMS stock having a market value of at least $200,000 that is communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000." The practical result of the amendment would be that actionable IOIs that do not meet the size discovery exclusion would be "bids" or "offers."

"Bid" and "offer" are key terms that determine the scope of Rule 602 of Regulation NMS. In general, Rule 602 requires exchange members and OTC market makers to provide their best-priced bids and offers to their respective exchanges and FINRA. The exchanges and FINRA, in turn, are required to make their best bids and offers available in the consolidated quotation data. The exchanges subject to the requirements of Rule 602 are not small entities as defined by Commission rules,[205] and FINRA, a national securities association, is not a small entity.

RFA. Those definitions, as relevant to this proposed rulemaking, are set forth in Rule 0-10, 17 CFR 240.0-10. See Securities Exchange Act Release No. 18451 (January 28, 1982), 47 FR 5215 (February 4, 1982) (File No. AS-305).

204 See 5 U.S.C. 605(b).

205 See 17 CFR 240.0–10(e).

The proposed amendment to Rule 600(b)(8) could increase the number of "bids" and "offers" exchange members and certain OTC market makers must review to determine their best-priced bids and offers. Some exchange members and OTC market makers may be small entities pursuant to Rule 0-10(c) under the Exchange Act.[206] It is the Commission's understanding that all exchange members and OTC market makers currently have systems and procedures in place to determine their best-priced bids and offers. As a result, the Commission believes that the proposed amendment would not result in a significant economic impact on a substantial number of exchange members and OTC market makers when determining their best-priced bids and offers due to the proposed inclusion of actionable IOIs in the definition of "bid" or "offer."

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

B. ATS Display Obligations

The Commission also certifies that the proposed amendments to Rule 301(b)(3) of Regulation ATS would not, if adopted, have a significant economic impact on a substantial number of small entities.

For purposes of Commission rulemaking in connection with the RFA, a small entity includes a broker-dealer with 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) under the Exchange Act,[207] or, if not required to file such statements, a broker-dealer with total capital (net worth plus subordinated liabilities) of less than $500,000 on the last day of the preceding fiscal year (or in the time that it has been in business, if

206 See 17 CFR 240.0–10(c).

207 See 17 CFR 240.17a-5(d).

shorter); and is not affiliated with any person (other than a natural person) that is not a small business or small organization.[208] An entity that complies with Regulation ATS must, among other things, register as a broker-dealer.[209] Thus, the Commission's definition of small entity as it relates to broker-dealers also applies to ATSs.

The proposed amendments to Rule 301(b)(3) would lower the average daily trading volume threshold that triggers the order display and execution access requirements applicable to ATSs. Accordingly, the proposed amendments to Rule 301(b)(3) could result in more ATSs being subject to these requirements.

The Commission notes that there are approximately 73 ATSs that are subject to Regulation ATS. Of these, approximately 11 communicate actionable IOIs in NMS stocks to more than one person and approximately one other ATS displays subscriber orders in NMS stocks on a limited basis in some other fashion. Therefore, the Commission preliminarily believes that approximately 12 respondents could be impacted by the proposed amendments to Rule 301(b)(3).[210] The Commission preliminarily does not believe that any of these 12 ATSs would be a "small entity" as defined above.[211] Therefore, the Commission certifies that the

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208 See 17 CFR 240.0-10(c).

209 See 17 CFR 242.301(b)(1).

210 The Commission preliminarily believes that the remaining 61 ATSs would not be affected by the proposed amendments because they: (a) do not display subscriber orders in NMS stocks to more than one person (whether by communicating actionable IOIs or otherwise), (b) are ECNs and already publicly display subscriber orders, or (c) do not effect transactions in NMS stocks.

211 This preliminary estimate is based on discussions with industry participants, including ATSs that could be impacted by the proposed changes to Rule 301(b)(3) and information provided in Forms ATS and ATS-R, as filed with the Commission. The Commission notes that most of the 12 potential ATS respondents are affiliated with large broker-dealer firms, none of which is a "small entity" under the RFA.

proposed amendments to Rule 301(b)(3), if adopted, would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any impact on small entities and provide empirical data to support the extent of the impact.

C. Post-Trade Transparency for ATSs

The Commission also certifies that the proposed amendments to the CTA Plan and Nasdaq UTP Plan, would not, if adopted, have a significant economic impact on a substantial number of small entities.

Rule 608,[212] adopted by the Commission under Section 11A, establishes procedures for proposing amendments to national market system plans such as the CTA Plan and the Nasdaq UTP Plan. Paragraph (b)(2) states that the Commission may propose amendments to an effective national market system plan by publishing the text of the amendment together with a statement of purpose of the amendments.

The CTA Plan and the Nasdaq UTP Plan amendments apply to the twelve Plan Participants, none of which is a small entity. The requirement for trade reports to now include a unique identifier for ATS transactions, which would be included on the trade reports in the public data stream, would require FINRA, for trades effected by ATSs, to include an additional data element in the trade report that is submitted to the SIPs. FINRA, a national securities association, and the SIPs are not small entities.

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212 17 CFR 242.608

The Commission's definition of small entity as it relates to broker-dealers also applies to ATSs.[213] The Commission preliminarily believes that there would be no significant economic impact on any of the 73 ATSs that are subject to Regulation ATS that meet the definition of small entity as defined above. Currently, the identity of an ATS transaction is not disseminated with the trade information they report to the public data stream. The CTA Plan and the Nasdaq UTP Plan amendments would require that each ATS use a unique MPID to report its transactions to FINRA, rather than report its transactions using the MPID of its sponsoring broker-dealer. The ATSs that do not already use a unique MPID would need to replace the MPID for their sponsoring broker-dealer with a unique MPID at no significant economic cost to the ATS. Therefore, the Commission certifies that the proposed amendments to the Plans, if adopted, would not have a significant economic impact on a substantial number of small entities for purposes of the RFA.

The Commission encourages written comments regarding this certification. The Commission requests that commenters describe the nature of any effect on small entities and provide empirical data to support the extent of the impact.

X. Statutory Authority

Pursuant to the Exchange Act and particularly, Sections 2, 3(b), 5, 6, 11, 11A, 15, 15A, 17(a) and (b), 19, 23(a), and 36 thereof, 15 U.S.C. 78b, 78c(b), 78e, 78f, 78k, 78k-1, 78o, 78o-3, 78q(a) and (b), 78s, 78w(a), and 78mm, the Commission proposes to amend Rule 600 of Regulation NMS, Rule 301 of Regulation ATS, and the CTA Plan and Nasdaq UTP Plan.

XI. Text of Proposed Amendments to the CTA Plan and Nasdaq UTP Plan

A. The CTA Plan

213 See supra notes 207-209 and accompanying text.

The Commission hereby proposes to amend the CTA Plan to amend the definition of trade report to provide for a unique identifier on each trade report of a trade effected by an Alternative Trading System.

Set forth below are the changes the Commission is proposing to the language of the CTA Plan. Additions are underlined and deletions are in brackets.

I. Definitions.

(m) "Last sale price information" means (i) the last sale prices reflecting completed transactions in Eligible Securities, (ii) the volume and other information related to those transactions, (iii) the identifier of the Participant furnishing the prices, <u>(iv) the identifier of the Alternative Trading System furnishing the prices to FINRA</u>, and [iv] <u>(v)</u> other related information.

VI. Consolidated Tape.

(f) **Market Identifiers.** Each such last sale price when made available by means of the high speed line shall be accompanied by the appropriate alphabetic symbol identifying the market of execution; provided, however, that all last sale prices collected by FINRA and reported to the Processor shall, when so made available by the Processor, be accompanied by a distinctive alphabetic symbol distinguishing such last sale prices from those reported by any exchange or other reporting party, and all last sale prices reported by brokers or dealers required to file a plan with the SEC pursuant to the Rule shall, when so made available by the Processor, be accompanied by a distinctive alphabetic symbol distinguishing such last sale prices from those reported by FINRA or any exchange.

<u>All last sale prices collected by FINRA from Alternative Trading Systems that are subject to Regulation ATS shall be accompanied by a unique identifier identifying the Alternative</u>

Trading System that executed the trade ("ATS Identifier"). All last sale prices collected by FINRA from Alternative Trading Systems that are subject to Regulation ATS shall, when reported to the Processor by FINRA and when made available by the Processor, be accompanied by a unique ATS Identifier, unless the last sale price is for a transaction with a market value of at least $200,000.

VIII. Collection and Reporting of Last Sale Data.

(a) **Responsibility of Exchange Participants**. The AMEX, BATS, the BSE, the CBOE, the CHX, the ISE, Nasdaq, the NSX, the NYSE, NYSE Arca and the PHLX will each collect and report to the Processor all last sale price information to be reported by it relating to transactions in Eligible Securities taking place on its floor. In addition, FINRA shall collect from its members all last sale price information to be included in the consolidated tape relating to transactions in Eligible Securities not taking place on the floor of an exchange and shall report all such last sale price information to the Processor in accordance with the provisions of Section VIII(b) hereof, unless the last sale price is collected by FINRA from an Alternative Trading System subject to Regulation ATS for a transaction with a market value of at least $200,000, in which case FINRA shall not report an ATS Identifier as part of the last sale price. It will be the responsibility of each Participant and each other reporting party, as defined in Section III(d) hereof, to (i) report all last sale prices relating to transactions in Eligible Securities as promptly as possible, unless the last sale price is collected by FINRA from an Alternative Trading System subject to Regulation ATS for a transaction with a market value of at least $200,000, in which case FINRA shall not report an ATS Identifier as part of the last sale price, (ii) establish and maintain collection and reporting procedures and facilities such as to assure that under normal conditions not less than 90% of such last sale prices will be reported within that period of time (not in excess of one and one-half minutes) after the time of execution as may be determined by CTA from time to time in light of experience, and (iii) designate as "late" any last sale price not collected and reported in accordance with the above-referenced procedures or as to which the reporting party has knowledge that the time interval after the time of execution is significantly greater than the time period referred to above. CTA shall seek to reduce the time period for reporting last sale prices to the Processor as conditions warrant.

B. The Nasdaq UTP Plan

The Commission hereby proposes to amend the Nasdaq UTP Plan to amend the definition of trade report to provide for a unique identifier on each trade report of a trade effected by an Alternative Trading System.

Set forth below are the changes the Commission is proposing to the language of the Nasdaq UTP Plan. Additions are underlined and deletions are in brackets.

III. Definitions

U. "Transaction Reports" means reports required to be collected and made available pursuant to this Plan containing the stock symbol, price, and size of the transaction executed, the Market in which the transaction was executed, and related information, including a buy/sell/cross indicator and trade modifiers, reflecting completed transactions in Eligible Securities <u>and, in the case of FINRA, the FINRA member that entered the report, if such member is an alternative trading system subject to Regulation ATS.</u>

VI. Functions of the Processor

C. Dissemination of Information

3. Transaction Reports

The Processor shall disseminate on the UTP Trade Data Feed a data stream of all Transaction Reports in Eligible Securities received from Participants. Each transaction report shall be designated with a symbol identifying the Participant in whose Market the transaction took place, and in the case of FINRA, with the identity of the FINRA member reporting the transaction if such member is an alternative trading system subject to Regulation ATS, unless the last sale price is for a transaction with a market value of at least $200,000.

VIII. Transmission of Information to Processor by Participants

B. Transaction Reports

Each Participant shall, during the time it is open for trading, be responsible promptly to collect and transmit to the Processor Transaction Reports in Eligible Securities executed in its Market by means prescribed herein. With respect to orders sent by one Participant Market to another Participant Market for execution, each Participant shall adopt procedures governing the reporting of transactions in Eligible Securities specifying that the transaction will be reported by the Participant whose member sold the security. This provision shall apply only to transactions between Plan Participants.

Transaction Reports shall include:

1. identification of the Eligible Security, using the Nasdaq Symbol;
2. the number of shares in the transaction;
3. the price at which the shares were purchased or sold;
4. the buy/sell/cross indicator;
5. the Market of execution; [and,]
6. through appropriate codes and messages, late or out-of-sequence trades,

corrections and similar matters[.]; and,

7. in the case of FINRA, the identity of the FINRA member reporting the transaction if such member is an alternative trading system subject to Regulation ATS, unless the last sale price is for a transaction with a market value of at least $200,000.

XII. Text of Proposed Rule Amendments

List of Subjects in 17 CFR Part 242

Brokers, Reporting and recordkeeping requirements, Securities.

For the reasons set out in the preamble, the text of Title 17, Chapter II, of the Code of Federal Regulations is proposed to be amended as follows.

Part 242 -- REGULATIONS M, SHO, ATS, AC, AND NMS AND CUSTOMER MARGIN REQUIREMENTS FOR SECURITY FUTURES

1. The authority citation for Part 242 continues to read in part as follows:

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 78mm, 80a-23, 80a-29, and 80a-37.

2. Revise § 242.301(b)(3)(i) and (ii) to read as follows:

§ 242.301 Requirements for alternative trading systems.

* * * * *

(b) * * *

(3) * * *

(i) An alternative trading system shall comply with the requirements set forth in paragraph (b)(3)(ii) of this section, with respect to any NMS stock in which the alternative trading system:

(A) Displays subscriber orders to any person (other than alternative trading system employees); and

(B) During at least 4 of the preceding 6 calendar months, had an average daily trading volume of 0.25 percent or more of the aggregate average daily share volume for such NMS stock as reported by an effective transaction reporting plan.

(ii) Such alternative trading system shall provide to a national securities exchange or national securities association the prices and sizes of the orders (other than orders having a market value of at least $200,000 that are displayed only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000) at the highest buy price and the lowest sell price for such NMS stock, displayed to more than one person (other than alternative trading system employees), for inclusion in the quotation data made available by the national securities exchange or national securities association to vendors pursuant to § 242.602.

* * * * *

3. Section 242.600 is amended by revising paragraph (b)(8) to read as follows:

§242.600 NMS security designation and definitions.

* * * * *

(b) * * *

(8) <u>Bid</u> or <u>offer</u> means the bid price or the offer price communicated by a member of a national securities exchange or member of a national securities association to any broker or dealer, or to any customer, at which it is willing to buy or sell one of more round lots of an NMS

security, as either principal or agent, but shall not include indications of interest that are not actionable and indications of interest for a quantity of NMS stock having a market value of at least $200,000 that are communicated only to those who are reasonably believed to represent current contra-side trading interest of at least $200,000.

*   *   *   *   *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: November 13, 2009

[OCC-4810-33-P 12.5%]

[FRB-6210-01-P 12.5%]

[FDIC-6714-01-P 12.5%]

[OTS-6720-01-P 12.5%]

[NCUA-7535-01-P 12.5%]

[FTC-6750-01 12.5%]

[CFTC-6351-01 12.5%]

[SEC-8011-01 12.5%]

DEPARTMENT OF THE TREASURY
Office of the Comptroller of the Currency
12 CFR Part 40
Docket ID OCC-2009-0011
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-2009-0014
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

20 of 38

SECURITIES AND EXCHANGE COMMISSION
17 CFR Part 248
[Release Nos. 34-61003, IA-2950, IC-28997; File No. S7-09-07]
RIN 3235-AJO6

Final 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 Commission (FTC); Commodity Futures Trading Commission (CFTC); and Securities and Exchange Commission (SEC).

ACTION: Final rule.

SUMMARY: The OCC, Board, FDIC, OTS, NCUA, FTC, CFTC, and SEC (the "Agencies") are publishing final amendments to their rules that implement the privacy provisions of Subtitle A of Title V of the Gramm-Leach-Bliley Act ("GLB Act"). These rules require financial institutions to provide initial and annual privacy notices to their customers. Pursuant to Section 728 of the Financial Services Regulatory Relief Act of 2006 ("Regulatory Relief Act" or "Act"), the Agencies are adopting a model privacy form that financial institutions may rely on as a safe harbor to provide disclosures under the privacy rules. In addition, the Agencies other than the SEC are eliminating the safe harbor permitted for notices based on the Sample Clauses currently contained in the privacy rules if the notice is provided after December 31, 2010. Similarly, the SEC is eliminating the guidance associated with the use of notices based on the Sample Clauses in its privacy rule if the notice is provided after December 31, 2010.

DATES: This rule is effective on [30 DAYS AFTER DATE OF PUBLICATION], except for the following amendments, which are effective January 1, 2012:

Instructions 3B, 10B, 17B, 24B, 31B, 38B, 45B, and 52B removing paragraphs (g) to 12 CFR 40.6, 216.6, 332.6, 573, and 716.6, 16 CFR 313.6, and 17 CFR 160.6 and 248.6, respectively; and

Instructions 7B, 14B, 21B, 28B, 35B, 42B, 49B, and 55B removing Appendixes B to 12 CFR parts 40, 216, 332, 573, and 716, 16 CFR part 313, and 17 CFR parts 160 and 248, respectively.

FOR FURTHER INFORMATION CONTACT:

OCC: Stephen Van Meter, Assistant Director, Community and Consumer Law Division, (202) 874-5750; Heidi Thomas, Special Counsel, Legislative and Regulatory Activities Division, (202) 874-5090; or David Nebhut, Director, Policy Analysis Division, (202) 874-5220, Office of the Comptroller of the Currency, 250 E Street SW, Washington, DC 20219.

Board: Jeanne Hogarth, Consumer Policies Program Manager, Jelena McWilliams, Attorney, or Ky Tran-Trong, Counsel, Division of Consumer and Community Affairs, (202) 452-3667; Kara Handzlik, Attorney, Legal Division, (202) 452-3852; Board of Governors of the Federal Reserve System, 20th Street and Constitution Avenue, NW, Washington, DC 20551.

FDIC: Samuel Frumkin, Senior Policy Analyst, Division of Supervision and Consumer Protection, (202) 898-6602; or Kimberly A. Stock, Counsel, (202) 898-3815, Legal Division; Federal Deposit Insurance Corporation, 550 17th Street, N.W., Washington, DC 20429.

OTS: Ekita Mitchell, Consumer Regulations Analyst, (202) 906-6451; or Richard Bennett, Senior Compliance Counsel, Regulations and Legislation Division, (202) 906-7409; 1700 G Street, NW, Washington, DC 20552.

NCUA: Regina Metz, Staff Attorney, (703) 518-6561, Office of General Counsel, National Credit Union Administration, 1775 Duke Street, Alexandria, Virginia 22314-3428.

FTC: Loretta Garrison, Senior Attorney, and Anthony Rodriguez, Attorney, Division of Privacy and Identity Protection, Bureau of Consumer Protection, (202) 326-2252, Federal Trade Commission, 600 Pennsylvania Avenue, NW, Stop NJ-3158, Washington, DC 20580.

CFTC: Laura Richards, Deputy General Counsel, (202) 418-5126, or Gail B. Scott, Counsel, Office of General Counsel, (202) 418-5139, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW, Washington, DC 20581.

SEC: Paula Jenson, Deputy Chief Counsel, or Brice Prince, Special Counsel, Office of the Chief Counsel, Division of Trading and Markets, (202) 551-5550; or Penelope Saltzman, Assistant Director, Thoreau Bartmann, Senior Counsel, or Daniel

Chang, Staff Attorney, 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 publishing final 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").[1]

1 Because the Agencies' privacy rules generally use consistent section numbering, relevant sections will be cited, for example, as "section __.6" unless otherwise noted.

I. INTRODUCTION

A. Statutory Authority and Overview

The Regulatory Relief Act was enacted on October 13, 2006.[2] 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]."[3] 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.

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2 Pub. L. No. 109-351, 120 Stat. 1966 (2006).

3 Id., adding 15 U.S.C. 6803(e). See also infra discussion at section II.A. on the GLB Act requirements for financial privacy notices. 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.

On March 29, 2007, the Agencies published a proposed model privacy form (the "proposed model form") that financial institutions would be able to use to comply with certain disclosures under the privacy rule.[4] On April 15, 2009, the SEC reopened the comment period on the proposed rulemaking to solicit comment on a research report and test data pertaining to additional consumer testing of the proposed model privacy form.[5] Today, the Agencies are amending the privacy rule to include a model privacy form that institutions may use to provide required disclosures. The final model form is substantially as proposed with changes based on comments we received as well as additional consumer testing.

B. Overview of the Final Model Privacy Form

As explained more fully in the Agencies' Proposed Rule, key elements of the final model form's structure and design, as well as vocabulary, reflect the research findings of the qualitative consumer testing.[6] The Agencies believe that the final model form as revised meets all the requirements of the Act and, based on the qualitative research that led to the development of the proposed model form and the quantitative consumer testing described below, is easier to understand and use than most privacy notices currently being disseminated.

While the model form provides a legal safe harbor, institutions may 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 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.[7] Likewise, while the Agencies are eliminating the Sample

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4 See Interagency Proposal for Model Privacy Form under the Gramm-Leach-Bliley Act ("Proposed Rule"), 72 FR 14940 (Mar. 29, 2007), available at http://www.ftc.gov/os/2007/03/CorrectedNeptuneMarsandGenericFormsfrn.pdf. A Correction Notice was published at 72 FR 16875 (Apr. 5, 2007).

5 See Interagency Proposal for Model Privacy Form under the Gramm-Leach-Bliley Act, Securities Exchange Act Release No. 59769, Investment Company Act Release No. 28697 (Apr. 15, 2009) [74 FR 17925 (Apr. 20, 2009)].

6 The Agencies conducted the consumer research in two phases: the first was qualitative testing or form development; the second was quantitative testing. See infra section II.

7 See privacy rule, section ___.6(c)(5), NCUA section 716.6(e)(5).

Clauses and related safe harbor (or, for the SEC, guidance), institutions may continue to use notices containing these clauses, so long as these notices comply with the privacy rule.[8]

The following section briefly summarizes the key features of the final model form and the changes to the proposed form. A detailed discussion of the elements of the final model form appears in section III.

1. The Structure

The final model form has two pages, rather than the three pages in the proposed form, and may be printed on a single piece of paper.[9] Together, pages one and two address the legal requirements of applicable Federal financial privacy laws and are designed to increase consumer comprehension. The Agencies are not mandating a specific paper size in the final model form as long as the paper is in portrait orientation and sufficient to accommodate minimum font size, spacing, and content requirements.

2. Page One – Background Information, the Disclosure Table, and Opt-Out Information

Page one of the final model form has five parts: (1) the title; (2) an introductory section called the "key frame" which provides context to help the consumer understand the required disclosures; (3) a disclosure table that describes the types of sharing used by financial institutions consistent with Federal law, which of those types of sharing the institution actually does, and whether the consumer can limit or opt out of any of the institution's sharing; (4) only if needed, a box titled "To limit our sharing" for opt-out information; and (5) the institution's customer service contact information. Where the institution provides a mail-in opt-out form, that form appears at the bottom of page one.

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8 See infra section IV.

9 For ease, the Appendix provides three versions of the final model form: (1) model form with no opt-out; (2) model form with telephone and Web opt-out only; and (3) model form that includes a mail-in opt-out form. An alternative mail-in form (version 4) may be substituted for the mail-in portion of the model form in version 3. For those institutions that use the model form and need to provide a mail-in opt-out form, the reverse side to that opt-out form must not include any content of the model form. See F.4 of the Frequently Asked Questions for the Privacy Regulation, available at http://www.ftc.gov/privacy/glbact/glb-faq.htm (Dec. 2001) (staff guidance issued by the Board, FDIC, FTC, OCC, OTS, and NCUA) (stating that a consumer generally should be able to detach a mail-in opt-out form from a privacy notice without removing text from the privacy policy).

There are three significant changes on page one of the final model form.[10] First, the "What?" box has been modified to permit institutions to select from a menu of terms the types of information collected and shared (other than Social Security number). Second, information (if needed) about how to limit sharing or opt out follows the disclosure table. If the institution provides a mail-in opt-out form, that form appears at the bottom of page one. Third, the final model form includes at the top of the page in the right-hand corner the date by month and year of the most recent version of the notice. Institutions may include at the bottom of page one a "tagline" (an internal identifier) or barcode for information internal to the company, so long as these do not interfere with the clarity or text of the form.[11]

3. Page Two – Supplemental Information

As in the proposed model form, the second page of the final model form 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 the privacy rule. There is supplemental information in the form of Frequently Asked Questions ("FAQs")[12] at the top and definitions below. There are three significant changes to the disclosures on page two of the final form.[13] First, a new FAQ appears at the top of page two that can be used to identify those institutions that jointly provide the notice. Second, the FAQ on the collection of information has been modified to allow institutions to select from a menu of terms. Third, a new box has been provided at the bottom of page two titled "Other important information." This box can be used in only two ways: (1) to discuss state and/or international privacy law requirements; and (2) to provide an acknowledgment of receipt form.[14]

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10 See infra section III.I.

11 See, e.g., comment letters of T. Rowe Price Associates, Inc. (May 29, 2007); Wolters Kluwer Financial Services (May 24, 2007).

12 Note that a financial institution must insert its name or a common corporate identity as indicated in the two questions in this section each time that "[name of financial institution]" appears. The revised form has eliminated the FAQ "How does [**name of financial institution**] notify me about its practices."

13 See infra section III.J.

14 This use was provided in response to a request by the National Automobile Dealers Ass'n, whose members routinely ask customers to sign an acknowledgment of receipt

II. BACKGROUND

A. The Gramm-Leach-Bliley Act Privacy Notices

Subtitle A of title V of the GLB Act, captioned "Disclosure of Nonpublic Personal Information,"[15] requires each financial institution to provide a notice of its privacy policies and practices to its customers who are consumers.[16] In general, the privacy notice 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.[17] The notice also must provide a consumer a reasonable opportunity to direct the institution generally not to share nonpublic personal information[18] 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).[19] The privacy notice must

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on a copy of the dealer's privacy notice and retain this record verifying delivery of the notice. Comment letter of the National Automobile Dealers Ass'n (May 29, 2007).

15 Codified at 15 U.S.C. 6801-6809.

16 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), NCUA section 716.3(n). 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). Financial institutions are required to provide an initial notice to their customers and a notice annually thereafter for as long as the customer relationship continues. 15 U.S.C. 6803(a); Privacy rule, sections __.4 and __.5. Institutions are also required to provide to their non-customer consumers a notice if the institution discloses nonpublic personal information outside the exceptions in sections __.14 and __.15 before any such disclosure is made. 15 U.S.C. 6802(a); privacy rule, sections __.4.

17 15 U.S.C. 6803(a)-(c).

18 "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. <u>See</u> 15 U.S.C. 6809(4); privacy rule, sections __.3(n) and (o), SEC sections 248.3(t) and (u), CFTC sections 160.3(t) and (u).

19 15 U.S.C. 6802; privacy rule, sections __.14 and __.15.

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.[20]

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 thereafter 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.[21]

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.[22] The Appendix to each privacy rule contains Sample Clauses that institutions may use in privacy notices to satisfy the privacy rule.

Financial institutions were required to provide privacy notices to their customers by July 1, 2001.[23] Many notices provided to consumers were long and complex. 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 practices.[24] The Agencies first explored issues related to the complexity of privacy notices in a workshop held in December 2001.[25]

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20 15 U.S.C. 1681a(d)(2)(A)(iii) (FCRA); 15 U.S.C. 6803(c)(4) (GLB Act).

21 See sections __.4, __.5, and __.6 of the privacy rule.

22 15 U.S.C. 6802, 6803; privacy rule, section __.3(b), SEC section 248.3(c), CFTC section 160.3(b)(1).

23 See, e.g., Privacy of Consumer Financial Information, 65 FR 35162 (June 1, 2000). 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. Privacy of Consumer Financial Information, 66 FR 21236 (Apr. 27, 2001).

24 See Rulemaking Petition from Public Citizen, et al., at 4 (July 26, 2001) (available at http://www.ftc.gov/bcp/workshops/glb/comments/nader.pdf) ("Public Citizen Petition") (stating that notices were "dense," "complicated," and written by those trained in obfuscation rather than to express ideas clearly).

25 See Get Noticed: Writing Effective Financial Privacy Notices, Interagency Public Workshop (Dec. 4, 2001) ("Get Noticed Workshop"). Workshop transcripts and other

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 ("ANPR") to solicit public comment on a wide range of issues related to improving privacy notices.[26] The ANPR stated that the Agencies expected that consumer testing would be a key component in the development of any specific proposals.[27]

During January and February 2004, the Agencies met with a number of interested groups and individuals to discuss the issues raised in the ANPR and subsequently received forty-four comments in response to the ANPR.[28] 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. Development of the Proposed Model Privacy Form

Over the years during which GLB Act privacy notices have been delivered to consumers, the Agencies have observed wide variations in these notices. Today, privacy notices vary considerably – not just in format, presentation, language, length, style, or tone – but also in how they inform consumers of their rights to limit certain sharing of personal information. For example, the Agencies have found the following variations in current privacy notices. Some institutions incorporate privacy notices into lengthy terms and conditions statements, making it harder for consumers to find information about the institution's privacy practices, and raising questions about whether

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supporting documents are available at http://www.ftc.gov/bcp/workshops/glb/index.html. The Get Noticed Workshop, discussed in the preamble to the Proposed Rule, supra note 4 at n.14, provided a public forum to consider how financial institutions could provide more useful privacy notices to consumers.

26 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. 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.

27 Id. at text following n.5.

28 Summaries of the outside meetings and public comments to the ANPR are available at http://www.ftc.gov/privacy/privacyinitiatives/financial_rule_inrp.html.

such notices comply with the requirement that they be clear and conspicuous. Institutions also use messages in their notices' opening statements about how they value privacy and strive to "protect" personal information, thus providing assurances to consumers that imply their personal information is not shared broadly, while obscuring or directing attention away from the required disclosures of actual information sharing practices. Finally, the Agencies have seen a number of institutions employ the statement in their privacy policy "We do not sell your information to third parties" in a context that raises concerns about misrepresentations.[29]

These examples illustrate the need to make disclosure of institutions' information sharing practices and consumer choices more transparent and underscore the Agencies' interest in initiating a joint consumer research project to develop an easy-to-read and understandable model privacy notice for consumers.

In the summer of 2004, six of the Agencies[30] launched 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. The Agencies conducted the consumer research in two sequential phases.[31]

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29 In some cases, the Agencies have identified notices that violate the privacy rule. For example, one institution's privacy notice did not include an opt-out form, but provided that consumers could only obtain an opt-out form by visiting a bank office, in violation of sections __.7(h), __.9(a), and __.10(a)(1) of the privacy rule. Another notice provided that consumers could only opt out by writing a letter to the institution, in violation of section __.7(a)(1) of the privacy rule. Offering only these very restrictive methods of obtaining an opt-out form and opting out also is not supported by the examples in the privacy rule. <u>See</u> sections __.7(a)(2), __.9(b), and __.10(a)(3) of the privacy rule.

30 The six agencies that initially sponsored the Notice Project were the Board, FDIC, FTC, NCUA, OCC, and SEC. The OTS joined the Notice Project for the phase two quantitative testing. Information related to the Notice Project is available at http://www.ftc.gov/privacy/privacyinitiatives/financial_rule_inrp.html.

31 The first phase was designed as qualitative testing or 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.

In September 2004, the 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 institutions, and that addressed all relevant legal requirements of the GLB Act and FCRA.

The form development phase culminated in an extensive research report prepared by Kleimann and released by the Agencies in March 2006 (the "Kleimann Report").[32] The Kleimann Report details the process by which the Agencies and Kleimann developed an alternative privacy notice. The structure, content, ordering of the text information, and title of the proposed model form all reflect the research findings from the qualitative consumer testing.

In October 2006, Congress passed the Regulatory Relief Act, which directed the Agencies to propose a model form based on standards similar to the Notice Project research goals. On March 29, 2007, the Agencies issued for public comment the proposed model form as produced in the form development phase with some minor revisions.

C. Overview of Comments Received

The Agencies collectively received approximately 110 unique comments from a variety of banks, thrifts, credit unions, credit card companies, securities firms, insurance companies, and industry trade associations, as well as from consumer and other advocacy groups, the National Association of Attorneys General ("NAAG"), the National Association of State Insurance Commissioners ("NAIC"), and individual consumers.[33]

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32 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.

33 Comments received by all the Agencies are available at http://www.ftc.gov/privacy/privacyinitiatives/financial_rule_inrp.html. Many commenters sent copies of the same letter to more than one agency. Some association commenters sent several letters, both individually and jointly with other associations.

A number of institutions expressed support for the model form. Some stated that they are either already using it (submitting copies of their notices) or intend to use it once it is finalized. One industry association conducted an informal poll of its community bank members and found that many are likely to use the model form and that most found the new form more consumer-friendly than the Sample Clauses. These commenters commended the Agencies for proposing simpler language and making the disclosure terms more understandable and accessible to consumers.

Consumer and other advocacy groups, the NAIC, NAAG, and individual consumers generally supported the Agencies' proposal and the clearer language and omission of extraneous information in the proposed model form. These commenters stated that the proposal could be strengthened in certain respects, for example, by making the default opt-in rather than opt-out and creating a one-stop opt-out repository similar to the National Do Not Call Registry.

There was general support by many commenters for additional consumer research and testing. While some industry commenters provided substitute language or submitted alternate forms of the notice, none submitted other research findings. However, the NAIC submitted a consumer study on notices with research findings that the Agencies did consider.

Most industry commenters, however, objected to several key aspects of the proposal. The most significant areas of concern raised by industry commenters related to: the standardized approach; the format of the proposed model form; the limited examples of types of personal information collected and shared; the disclosure table; incorporation of state law information; and revocation of the Sample Clauses. The thrust of many industry comments was that the proposed form was overly simplistic and not nuanced enough to describe precisely what the various laws permit or to allow accurate descriptions of more complex information sharing policies and practices. One commenter expressed concern that the form would lead to consumer confusion because of inaccurate disclosures on sharing practices and result in high opt-out rates, discouraging use of the form. Many industry commenters expressed concern about liability under state unfair or deceptive practice laws relating to privacy disclosures. At the same time, many institutions urged flexibility to allow inclusion of other information –

such as describing the benefits of sharing, or providing marketing messages or privacy tips such as on identity theft and fraud prevention. One institution proposed allowing institutions to pick and choose which elements of the notice to use and still receive a safe harbor.

D. Quantitative Research

Following publication of the model form proposal in March 2007 and subsequent review of the comments, the Agencies revised the proposed model form for further testing.[34] In the fall of 2007, the Agencies turned their attention to developing the research protocol and methodology for conducting the second phase of the research: the quantitative consumer testing. In August 2006, prior to enactment of the Regulatory Relief Act, the Agencies had selected Macro International Inc. ("Macro") to conduct the quantitative research study.

In the spring of 2008, Macro conducted a survey of approximately 1,000 consumers using a mall-intercept methodology. The selected participants for the study reflected a range of demographic characteristics for gender, age, and educational level. The testing was conducted in five shopping mall locations – Baltimore, MD; Dallas, TX; Detroit, MI; Los Angeles, CA; and Springfield, MA – over a period of five weeks during March and April 2008.[35]

The test objectives were to evaluate the effectiveness of the revised proposed model form[36] developed by Kleimann ("Table Notice") for comprehension and usability as compared to three other styles or formats of notices. The other notice formats were: (1) the prose version of the prototype table notice also developed and tested by

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34 See Mall Intercept Study of Consumer Understanding of Financial Privacy Notices: Methodological Report, submitted by Macro International Inc. ("Macro Report"), Appendix C, for copies of the test notices. The Macro Report is available at: http://www.ftc.gov/privacy/privacyinitiatives/Macro-Report-on-Privacy-Notice-Study.pdf. See also infra section III for a discussion about the changes made to the final model form since the Proposed Rule was issued for comment.

35 Macro provided the test data to the Agencies in the summer of 2008 and its research methodology report in September. The study data and codebook are available at: http://www.ftc.gov/privacy/privacyinitiatives/Privacy-Notice-Study-Dataset.pdf and http://www.ftc.gov/privacy/privacyinitiatives/Privacy-Notice-Study-Codebook.pdf.

36 The proposed model form was revised based on the comments received, and a version of that revised form was used in the quantitative testing.

Kleimann ("Prose Notice"); (2) a current version of a common notice used by financial institutions ("Current Notice"); and (3) a notice comprised solely of the Sample Clauses found in the appendix to the privacy rule ("Sample Clause Notice"). Within each format, there were three different notices, each reflecting a different level of sharing. Each level of sharing had a common fictional bank name across the four notice formats: Mars Bank had a low level of sharing; Mercury Bank had a medium level of sharing; and Neptune Bank had the highest level of sharing. Both Mercury and Neptune Banks offered opt-out choices; however, the pattern of sharing was such that after exercising all available opt-outs, Neptune Bank continued to share more broadly than Mercury Bank and Mercury Bank continued to share more than Mars Bank. This design was intentional for the comparison testing.[37]

On December 15, 2008, two expert advisors to the Agencies, Dr. Alan Levy and Dr. Manoj Hastak, submitted a report to the Agencies analyzing the research data provided by Macro (the "Levy-Hastak Report").[38] The Levy-Hastak Report confirmed the overall effectiveness of the proposed model form (as modified) as against the three alternative notice formats. On April 15, 2009, the SEC published the Levy-Hastak Report, along with the Macro Report and test data, for public comment. The SEC received nine comments.[39]

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37 Study participants were randomly assigned to see one of the four notice formats. Each participant read three privacy notices in the same format and was asked a series of questions, first about one pair of notices, and next about a second pair of notices, with one of the three notices used twice in each round. The order and repetition of the notices were rotated among the participants so that the same notice was not always viewed twice. Participants answered additional questions about the notices and their attitudes on information sharing. The interview sought information about participants' choice of a bank based solely on the notice content; responses to factual questions, such as which of two banks shared more or whether any of the banks offered an opportunity to limit or opt out of sharing; performance of a task, such as determining which bank shared more after exercising all options to limit or opt out of sharing; and responses to questions about their attitudes toward the use and sharing of their information. <u>See</u> Macro Report, <u>supra</u> note 34, Appendix A.

38 <u>See</u> <u>http://www.ftc.gov/privacy/privacyinitiatives/Levy-Hastak-Report.pdf</u>.

39 <u>See</u> <u>http://www.sec.gov/comments/s7-09-07/s70907.shtml</u>.

The Levy-Hastak Report examined two measures on how effectively the notices communicated information: (1) judgment quality; and (2) perceptual accuracy.[40] According to the Report, judgment quality focused on the extent to which study participants could provide logical, defensible reasons for choosing one bank over the other based solely on the notice. Perceptual accuracy focused on the ability of the participants to recognize accurately the differences between the banks in information collection and sharing practices, in opt-out choices, and in relative sharing after all opt-out choices were exercised.[41]

The Levy-Hastak Report concluded that, overall, the Table Notice outperformed the other notices.[42] The Table Notice performed particularly well on difficult tasks[43] while the Current Notice performed poorly on all measures. While the Sample Clause Notice performed well on simple tasks, about equal to the Table and Prose notices, it performed significantly less well than the Table Notice on measures of judgment quality.[44] The Report concluded that the table format is likely a key explanation for the improvement in comprehension demonstrated by the study participants who saw the Table Notice as compared to those who saw the other notice styles – especially for difficult perceptual accuracy tasks.[45]

While the notice format significantly affected participants' ability to comprehend and compare the notices, the testing showed that participants' general attitudes about the sharing of their personal information were not affected by the notices they saw.[46] Following the two rounds of questions on the content of, and comparison between, the

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40 Levy-Hastak Report at 7-14.

41 Id. at 4-5.

42 Id. at 16.

43 Id. at 17. According to the Report, an example of a difficult task was: participants were asked to assume that they had limited or opted out of all possible sharing for both banks; based on that assumption, respondents were asked whether one bank shared more personal information than the other or whether both banks shared information equally. An example of an easy task was: using the notice, participants were asked to identify how they could tell the bank that they wanted to limit or opt out of sharing personal information.

44 Levy-Hastak Report at 9-10.

45 Levy-Hastak Report at 17.

46 Id. at 15.

notices, the study participants were asked to rate their attitudes in general toward information sharing, for example, sharing with affiliated banks and with nonaffiliated banks. The results showed that participants' attitudes were about the same across the four notice formats.[47]

The Levy-Hastak Report analyzed two specific areas where the Table Notice seemed to perform less well than the other notices. First, the Report described an anomaly with respect to responses to the question [Q. 19/30]: "Which of these two banks gives you the opportunity to limit or to opt out of the sharing of your personal information?"[48] Generally participants identified the bank or banks that provided an opt-out. However, some participants who saw the Table and Prose notices selected Mars Bank, the one that shared the least and offered no opt-out option. Because answering "Mars Bank" was identified as an incorrect answer, the Current and Sample Clause notices out-performed the Table and Prose notices on this question.

In contrast, the Table and Prose notices out-performed the other two notices on the most difficult task in the test. In this task, participants were asked to assume that they had exercised all possible options to limit or to opt out of sharing and then to identify which bank shared more. Here, the Table and Prose notices significantly out-performed the other notices. More participants who saw the Table and Prose notices correctly gave as their answer the higher sharing bank. This result suggests that participants who saw the Table and Prose notices did understand which bank(s) offered an opportunity to limit or to opt out of their sharing.

In analyzing this discrepancy, the Levy-Hastak Report observed that the simpler question had two different, yet accurate, responses, depending on how participants interpreted the question. Some of the participants might have understood the question to apply at the point of *choosing between* the two bank notices; those participants selected the lower sharing bank. In contrast, other participants might have understood the question to mean: which bank lets me opt out of sharing personal information once I am doing business with the bank. The second interpretation was the intended

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47 Id. Study participants generally did not like their information being shared with either affiliates or with nonaffiliates.

48 See id. at 12-14.

meaning of the question. Drs. Levy and Hastak hypothesized that some participants who saw the Table and Prose notices understood the question to have the first meaning, while other participants, particularly those who saw the Sample Clause and Current notices, understood the question to have the second meaning.[49]

To test this hypothesis, Drs. Levy and Hastak examined the pattern of factual mistakes that participants made when they answered a separate set of questions.[50] There, study participants were asked in Q. 16/27 why they preferred one bank over the other, based solely on the notice. Some participants who selected a bank that shared relatively little information and did not offer an opt-out stated that this bank offered more opportunity to limit or to opt out of sharing than the higher sharing bank, which was labeled a "false opt-out mistake" in the Report. The Report found that participants who saw the Table and Prose notices were on average almost three times as likely to make the false opt-out mistake as those who saw the Current and Sample Clause notices.[51]

This finding supports the hypothesis that users of the Table and Prose notices who selected the lower sharing bank in response to Q. 19/30 understood the question in its first meaning: they selected a bank that gave them an opportunity to limit or opt out of sharing at the time of *choosing between* the two bank notices. Under that interpretation, these participants could limit sharing by selecting the bank that shared less information. Thus the Levy-Hastak Report's analysis of the false opt-out mistake pattern in Q. 16/27 is consistent with their hypothesis regarding the responses to Q.

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49 Significantly, unlike the Sample Clause and Current notices, neither the Table nor the Prose notice uses the word "opt-out" in the model form; rather, these forms refer to "limiting sharing." This word choice was intentional to help consumers understand that some sharing is necessary and that consumers cannot stop all sharing – a concept that consumers who knew the term equated with "opt-out." See Kleimann Report, supra note 32, at 101-108. Because the Table and Prose notices did not use the word "opt-out," participants using these notices did not have that word as a visual "cue" when they were asked the question.

50 The Report also examined a second mistake: where participants selected the lower sharing bank when they were asked to identify which bank shared more (labeled a "false sharing mistake"). See Levy-Hastak Report at 9. In that case, there was not an unusual pattern in the distribution of responses. Rather, the Report found that the study participants who made this mistake were equally distributed across all four notice styles. Id. at 13.

51 Id.

19/30. In addition, the Report found that the educational level of the study participants produced a significant effect only on the responses to the opt-out question, with better educated participants more likely to answer the question in the intended manner.[52] This finding is also consistent with the Report hypothesis that participants who saw the Table and Prose notices understood the question in two different, yet equally correct ways, unlike those who saw the Sample Clause and Current notices.

The Table Notice also seemed to perform less well in a second, unrelated area. Specifically, all the test notices provided only two methods for consumers to opt out of or limit sharing: use of a toll-free telephone number or access to the opt-out on the institution's Website. When study participants were asked to identify which contact modes were identified in the notice as ways to limit or opt out of sharing, they correctly identified the two modes more frequently when using the Sample Clause Notice than the Table, Prose, and Current notices.

Noting that this type of question appears to invite skimming the notice to find the answer quickly and easily, the Levy-Hastak Report examined the great variability in notice length and found that the Sample Clause Notice was significantly shorter than any of the other notices. The Levy-Hastak Report observed that the shortness of the Sample Clause Notice may have made it easier for participants to scan the notice and find the answer to this question. The Report opined that notice length likely has an effect on scanability and reading ease.[53]

While the Levy-Hastak Report findings confirmed the overall effectiveness of the Table Notice,[54] the Report's analysis prompted the Agencies to consider a further refinement to the proposed model form. The change, discussed in more detail later,

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52 Id. at 13-14.

53 Levy-Hastak Report at 14. In addition, the use of check boxes in the design of the opt-out section of the Table and Prose notices (a carry-over from the original mail-in format of the proposed model form) appeared to confuse some participants when they were asked this question. The responses recorded for these two notices reflected a somewhat higher number of "other" responses, even though all the notices offered the same two options. Macro reported anecdotally that a number of participants who viewed the Table and Prose notices reported "check this box" as one of the methods offered to opt out or limit sharing – a response that was recorded as "other."

54 Id. at 17.

was to modify the opt-out section of the model form to place the opt-out information on page one directly following the disclosure table so that all the key information appears on that page.[55] The Agencies considered this change to facilitate quick scanning for important information without sacrificing the model form's performance in other respects. To ensure that locating the opt-out information on page one worked from a usability perspective, the Agencies decided to conduct validation testing which led to separate formats for the telephone and Internet opt-out and for the mail-in opt-out that the Agencies are adopting.

E. Public Comments on the Quantitative Test Data

Nine commenters representing insurance, securities, and financial services associations, a bank, and two investment advisers submitted comments in response to the SEC's solicitation for public comments on the quantitative testing. Most of the commenters re-stated their earlier general objections to the proposed model form. These concerns are addressed in section III.

All but one of these commenters made general observations about the quantitative test methodology and the Levy-Hastak Report. Five commenters observed that the test notices were designed for banks and not for insurance companies or securities firms (i.e., broker-dealers, investment companies, or SEC-registered investment advisers), thereby omitting a significant portion of the financial services industry that provide these notices.[56] Two commenters opined that the study participants' demographic characteristics did not reflect those consumers who will receive financial privacy notices.[57] One expressed concern about the demographic diversity in the mall selections and questioned whether there was consistent coding of

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55 Some commenters had urged the Agencies to consolidate the model form on two sides of a single piece of paper, and a few suggested that the Agencies consider moving the opt-out to page one. See, e.g., comment letters of Securities Industry and Financial Markets Ass'n (May 29, 2007); World's Foremost Bank (May 25, 2007); World Financial Network National Bank (May 29, 2007); World Financial Capital Bank (May 25, 2007).

56 See comment letters of American Council of Life Insurers (May 20, 2009), National Ass'n of Mutual Insurance Cos. (May 20, 2009), American Insurance Ass'n (May 20, 2009), Investment Adviser Ass'n (May 20, 2009), The Financial Services Roundtable and BITS (May 20, 2009).

57 See comment letters of National Ass'n of Mutual Insurance Cos. (May 20, 2009); The Financial Services Roundtable and BITS (May 20, 2009).

the open-ended responses.[58] One commented that the testing criteria ruled out non-English speaking participants.[59]

Some of the commenters disagreed with the Levy-Hastak Report's conclusion that the Table Notice outperformed the other notice formats. They opined that the Report's conclusion is flawed because: (1) the Sample Clause Notice did better on simpler tasks than the Table Notice;[60] (2) the anomalies discussed in the Levy-Hastak Report may be due to other explanations;[61] and (3) while the Table Notice's overall performance was better than the other notices, actual performance accuracy was relatively low.[62] Several commented that the overly simplified and inflexible format of the Table Notice is not a true test of consumers' understanding of institutions' actual collection and disclosure practices.[63] In addition, all commenters on the quantitative testing urged retention of the Sample Clauses and related safe harbor.

The test notices for the quantitative study were created for fictitious banks, even though the model form can be used by any financial institution subject to the GLB Act and the privacy rule. Because the vast majority of consumers are familiar with or have

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58 See comment letter of The Financial Services Roundtable and BITS (May 20, 2009).

59 See id. The Agencies used a single form, printed in English, for simplicity in conducting the testing. We recognize that institutions can and do provide notices in a variety of other languages when their customers are non-English speaking. We anticipate that those institutions that use the final model form will continue to provide their notices in other languages to ensure that their non-English speaking customers can read and use the form. See also Transcript of Get Noticed Workshop, available at http://www.ftc.gov/bcp/workshops/glb/GLBtranscripts.pdf, comments of Irene Etzkorn (recognizing that banks do provide financial privacy notices in languages other than English); comments of Tena Friery (noting that the Privacy Rights Clearinghouse promotes notices and educational materials in other languages and that 80-100 different languages are spoken in Los Angeles alone).

60 See comment letters of American Insurance Ass'n (May 20, 2009); National Ass'n of Mutual Insurance Cos. (May 20, 2009). While some commenters find greater virtue in the better performance of the Sample Clause Notice on only the simpler tasks or disagree with the Levy-Hastak Report's analyses, the evidence is compelling that the Table Notice performed better overall across all comprehension and comparison measures. See Levy-Hastak Report at 6.

61 See comment letter of American Council of Life Insurers (May 20, 2009).

62 Id.

63 See, e.g., comment letter of The Financial Services Roundtable and BITS (May 20, 2009).

experience with a bank, the Agencies used a notice designed for a bank to increase the likelihood that most of the test participants could readily understand the terms in the notice, such as "account balances," "income," or "credit history," which describe information collected and shared by many banks, as well as by many other financial institutions.

The Macro Report presented data on the demographic characteristics of the study participants recruited for the study. Participants at each mall were pre-selected for a representative mix based on gender, age, and education levels, and information on participants' race/ethnicity, income, and household size was obtained at the end of each interview.[64] Since a significant majority of consumers in America receive a financial privacy notice – including from banks, credit unions, securities firms, insurance companies, auto dealers, debt collectors, and payday lenders – the Agencies wanted to ensure that a representative cross-section of consumers be included in the study.

The Agencies hired Macro as an outside independent expert to handle all aspects of the collection and reporting of the study data. Macro conducted all training of field staff, implemented a series of checks to ensure greater accuracy of the study data, reviewed, on an ongoing basis, all daily downloads of data from the field, and coded all of the open-end responses.[65]

With respect to the comment that the accuracy of the study participants' responses overall was relatively low, the commenter cited the judgment quality measure of the participants' fact-based reasons for choosing the lower sharing bank.[66] While the results showed that most consumers likely have a limited understanding of information sharing practices after a brief exposure to any of the notice styles, nevertheless the Levy-Hastak Report confirms that overall the Table Notice out-performed the other notices and is the most effective notice of all the privacy notices tested.

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64 Macro Report, supra note 34, at 3 & Appendix B; Levy-Hastak Report at 2.

65 Macro Report, supra note 34, at 3-4.

66 The commenter looked to the Table Notice score of 40.6% in Table 1 of the Levy-Hastak Report. Levy-Hastak Report at 12. This data evaluated how well study participants could explain their reasons for preferring one bank notice over another where they selected, as their preferred bank, the lower sharing bank. While the commenter pointed to a single measure in the Levy-Hastak Report, the Report relied on a number of accuracy measures that varied in difficulty level. See, e.g., id., Table 3 at 12.

Finally, two commenters requested that if both the model privacy form and the SEC's proposed amendments to its privacy rule, Regulation S-P, were adopted, the SEC should coordinate the compliance dates so as to minimize the compliance burden and the potential for multiple revisions of an institution's privacy notice.[67] The SEC appreciates institutions' desire to minimize revisions to their privacy notices and reduce the costs of compliance with its rules. However, the model privacy form the Agencies are adopting today is just that – a model – and no institution is required to use the model form. A financial institution that intends to use the model privacy notice and minimize potential costs, if any, related to revising its privacy notices in light of amendments to Regulation S-P could begin to use the model form after the compliance date of any final amendments to Regulation S-P.

F. <u>Validation Testing</u>

In revising the model form based on public comments and findings from the Levy-Hastak Report, the Agencies streamlined the form to consolidate the information on the front and back sides of a single piece of paper and moved the opt-out information to the bottom of page one. In December 2008, the Agencies engaged Kleimann to conduct validation testing to confirm that these changes would not affect the comprehension, usability, and design integrity of the model form. In particular, Kleimann's new research focused on the placement of the opt-out information on page one. Kleimann conducted targeted in-depth interviews in January and February 2009 to test, revise, and re-test the model form. On February 12, 2009, Kleimann submitted a report to the Agencies, "Financial Privacy Notice: A Report on Validation Testing Results," with a revised opt-out form recommendation ("Kleimann Validation Report").[68]

The validation testing examined various formats for displaying opt-out information where the opt-out methods are by toll-free telephone number,[69] the Internet, or a mail-in

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67 <u>See</u> Part 248-Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Personal Information, Securities Exchange Act Release No. 57427, Investment Company Act Release No. 28718 (Mar. 4, 2008) [73 FR 13692 (Mar. 13, 2008)]. <u>See also</u> comment letters of American Council of Life Insurers (May 20, 2009) and Investment Advisers Ass'n (May 29, 2007).

68 <u>http://www.ftc.gov/privacy/privacyinitiatives/validation.pdf</u>.

69 <u>See</u> section __.7(a)(2)(ii)(D) of the privacy rule.

form. The validation testing confirmed the usability of the following changes to the proposed model form: (1) inserting a new box titled "To limit our sharing" below the disclosure table to inform consumers how they can limit sharing, such as by a toll-free telephone number or online; (2) replacing the "Contact Us" box with a box titled "Questions" following the "To limit our sharing" box; and (3) as applicable, inserting a mail-in form at the bottom of the page, which would require a longer piece of paper.[70]

III. THE FINAL MODEL PRIVACY FORM

A. Standardization

Like the proposed model privacy form, the final model form uses a standardized format. Some industry commenters expressed support for the standardized format, with one noting that standardized notices would serve as an effective means of allowing consumers to understand in a simple manner companies' information practices.[71] Another commenter pointed to the success of the "Schumer box," a standardized format that makes the disclosure of credit card terms more accessible to consumers.[72]

Privacy and advocacy groups and NAAG supported the proposed standardized format, recognizing the important findings of the research and the model form's structure – in particular the elements on page one – as benefiting both consumers and companies by making the disclosure information accessible.[73]

A number of industry commenters, however, objected to the standardized form, asserting variously that: it causes confusion; because it is an abrupt change in the way

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70 Kleimann Validation Report, Appendix E. The Kleimann Validation Report found that the information for telephone or Internet options could be readily displayed on a standard 8½ x 11-inch page, but the addition of a mail-in form required a longer piece of paper.

71 Comment letter of The Direct Marketing Ass'n (May 29, 2007) (commenting that it has an automated software program that allows companies to create a customized privacy notice in a standardized format).

72 See comment letter of Capital One Financial Corporation (May 29, 2007); see also 12 CFR 226.5a(a)(2)(i)-(ii).

73 See, e.g., comment letters of Center for Democracy and Technology (May 29, 2007); National Ass'n of Attorneys General (June 14, 2007); Privacy Rights Clearinghouse (May 16, 2007). See also The Center for Information Policy Leadership (May 29, 2007) (recognizing that the proposed model form addresses the requirements of the GLB Act and that the research provided insight into what effectively communicates to consumers, including "important information about how people learn about privacy, about the use of tables to facilitate comparisons across companies, and about the need to inform consumers about why they are receiving a privacy notice").

information-sharing practices are disclosed, it could cause consumers to believe that the institution is changing its policies; because the model form has too much boilerplate, it detracts from the ability to compare policies; and it makes the notice less clear. Others stated that the standardized form is too inflexible and does not accurately reflect institutions' financial practices or accurately describe the scope of consumers' rights. Several stated that the model form language does not adequately capture the complex privacy policies and practices of many institutions.

Based on the statutory requirement that the Agencies propose "a model form," the final model privacy form utilizes a standardized format.[74] Moreover, as more fully discussed in the preamble to the Proposed Rule, the Agencies' research supports uniform disclosures to help consumers better understand companies' information sharing practices.[75] We reaffirm that use of the model form is voluntary; institutions are not required to use it.

B. Instructions for Use

The General Instructions to the Model Privacy Form require that no additional information – other than what is specifically permitted – may be included in the model form in order to obtain the benefit of the safe harbor.[76]

A number of industry commenters objected to the Agencies' statement in the preamble to the Proposed Rule that the model form should not be incorporated into any

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74 Cf. Press Release, U.S. House of Representatives, Committee on Financial Services, Financial Services Committee Democrats Call for Simplified Privacy Notices, (July 25, 2003) available at: http://financialservices.house.gov/pr062503.html.

75 See Proposed Rule, supra note 4 at text accompanying n.30. See also Janice Tsai, Serge Egelman, Lorrie Cranor, and Alessandro Acquisti, "The Effect of Online Privacy Information on Purchasing Behavior: An Experimental Study," The 6th Workshop on the Economics of Information Society (WEIS) (June 2007) http://weis2007.econinfosec.org/papers/57.pdf (more accessible privacy information reduces information asymmetry between the merchant and the consumer as to the use of consumers' personal information; aids consumers in making informed choices; and demonstrates that consumers tend to purchase from merchants offering more privacy protection, including paying a premium for such a purchase).

76 See Instruction C to the Model Privacy Form.

other document.[77] Some expressed concern that this would require the notice to be mailed separately.[78] Several commenters stated that a private label or co-branded credit card application incorporates the lender's privacy policy into a brochure with a tear-off application to make it easier for the store clerks to provide all required information in a single document.[79] Others observed that the privacy notice is typically included in a single document with other important reference information.

Recognizing these concerns, the Agencies agree that institutions may incorporate the model form into another document, but they must do so in a way that meets all the requirements of the privacy rule and the model form instructions, including that: the model form must be presented in a way that is clear and conspicuous;[80] it must be intact so that the customer can retain the content of the model form;[81] and it must retain the same page orientation, content, format, and order as provided for in this Rule.

C. Format of the Notice

In response to numerous comments relating to the format of the proposed model form, the Agencies have revised certain of the requirements relating to paper size, orientation, number of pages, type size, and color and logo placements, as discussed below.

Paper Size: To allow institutions greater flexibility, the final model privacy form may be printed on paper the size of which must be sufficient to meet the layout and

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77 See, e.g., comment letters of American Council of Life Insurers (May 29, 2007); Investment Company Institute (May 29, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007).

78 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); American Insurance Ass'n (May 29, 2007) Visa U.S.A, Inc. (May 29, 2007).

79 See, e.g., comment letters of Consumer Bankers Ass'n (May 29, 2009); National Retail Federation (May 29, 2007).

80 The term "clear and conspicuous" is defined in the privacy rule at section __.3(b), SEC section 248.3(c), and includes as a requirement that the notice be designed to call attention to the nature and significance of the information in the notice. In addition, the privacy rule requires that consumers should reasonably be expected to receive the notice. See section __.9 of the privacy rule.

81 Institutions that incorporate the model privacy form into other documents must take care that the customer's execution of other forms in the document will leave the model form intact.

minimum font size requirements with sufficient white space on the top, bottom, and sides of the content.[82] Many industry commenters objected to the proposed requirement that the model form appear on 8½ by 11-inch size paper.[83] Commenters stated that the proposed model form would require significant materials, postage, and production costs. Industry commenters explained that institutions use a variety of sizes and styles to present their privacy notices. Some institutions – particularly credit card institutions – enclose their privacy notices with a billing or periodic statement or a bankcard carrier. Envelopes for certain of these statements or for multi-panel formats are smaller than 8½ inches and may not accommodate the proposed size.

The Agencies have reviewed numerous financial institution privacy notices over the past eight years, many of which are printed on smaller-sized paper in a multi-panel, multi-fold display. The density of the small-font text, in addition to the complex legal language, make these notices very difficult to read or understand.[84] The final requirement for paper size is designed to provide financial institutions with some flexibility, while prohibiting a paper size that is too small to accommodate the font and orientation requirements in the model form set forth below.

Orientation: Like the proposed model form, the final model privacy form must be printed in "portrait" orientation. Some institutions objected to this orientation, suggesting instead that institutions be permitted to design their own model form in other orientations, such as the commonly-used multi-fold display.[85] According to these

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82 See Instruction B to the Model Privacy Form. The Agencies understand that most privacy policies provide for opting out by toll-free telephone or on the Internet. The paper size for those policies will likely be about 8½ x 11 inches. However, for those institutions that provide a mail-in opt-out form, the paper size will likely need to be longer, around 8½ x 14 inches, in order to accommodate the mail-in form.

83 See, e.g., comment letters of Consumer Bankers Ass'n (May 29, 2007); American Bankers Ass'n (May 25, 2007); Bank of America Corporation (May 29, 2007); Independent Community Bankers of America (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007); Investment Company Institute (May 29, 2007); National Retail Federation (May 29, 2007); National Ass'n of Mutual Insurance Cos. (May 29, 2007); Credit Union National Ass'n (May 29, 2007).

84 See supra notes 24-25 and infra note 95.

85 See, e.g., comment letters of National Retail Federation (May 29, 2007); Investment Advisers Ass'n (May 20, 2009); American Bankers Ass'n (May 25, 2007); Credit Union National Ass'n (May 29, 2007). Some of these commenters pointed to the preamble

commenters, this landscape format has three or more "pages" of text visible on each side of the paper when the notice is fully opened. The size of the paper varies considerably, with some as small as approximately 7 by 11 inches before it is folded. In such a display, each "page" is approximately 3⅓ by 7 inches – considerably smaller than can accommodate the model form.[86]

The design of the model form does not lend itself to a multi-panel display. The utility of the form's design for reading ease depends in large measure on both larger, more readable type size and how the content is presented. While one commenter objected to the "significant empty space" in the model form,[87] the guidance from communications experts and form designers is that appropriate white space between the text and margins, as well as the use of headings and bullets, make a more effective, readable notice.[88] The table – the heart of the model form – cannot be squeezed into a tighter space or so reduced in size as to make it virtually unreadable. For these reasons, the Agencies do not agree that the orientation of the model form should be altered to accommodate a multi-panel display.

Number of Pages: In response to numerous commenters, the instructions to the final model privacy form permit the form to be printed on two sides of a single piece of

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language in the final privacy rule which states: "The Agencies believe that in most cases the initial and annual disclosure requirements can be satisfied by disclosures contained in a tri-fold brochure." 65 FR 33 646, 33662 (May 24, 2000) (FTC); 65 FR 35162, 35175 (June 1, 2000) (banking agencies); (Regulation S-P) 65 FR 40334, 40347 (June 29, 2000) (SEC). This statement was written in 2000 before the Agencies or institutions had any experience with the GLB Act privacy notices. In the intervening period, both the Agencies and institutions have learned much through their own testing about improved notice design and consumer comprehension. The impetus for the Agencies' consumer research, borne out by the research findings, is that the current notices, including those utilizing multi-fold formats, are not effective. Moreover, the important information on page one of the model form – including the context information and disclosure table – could not be appropriately displayed in such a cramped format and still comply with the minimum space and font requirements of the model form.

86 Examples provided by commenters included: 3.5 x 7.5 inches, printed double sided; 3.5 x 8; 7x10.812 inches folded to 7 x 3.625 inches; 7 x 3.5 inches (finished folded size). See, e.g., comment letter of National Retail Federation (May 29, 2007).

87 See comment letter of Consumer Bankers Ass'n (May 29, 2007).

88 See supra note 25.

paper or on two single-sided sheets.[89] By incorporating the opt-out information on the bottom of page one, the revised model form may now appear on the front and back of a single piece of paper.

Industry commenters generally objected to the proposed requirement that the model form be printed only on one side of a page.[90] Many raised environmental concerns and the increased costs associated with printing the notice on multiple pages.

While the proposed single-sided model form was based on the initial consumer research and testing, the Agencies believe that the concerns expressed by commenters justify double-sided printing. Moreover, the Agencies used double-sided printed notices in the quantitative and validation testing, with no demonstrable loss in effectiveness relative to the single-sided notice.[91]

D. Appearance of the Model Privacy Form

The Regulatory Relief Act requires that the model form "use an easily readable type font." While a number of factors affect the readability of a document, as in the proposal, the final model privacy form must use: (1) 10-point font as the minimum font size (unless otherwise specified in the Instructions) and (2) sufficient spacing between the lines of type (leading).[92]

The Agencies separately provided optional guidance in the preamble to the Proposed Rule on readable type styles and other formatting suggestions for institutions. This optional guidance is not required; it was to assist institutions that want to provide more readable and attractive privacy notices to consumers. The Agencies are republishing this optional guidance in section III.E to assist interested institutions.

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89 See Instruction B.2 to the Model Privacy Form.

90 See, e.g., comment letters of American Insurance Ass'n (May 29, 2007); Bank of America Corporation (May 29, 2007); Citigroup Inc. (May 30, 2007); National Retail Federation (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007).

91 See Levy-Hastak Report at 15.

92 While a variety of type styles would be suitable for the model notice, the Agencies caution institutions that use of idiosyncratic fonts or highly stylized typefaces will not meet the model form safe harbor standard. See Instruction B.3(a) to the Model Privacy Form.

Type Size: A number of commenters expressed various concerns about the proposed 10-point minimum font requirement.[93] A few commenters noted that the proposed model form included several different type sizes for various parts of the model form and were confused about what type size(s) the Agencies proposed as a requirement.[94] Other commenters raised concerns that a minimum type size requirement for the model form would conflict with state law mandated requirements. A few stated that a minimum font size is not legally required for the model form.

Many of the criticisms about current notices are, in part, about the tiny print that make these notices so difficult for consumers to read.[95] Based on the statutory directive, as well as the findings elicited from the Agencies' consumer research and expert views, the Agencies believe that the model form should have a minimum 10-point font. Requiring a minimum 10-point font is consistent with state law mandates for consumer disclosures.[96]

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 these circumstances, the ascenders (such as the upward line in the letter "h") and descenders (such as the

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93 See, e.g., comment letters of American Council of Life Insurers (May 29, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007); National Retail Federation (May 29, 2007); Financial Services Roundtable and BITS (May 29, 2007).

94 The type size information in Example 3 in the preamble to the Proposed Rule identified the five type sizes used in various elements of the proposed form. This example was intended solely to show how key features of the form – such as headings – can be distinguished by using different font sizes to make the form more visually appealing. Contrary to some commenters' assumption, the different sizes were not a proposed requirement for users of the model form.

95 See Kleimann Report, supra note 32, at 33. See also, e.g., Public Citizen Petition, supra note 24 at 7 ("[S]mall font sizes...deprive consumers of their right to prevent financial institutions from sharing private information."); "UNDERSTANDING THE FINE PRINT: How to make sure the gotchas don't get you," Consumer Reports Money Adviser (Oct. 2008) ("Fine print is everywhere - contracts; retail Web sites; sales receipts; print, broadcast, and Internet offers; prospectuses; privacy notices; product manuals; and manufacturer warranties."); David Colker, "Stopping junk mail for living and dead; Opt-outs can slow the torrent of solicitations to computer and postal mailboxes and phones;" Los Angeles Times, July 22, 2007, at C3 ("[B]y law, financial institutions have to offer an opt-out if they are making this data available to non-affiliated businesses. The problem is that their guides to opting out are often contained in their privacy notices – in small print.").

96 See, e.g., Cal. Fin. Code div. 1.2 § 4053(d)(1)(B) (requiring 10-point minimum font).

downward line in a "g") may touch, blending the lines of type and making it much harder to distinguish the letters on the page. The final instructions to the model form require only that the leading used allow for sufficient spacing between the lines, but do not mandate a specific amount.

E. Optional General Guidance for Easily Readable Type

The Proposed Rule included optional guidance on readable type styles and other formatting suggestions for institutions that want to provide privacy notices that are more readable and attractive to consumers, as well as those that want to develop their own model privacy form.[97] A number of commenters were concerned by this guidance for easily readable type, and in some cases, they assumed the guidance would be mandatory. The Agencies expressly state that the guidance in this section III.E. is not mandatory and is not a requirement for proper use of the model form.

In more closely examining the statutory directive for "easily readable type," the Agencies determined that a number of type-related factors can greatly affect the readability of a form. Type size, type style, leading, x-height, serif versus sans serif,[98] upper and lower case type, along with the page layout — together play an important role in designing a typeface that is highly readable. Therefore, in considering these various factors for the design of an easily readable type font, institutions that elect to use the model form may voluntarily consider this additional guidance for an easily readable appearance to the notice.

Leading: Research on the legibility of typography indicates that people read faster when text is set with 1 to 4 points of leading.[99] Institutions may, but are not required to, consider 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.[100]

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97 See Proposed Rule, supra note 4, at section II.F.

98 Serif typeface has small strokes at the ends of the lines that form each letter. Sans serif typeface does not have those small strokes.

99 KAREN A. SCHRIVER, DYNAMICS IN DOCUMENT DESIGN ("SCHRIVER") 274 (1997).

100 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).

Type style and "x"-height: 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.

Experts differ on the question of the most desirable type style. The model form uses sans serif and "monoweight" type, and upper and lower case lettering in the body of the form.[101]

Larger x-height[102] 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-heights during the normal reading process, so that is where the primary identification of each letter takes place."[103] Generally, a font with an x-height ratio of around .66 is easier to read.[104]

While not mandating a particular type style or x-height, 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.[105]

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101 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 online. These changes in Web design are also beginning to affect font styles in printed materials. Some typography designers are now using sans serif typefaces, as well as type with a uniform thickness throughout the letter (monoweight typeface), finding these typefaces easier to read than those with variable thickness.

102 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.

103 ERIK SPIEKERMANN & E.M. GINGER, STOP STEALING SHEEP & FIND OUT HOW TYPE WORKS 93 (1993).

104 See, e.g., Hewlett-Packard Corporation, Panose Classification Metrics Guide (2006), available at http://www.monotypeimaging.com/productsservices/pan2.aspx.

105 See SCHRIVER, supra note 99, at 264; see also id. at 258-59. Fonts that satisfy the type style and x-height recommendations include sans serif fonts such as Tahoma, Century Gothic, Myriad, Avant Garde, Bk Avenir Book, ITS Franklin Gothic, Arial-Helvetica, and Gill Sans, and serif fonts such as the Chaparral Pro Family, Minion Pro, Garamond, Monotype Bodoni, and Monotype Century. A number of these font styles, including Arial-Helvetica, Tahoma, Century Gothic, Garamond, and Bodoni, are preloaded in commonly used word processing applications with most new personal computers. The other font styles are commercially available as well.

For ease of reference, the following table summarizes the optional guidance discussed here. None of the standards in the table below is mandatory; rather, the information in the table is offered only as suggestions for institutions that design their own forms.

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)

F. Printing, Color, and Logos

We are adopting the requirements for printing, color, and logos in the final model form as proposed. Commenters generally commended the Agencies' support for the use of color and company logos on the model form.[106] A few industry commenters expressed concern about the background shading in certain headers smudging in high speed printing operations.[107] Some commenters sought clarification as to whether logos can use more than one color.

The Agencies agree that the distinguishing features of company logos along with color are important to ensure that an institution's documents have a distinctive look that consumers may readily recognize. As the Agencies proposed, a financial institution that uses the 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

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106 See, e.g., comment letters of American Insurance Ass'n (May 29, 2007); National Ass'n of Mutual Insurance Cos. (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007); Consumer Bankers Ass'n (May 29, 2007).

107 See, e.g., comment letters of National Business Coalition on E-Commerce and Privacy (May 30, 2007). With the modern, high-speed printing equipment readily available, the Agencies do not foresee problems with re-producing background shading, just as they see no difficulties with printing blocks of color for company logos or advertising materials. Moreover, the validation testing research found that consumers appreciated shading as a navigation guide. See Kleimann Validation Report at 9-10.

constraints of each page. Institutions using the model form should 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 are not prohibiting the use of more than one color in a logo.

Other commenters asked for greater flexibility to include "markings" or "graphics" or other "visual effects" or to include a "branding phrase" or "advertising slogan."[108] The Agencies observe that few institutions' privacy policies include advertising slogans. We note that some include pictures or other large designs that occupy the front cover. The Agencies believe that these designs or slogans would distract from the content of the model form and that slogans would be inconsistent with the standardized language throughout the form. For these reasons, the final model form does not permit institutions to include slogans or images (other than logos) on the model form.

G. Jointly-Provided Notices

The final model privacy form includes a new FAQ at the top of page two: "Who is providing this notice?" Many commenters representing larger institutions observed that the proposed model form did not provide sufficient space to identify multiple entities that jointly provide a privacy notice, as permitted by the privacy rule.[109] Some suggested the Agencies provide extra space for this information either in the body of the notice or as a footnote. The new FAQ is not required where only a single financial institution is providing the notice and that institution is identified in the title. As discussed in section III.J.1, space is provided for the institution's response.

H. Use of the Form by Differently-Regulated Entities

A number of commenters sought clarification as to whether institutions regulated by different Agencies could together provide a single joint notice to consumers.[110]

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108 See, e.g., comment letters of Consumer Bankers Ass'n (May 29, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007).

109 See, e.g., comment letters of American Council of Life Insurers (May 29, 2007); Investment Advisers Ass'n (May 29, 2007).

110 See, e.g., comment letters of National Business Coalition on E-Commerce and Privacy (May 30, 2007); T. Rowe Price Associates, Inc. (May 29, 2007); Financial Services Roundtable and BITS (May 29, 2007); National Ass'n of Mutual Insurance Cos. (May 29, 2007); Investment Company Institute (May 29, 2007).

Insurance companies and their associations in particular expressed concern that the form did not allow for insurance-specific terminology and potentially put these institutions – regulated by the states – at some risk.[111]

The Agencies fully intend that differently-regulated entities can provide a single joint notice to consumers by using the final model form. The Agencies have consulted with the NAIC, which submitted a letter with proposed modifications to certain sections of the form. The Agencies have incorporated into the final model form two menus of terms adaptable to the wide range of financial institutions. The menus include both the SEC's and the NAIC's proposals, and enable a variety of institutions, including securities firms and insurance companies, to use the model form, either individually or jointly with other types of financial institutions.

I. Page One of the Model Form

1. Title

The Agencies are adopting the title, "What Does [Name of Financial Institution] Do With Your Personal Information?," as proposed. One commenter objected to the title, preferring instead to refer to it as a privacy notice.[112] Other commenters who provided sample revised notices also used alternate headings, such as, "our privacy notice for consumers," "privacy information," "privacy statement," and "keeping your information safe and secure."[113] The research found that the terms "privacy notice" or

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111 See, e.g., comment letters of National Ass'n of Mutual Insurance Cos. (May 29, 2007); American Insurance Ass'n (May 29, 2007); Great-West Life & Annuity Insurance Company (May 29, 2007). In addition to including insurance-specific phrases in the menu of terms for the "What?" box on page one and the collection of information FAQ on page two, the Rule also recognizes that institutions that provide insurance products or services and elect to use this model form can use the word "policy" instead of "account" for the joint accountholder description. See Instructions C.2(g)(1) and C.3(a)(5) to the Model Privacy Form. The Agencies have periodically consulted with the NAIC to ensure that the final model form is sufficiently flexible to address the insurance marketplace. The NAIC is continuing to evaluate how best to proceed regarding insurance company use and implementation of the form by individual jurisdictions. This effort may include the NAIC developing a model bulletin for regulatory use or amending its model Privacy of Consumer Financial and Health Information Regulation to replace the current sample clauses with the new model privacy form.

112 See, e.g., comment letter of MasterCard Worldwide (May 29, 2007).

113 See, e.g., comment letter of Citigroup Inc. (May 309, 2007); Wells Fargo & Company (May 29, 2007); Wachovia Corporation (May 25, 2007); Sovereign Bank (May 21, 2007).

"privacy policy" deterred consumers from reading the notice.[114] Consumers understood these terms to mean that the institution does not share personal information. The validation testing confirmed the effectiveness of the title.[115]

2. Key frame

The Agencies are adopting the basic structure of the key frame as proposed with some language changes to address comments received. Industry commenters raised several objections to the key frame – the "Why?," "What?," and "How?" boxes. Their principal concern was the inflexible nature of the information in these boxes. Many commenters took particular issue with the list of information collected and shared, noting that not all institutions collect and share the information listed.[116] These commenters asked for greater flexibility in identifying other types of information that may better relate to their practices. Commenters raised other issues about: vocabulary; the contents and number of the boxes; and the inclusion of certain information not required by the privacy rule. Some commenters proposed moving and deleting phrases – as well as using the phrase "as permitted by law" to describe the types of sharing they can do. Some commenters raised questions about the reference to former customers.

The Agencies appreciate the various suggestions provided – particularly on vocabulary and the structure and contents of the boxes – but note that the model form was developed through consumer research with the goal of making it understandable to consumers. The Agencies have decided to retain the basic structure and content of the key frame but have made certain modifications.

The Agencies recognize that financial institutions may collect and share types of information other than those listed on the proposed form, including institutions that provide insurance or investment advice or sell securities. The Agencies have, after consulting with the NAIC and based on consideration of the comments received, provided a menu of terms, including each of the terms that was proposed, from which

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114 See Kleimann Report, supra note 32, at 43, 66-67.

115 Kleimann Validation Report at 8.

116 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); Investment Company Institute (May 29, 2007); Investment Advisers Ass'n (May 29, 2007).

institutions may select to fill in the bracketed boxes.[117] Since all financial institutions collect Social Security numbers, this one term is required in all notices. The terms provided are designed to reflect the range of information typically collected by various types of institutions in language that consumers can more easily understand.

Further, the Agencies have revised the statement about former customers to: "When you are no longer our customer, we continue to share information about you as described in this notice." While some institutions objected in principle to the statement that former customers are subject to the same policy as current customers,[118] no commenters asserted that institutions actually implement a different policy for former customers.[119]

3. **Disclosure table**

We are adopting the disclosure table substantially as proposed, with some minor changes. Consumer and other advocacy groups, the NAIC, NAAG, and some industry commenters appreciated the easily understood display of information in the disclosure table of the proposed model form. One commenter noted the strength of the Schumer box standardized format.[120] Others lauded the use of a tabular format to display a company's sharing practices, noting that framing one institution's practices against the industry as a whole is a useful way to inform consumers of a company's relative sharing practices and facilitates the comparison of different institutions' practices.[121]

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117 See Instruction C.2(b)(2) to the Model Privacy Form. Similar to the proposal, the final model form requires institutions to provide examples that may be applicable to the institution's collection and sharing practices.

118 See, e.g., comment letters of Investment Advisers Ass'n (May 29, 2007); American Insurance Ass'n (May 29, 2007).

119 This sentence continues to appear in the "What?" box in the model form without an opt-out. However, based on the validation testing, the opt-out versions of the model form place this sentence in the "To limit our sharing" box following the sentence describing sharing information about a new customer. See Kleimann Validation Report at 9-10.

120 Comment letter of Capital One Financial Corporation (May 29, 2007).

121 See comment letters of The Center for Information Policy Leadership (May 29, 2007); Independent Community Bankers of America (May 29, 2007).

A number of industry commenters and associations, including many small community banks and a few larger banks, also expressed support for the clarity and consumer-friendly format of the disclosure table.[122]

However, many industry commenters sought flexibility in the table design for several reasons. Some reported that it is common for a financial institution to have multiple privacy policies for different products that they offer consumers.[123] Others asserted that the table contains a bias against larger, more complex corporate structures because it is overly simplistic and may show that certain types of institutions engage in widespread sharing.[124] One opined that the table structure made it appear that the entity was reckless in its sharing practices.[125] These commenters expressed particular concern that the model form would lead to high opt-out rates.[126] Many particularly objected to listing all the categories of sharing – especially when a consumer cannot limit or opt out of certain types of sharing – and others wanted to limit the list only to those categories used by the institution.[127] Some commenters wanted to use this space to explain the benefits of certain types of sharing.[128] Others wanted to convey that, for example, they only shared information with certain types of affiliates but

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122 See, e.g., comment letters of Independent Community Bankers of America (May 29, 2007); Bank of Edison (May 21, 2007); Capital One Financial Corporation (May 29, 2007); Citrus & Chemical Bank (May 24, 2007); First National Bank (Edinburg, TX) (Apr. 9, 2007); Florence Savings Bank (April 30, 2007); Iowa State Bank and Trust Company (May 22, 2007); ShoreBank (Apr. 6, 2007); Hometown Bank (May 8, 2007).

123 See, e.g., comment letters of Bank of America Corporation (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007); Mastercard Worldwide (May 29, 2007).

124 See, e.g., comment letters of Citigroup Inc. (May 30, 2007); Consumer Bankers Ass'n (May 29, 2007).

125 See comment letter of Consumer Bankers Ass'n (May 29, 2007).

126 See, e.g., comment letter of Johnson Financial Group (May 14, 2007).

127 See, e.g., comment letters of Huntington National Bank (May 25, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007).

128 See, e.g., comment letter of Consumer Bankers Ass'n (May 29, 2007).

not others and asserted that the disclosure table did not permit them to make this distinction.[129]

As the Agencies stated in the preamble to the Proposed Rule, based on the Kleimann Report and as confirmed by the quantitative research data and the Levy-Hastak Report, the disclosure table is the heart of the model form design and its most effective feature.[130] The table provides for greater transparency of a company's sharing practices. It allows consumers to see at a glance the types of information sharing a company may engage in, whether that particular company shares in that way, and, if so, whether the consumer can limit such sharing.[131] Based on the research, the Agencies have retained the disclosure table generally unchanged in the final model form.

Addressing industry concerns about bias against larger institutions, the Agencies appreciate these institutions' concern that some of their customers may react negatively to the sharing of their information. The purpose of the model form is not to direct consumer behavior, however, but rather to provide information effectively. While the Levy-Hastak Report found that a majority of survey participants objected to the sharing of their personal information with affiliated companies, and more so with nonaffiliated companies, these objections were consistent across all the survey participants and were not affected by any particular notice format.[132] The research confirms that the notice design more clearly informs consumers about how each company shares or uses the personal information it collects.

During the course of this project, the Agencies heard from smaller institutions that their customers wanted to stop all sharing and expressly asked for opt-outs even when the institution engaged in only limited sharing under the section __.14 and __.15

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129 <u>See</u>, <u>e.g.</u>, comment letters of American Council of Life Insurers (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007); American Insurance Ass'n (May 29, 2007); Consumer Mortgage Coalition (May 29, 2007).

130 <u>See</u> Proposed Rule, <u>supra</u> note 4, at text preceding and accompanying n.27; <u>see also</u> Levy-Hastak Report at 17.

131 The disclosure table in the model form provides information "at-a-glance" that facilitates the comparison of a company's information sharing practices, both as to the industry as a whole and with respect to any other specific companies. In this way, it meets the original legislative intent to easily compare companies' privacy practices. <u>See</u> H.R. REP. NO. 106-74, at 107 (1999).

132 Levy-Hastak Report at 15.

exceptions.[133] The neutral design of the form, particularly through the table, explains that some sharing is necessary for an institution's "everyday business purposes" and makes clear what sharing occurs. In addition, the model form uses the term "limiting" sharing, rather than stopping sharing altogether. These small institutions commented that this more balanced presentation of sharing practices is a very important feature of the notice, and one that they welcome, as it makes all institutions' sharing practices more transparent.[134]

The strength of the table design is that it facilitates comparison by showing what a particular institution's sharing practices are as compared to what all financial institutions can legally do. For this reason, the final model form incorporates all seven reasons for sharing, with only the affiliate marketing provision – "For our affiliates to market to you" – optional for those companies that elect to incorporate that disclosure in their GLB notices.[135]

While the middle column requires institutions to answer "yes" or "no" to whether it shares for each of the reasons, some commenters expressed concern that their information sharing practices were sufficiently complex that they could not answer "yes" or "no," stating that they had different practices for different products. Institutions that elect to use the model form must answer the questions in the final model form as directed in the proposal. If an institution elects to use the model form, it must either harmonize its practices so one notice applies to all its products, or it must provide separate notices for products subject to different information sharing practices.

A few commenters opined that they may not currently share but want to reserve the right to share in the future. In such a case, the correct response in the middle column is "yes," consistent with the privacy rule.[136]

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133 This comment was made by some of the Agencies' regulated entities at various times during the course of this project and was also discussed by members of the Board's Consumer Advisory Council during its discussions in 2007 about the Notice Project and model form proposals.

134 See, e.g., comment letter of Independent Community Bankers Ass'n (May 29, 2009).

135 See infra note 142.

136 See the privacy rule, section __.6(e), NCUA section 716.6(d) (notices can be based on current and anticipated policies and practices).

Many institution commenters objected that the proposed terms to describe sharing practices were abbreviated or incomplete and asserted that the Agencies limited sharing that is lawfully permitted. For example, commenters objected that the definition of "everyday business purposes" excluded a long list of permissible disclosures designated in sections __.14 and __.15.[137] However, as the Agencies stated in the proposal, the phrase "everyday business purposes" fully incorporates all the disclosures permitted by law under sections __.14 and __.15 of the privacy rule.[138] In addition, the Agencies have determined that service providers that do not fall under section __.14, but perform direct services to the institution such as opt-out scrubbing or market analysis or research under a section __.13 agreement, are included under this provision.[139]

The cited examples of "everyday business purposes"[140] are illustrative only, to enhance consumer understanding. While commenters urged us to include the phrase "as permitted by law" in this description, research has found that consumers are confused and concerned by this phrase; they do not know what it means or what "laws" it encompasses.[141] Including that phrase would be inconsistent with consumers' need

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137 See, e.g., comment letters of American Insurance Ass'n (May 29, 2007); Consumer Bankers Ass'n (May 29, 2007); Citigroup Inc. (May 30, 2007); Securities and Financial Markets Ass'n (May 29, 2007).

138 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); American Insurance Ass'n (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007). This language substantially replaces the "as permitted by law" phrase used in the Sample Clauses, covering all permitted disclosures – along with the attendant requirements on reuse and redisclosure – found under sections __.14 and __.15 of the privacy rule. Unlike that clause, "everyday business purposes" conveys more concrete information to consumers and, importantly, helps them understand that some sharing is necessary in order to obtain financial products or services.

139 Joint marketing with other financial institutions and section __.13 service providers contracted to do marketing for a financial institution are disclosed separately. See Instruction C.2(d)(3) to the Model Privacy Form.

140 The final model form consolidates all references to "everyday business purposes" in the first reason in the disclosure table, thereby eliminating the illustrative explanation in the "How?" box on page one and the definition on page two.

141 See Survey Research Center at the University of Georgia, National Ass'n of Insurance Commissioners Insurance Disclosure Focus Group Study ("NAIC Study"), available at http://www.ftc.gov/os/comments/modelprivacyform/528621-00012.pdf. See also infra discussion at text accompanying note 221.

for clear language to understand what their financial institution does with their information.

Because the laws governing disclosure of consumers' personal information are not easily translated into short, comprehensible phrases, the table uses more easily understandable short-hand terms to describe sharing practices. We do not believe that these short-hand terms diminish the laws' provisions, as some commenters asserted. If, as these commenters suggest, the Agencies add to the laundry list of descriptive terms to make the provisions in the table more "precise," we believe it will defeat the purpose of making this information more understandable to consumers. Thus, the Agencies have chosen not to provide detailed descriptions for each of the reasons in the table; we re-affirm that institutions' ability to share information in accordance with the statutory provisions would not be limited or otherwise modified by using the model form language.

The phrase "For our marketing purposes" captures the idea that nearly all, if not all, institutions share information to market their own products and services to their customers (for example, using a joint marketing agreement with a service provider such as a bulk mailer or data processor pursuant to section __.13 of the privacy rule) in a manner that does not trigger an opt-out right. Likewise, the phrase "nonaffiliates to market to you" does not diminish the information sharing permitted by the privacy rule, provided that institutions first provide an opportunity for consumers to opt out, as provided for in section __.10 of the privacy rule.

In all these instances, the lack of explicit references in the model form to certain of the exceptions does not mean that an institution cannot take advantage of all the exceptions provided for in the law.

4. <u>FCRA Opt-Outs</u>

The FCRA provisions are adopted in the model privacy form as proposed.[142] A number of industry commenters objected that the disclosure table did not provide a sufficiently complete or accurate description of the affiliate sharing provisions of the FCRA.[143] They urged the Agencies to revise these provisions to more precisely distinguish between the different types of information that can be shared with affiliates (both with and without an opt-out), to describe the applicable exceptions, and to more accurately describe the opt-out pertaining to information that can be used by affiliates for marketing.

The FCRA statutory provisions are quite complex and their legal intricacies are difficult for consumers to understand. The Agencies found through the consumer testing conducted by Kleimann that the short-hand FCRA terms used in the model form describing the types of personal information that can be shared with affiliates are sufficient to enable consumers to make informed decisions about such sharing. Again, these short-hand terms do not in any way diminish or modify the affiliate sharing

142 The table includes, as an optional disclosure, the opt-out required by section 624 of the FCRA (reason 6 in the table), 15 U.S.C. 1681s-3 (affiliate use of information for marketing), as added by section 214 of the Fair and Accurate Credit Transactions Act of 2003 (FACT Act), Pub. L. No. 108-159, 117 Stat. 1952. Section 624 generally provides that information that may be shared among affiliates – including transaction and experience information and certain creditworthiness information – cannot be used by an affiliate 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. Congress did not grant the CFTC rulemaking authority to implement section 624. The other Agencies have issued final regulations implementing the affiliate marketing provision of the FACT Act, 12 CFR Part 41 (OCC), 12 CFR Part 222 (Board), 12 Part 334 (FDIC), 12 CFR Part 571 (OTS), 12 CFR Part 717 (NCUA), 16 CFR Parts 680 and 698 (FTC), 17 CFR Part 248, Subpart B (SEC) ("affiliate marketing rule"). Because the Agencies' affiliate marketing rules generally use consistent section numbering, relevant sections will be cited, for example, as "section __.23" unless otherwise noted. The affiliate marketing rule included language stating that the section 624 disclosure as it appears in the model form will meet the requirements of that rule. See 72 FR 61424, 61452 (Oct. 30, 2007) (FTC); 72 FR 62910, 62932 (Nov. 7, 2007) (banking agencies); 74 FR 40398, 40418 (Aug. 11, 2009) (SEC) ("use of the [GLB Act] model privacy form will satisfy the requirement to provide an initial affiliate marketing opt-out notice"). See also section __.23(b) of the affiliate marketing rule.

143 See, e.g., comment letters of Citigroup Inc. (May 30, 2007); American Bankers Ass'n (May 25, 2007); Consumer Bankers Ass'n (May 29, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007); Visa U.S.A, Inc. (May 29, 2007).

provisions of the FCRA.[144] To give some meaning to the statutory term "other information," the disclosure table uses "Information about your creditworthiness" – a short-hand phrase that consumers reasonably understood. Testing also found that consumers reasonably understood the phrase "information about your transactions and experience" without further embellishment.[145]

Some institutions objected to the description of the optional affiliate marketing provision enacted under the FACT Act for which the Agencies have published final regulations.[146] These commenters are correct that this provision, unlike the others, is about the use of shared information for marketing. While the Agencies and Kleimann worked to ensure accuracy in the model form, it was evident at the outset that this particular provision would be very difficult to explain in a simple and clear way to consumers and be precisely true to the statutory language.

The final formulation we proposed tested sufficiently well to show that consumers understand its basic meaning.[147] Including the affiliate marketing notice and opt-out in the model form is optional. Institutions that are required to provide this notice, and elect not to include it in their GLB Act privacy notice, must separately send an affiliate marketing notice that complies fully with the affiliate marketing rule requirements.

For those institutions that elect to incorporate this provision in the model form, the Agencies believe that it is simpler and less confusing to consumers for the affiliate marketing opt-out to be of indefinite duration, consistent with the opt-out required under the GLB Act. If an institution elects to limit the time period for which the opt-out is effective, as permitted under the affiliate marketing rule, it must not include the affiliate marketing opt-out in the model form. Instead, the institution must comply separately with the specific affiliate marketing rule requirements.

5. Limiting Sharing: Opt-Out Information

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144 See section 603(d)(2)(A) of the FCRA relating to the sharing of "transaction and experience information" and the sharing of "other information" which triggers an opt-out notice.

145 Kleimann Report, supra note 32, at 63.

146 See supra note 142.

147 Levy-Hastak Report at 15.

In response to commenters and the results of the quantitative testing, the final model form includes opt-out information for those institutions that are required to provide an opt-out on the bottom of page one. The Agencies proposed that the information about limiting or opting out of certain sharing, as needed, would be provided on a separate third page. Many commenters objected to the use of a separate piece of paper for this information, particularly if the notice itself is quite short.[148]

This change eliminates the extra page from the proposed model form and places this important information on the first page that the consumer sees. In addition to the model form with no opt-out, the Agencies are providing two alternate versions to be used, as appropriate, depending on whether the institution offers the option to limit information sharing by mail.[149]

Institutions using the model form must include the opt-out section 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. Financial institutions that provide opt-outs are not required to provide all the opt-out choices and methods described in the model form; they should select those that accurately reflect their practices.[150]

A number of commenters objected to the statement describing the time period before information can first be shared according to an institution's privacy policy.[151]

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148 See, e.g., comment letters of American Council of Life Insurers (May 29, 2007); National Automobile Dealers Ass'n (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007).

149 Some commenters asked about providing the opt-out in an in-person transaction so that the customer could execute the opt-out at that time or could deliver the completed opt-out form in person. The privacy rule does not preclude obtaining a consumer's opt-out election in person. However, while an institution may accept an opt-out election from a consumer in person, requiring a consumer to obtain an opt-out form at a branch office as the only means to opt out violates the privacy rule. See sections __.7(h), __.9(a) and (b), and __.10(a)(1) and (a)(3) of the privacy rule.

150 Institutions that do not include the affiliate marketing disclosure on the model privacy form must not include the affiliate marketing notice or opt-out on the model form mail-in form; that notice must be provided in accord with the affiliate marketing rule, outside the model form.

151 See, e.g., comment letters of Bank of America Corporation (May 29, 2007); Wells Fargo & Company (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007); American Council of Life Insurers (May 29, 2007).

Recognizing that institutions will provide this form both to new customers and annually to existing customers, the Agencies have modified the language accordingly.[152] The revised model form allows institutions to insert a time period that is 30 days or longer from the date the notice was sent before it can begin sharing for new customers. Some commenters opined that in certain instances they should be able to require the consumer to make an opt-out decision at the time of the in-person or electronic transaction rather than waiting 30 days. While the Agencies recognize that certain situations may warrant an immediate decision, the basic rule is to allow a "reasonable" opportunity to opt out.[153]

Telephone and online opt-outs should closely match the options provided in the form. Consistent with the direction provided in the affiliate marketing rule,[154] the Agencies also contemplate that a toll-free telephone number would be adequately designed and staffed to enable consumers to opt out in a single telephone call. In setting up a toll-free telephone number that consumers may use to exercise their opt-out rights, institutions should minimize extraneous messages directed to consumers who are in the process of opting out.

A number of industry commenters requested clarification on how joint accountholders would be treated.[155] The Agencies have addressed this question with a new FAQ, described below. Further, if an institution elects to provide a choice for the joint accountholder to apply the opt-out only to that joint accountholder, that option must be provided in the telephone or Web prompt, as well as presented in the left-hand box on the mail-in form.[156]

A number of commenters from both industry and advocacy groups addressed the question whether consumers need to provide personal information such as a Social

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152 The revised language states: "If you are a new customer, we can begin sharing your information [30] days from the date we sent this notice." See also supra note 119.

153 See, e.g., sections __.10(a)(1)(iii) and __.10(a)(3)(iii) of the privacy rule.

154 See 72 FR 61424, 61448 (Oct. 30, 2007) (FTC); 72 FR 62910, 62935 (Nov. 7, 2007) (banking agencies); 74 FR 40398, 40421 (August 11, 2009) (SEC).

155 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); Discover Bank (May 29, 2007).

156 See also privacy rule, section __.7(d), NCUA section 716.7(d)(6).

Security number, account number, or other identification number in order to opt out. The consumer advocacy organizations, some industry commenters, and an industry association proposed omitting the account number field from the proposed form to reduce the risk of fraud.[157] These commenters expressed concerns about phishing and identity theft, and were especially concerned about institutions' use of the Social Security number to confirm an opt-out request. These commenters argued that a name and address should be sufficient to effect an opt-out from an institution's information sharing.

Many institutions argued that they needed a Social Security number or full account or policy number in order to authenticate the person who wanted to opt out or to apply the opt-out appropriately to all accounts held by the customer or only to specific accounts.[158] Some industry commenters urged limiting the information to only the last four digits of an account number as both safe for the consumer and sufficient to implement the opt-out.[159]

Having considered these comments and the context in which such sensitive information is used – to implement an opt-out for information sharing – the Agencies strongly encourage institutions to use some other form of identifier, such as a randomly generated "opt-out code" provided in the notice that consumers can use to exercise their opt-outs without jeopardizing the security of their most sensitive personal information. A random code – which some institutions currently use – both protects consumers' most sensitive information and at the same time can be used to link both the customer and account(s) to which the opt-out should apply. Such an approach would further simplify the opt-out process for consumers. If such an approach is not feasible, institutions could use a truncated account or policy number to protect sensitive

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157 See, e.g., comment letters of Center for Democracy and Technology (May 29, 2007); Privacy Rights Clearinghouse (May 22, 2007); National Automobile Dealers Ass'n (May 29, 2007.

158 See, e.g., comment letters of National Retail Federation (May 29, 2007); Citicorp (May 29, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007).

159 See, e.g., comment letters of Sun Trust Banks, Inc. (May 23, 2007); Central National Bank of Enid (May 24, 2007).

information.[160] Of course, any opt-out means provided – including any information requirements imposed on consumers – must be reasonable under the privacy rule and reasonable and simple under the affiliate marketing rule.[161] Institutions should keep these requirements in mind when requesting information beyond the consumer's name and address.

A number of industry commenters objected to the inability of the model form to provide for partial opt-outs, as permitted by the privacy rule.[162] The Agencies have observed that partial opt-outs are not widely employed. Trying to incorporate partial opt-outs in this model form would be unduly complicated and confusing for consumers, so the Agencies have determined to use the default provision of the privacy rule that provides for an opt-out that applies to all information.[163] Institutions that want to provide partial opt-outs cannot do so using the model form.

A number of commenters wanted to include in the model form the statement "If you have already told us your choice(s), you do not have to tell us again."[164] Because this statement would only be accurate if the institution has not changed its notice to include new opt-out options, the Agencies have decided not to include it in the model form. Institutions that choose to use this statement must do so outside the model form.

6. Additional Opt-Outs in the Model Form

Like the proposed form, the final model form permits institutions to provide for voluntary or state law-required opt-outs. For example, if an institution elects to offer its customers the opportunity to opt out of its marketing, it can do so by saying "yes" in the

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160 See also The President's Identity Theft Task Force, Combating Identity Theft, at 13 (Apr. 2007) ("Consumer information is the currency of identity theft, and perhaps the most valuable piece of information for the thief is the SSN").

161 See section __.7(a)(1)(iii) of the privacy rule and section __.25(a) of the affiliate marketing rule.

162 See, e.g., comment letters of American Council of Life Insurers (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007).

163 See section __.10(b) of the privacy rule.

164 See, e.g., comment letters of MasterCard Worldwide (May 29, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007); Wells Fargo & Company (May 29, 2007); Wolters Kluwer Financial Services (May 24, 2007).

third column. Similarly, an institution can offer its customers a right to opt out of joint marketing, if it chooses.

Institutions that must comply with various state law requirements, depending on their practices and the choices they offer, may be able to do so in one of two ways using the model form. For example, Vermont law requires institutions to obtain opt-in consent from Vermont consumers for affiliate sharing. The disclosure table permits institutions to do one of two things: (1) it can provide a notice directed to its Vermont customers that answers "no" to the question about whether it shares creditworthiness information with its affiliates, or (2) it can provide a generalized notice for consumers across a number of states including Vermont and answer "yes" to the question about sharing creditworthiness information with its affiliates and include a discussion on the application of Vermont law in the "Other important information" box on page two of the form.[165]

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 choices (beyond what is required under federal law) must make that opt-out available through the same opt-out options the institution provides in the notice, whether by telephone, Internet, or a mail-in opt-out form.[166]

7. Contact Information for Questions

Like the proposed form, the final model form provides contact information at the bottom of page one. Some commenters objected that it would be confusing if an opt-out is offered or the institution wants to limit such contact to a mail option only.[167] The Kleimann Report found that consumers want a way to contact their financial institution if

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165 California provides that a consumer can opt out of joint marketing. Cal. Fin. Code div. 1.2 § 4053(b)(2). Thus, an institution can provide a generalized notice offering no opt-out, with California-specific information in the "Other important information" box. Alternatively, an institution can provide a separate notice to its California customers. Institutions cannot use the model form to offer opt-in consent. See Instruction C.2(g)(5) to the Model Privacy Form.

166 See Instruction C.2(g) to the Model Privacy Form.

167 See, e.g., comment letters of Mastercard Worldwide (May 29, 2007); American Insurance Ass'n (May 29, 2007); American Council of Life Insurers (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007).

they have any questions.[168] The NAIC Study likewise found this to be one of the most important pieces of information that consumers want in a notice.[169] In revising the proposed model form to include the opt-out information on page one, the Agencies have modified the "Contact Us" box to label it "Questions" (to more clearly distinguish between the two) and clarified in the Instructions that this box is for customer service contact information, either by telephone or the Internet or both, at the institution's option.

Customer service contact information is for consumers who may have questions about the institution's privacy policy and may be the same contact information for consumers' questions relating to the institution's products or services. The Agencies are not requiring a separate customer service number solely to answer questions about the institution's privacy policy. The customer service contact information is different from the opt-out contact information, unless the customer service number is made available for consumers to opt out. The contact information should give consumers a way to communicate directly with the institution.[170]

8. Mail-In Opt-Out Form

The mail-in opt-out form for institutions that provide such a form is adopted with two modifications, with the changes based on comments, the quantitative testing, and the Levy-Hastak Report. The validation testing shaped the design for the opt-out information in the final model form.

As discussed in section III.I.5, the final model form displays all opt-out information, including the mail-in form, on page one, for institutions that provide an opt-out. In response to commenters, the Agencies have added information on joint accountholders to the model form by providing a new FAQ on page two. Institutions must include the joint accountholder information in the mail-in form only when the institution allows a joint accountholder to choose whether to apply an opt-out election

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168 Kleimann Report, supra note 32, at 35, 226.

169 NAIC Study, supra note 141.

170 See Instruction C.2(f) to the Model Privacy Form.

only to one accountholder.[171] Otherwise, that space is blank or omitted from the mail-in form.

Finally, institutions that use the mail-in opt-out form must insert the institution's mailing address either in the right-hand box or just below the mail-in form, as shown in version 3 and optional version 4 in the Appendix and as described in the Instructions to the Model Form.

J. Page Two of the Model Form

The Agencies have modified page two of the model form to streamline the information on the page and to provide flexibility for institutions to insert certain institution-specific information.

1. Frequently Asked Questions

To address the concerns about jointly-provided notices, the Agencies have added a new FAQ at the top of page two: "Who is providing this notice?" An institution may omit this FAQ only when one financial institution is providing the notice and that institution is identified in the title. The space to the right, which is limited (for reasons of space constraints) to a maximum of four (4) lines,[172] allows institutions that are jointly providing the notice to be identified.[173] This space must be used to:

1. State the common corporate name or other readily identifiable name that is also used for the title and various headings of the model form as the "name of financial institution;" and

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171 See also infra section III.J.1. Section III.I.5 provides guidance on the use of sensitive personal information (such as a Social Security number or account number) to effect an opt-out. Section III.I.6 discusses how voluntary or state-required privacy law opt-outs should appear in the mail-in opt-out form. See also Instruction C.2(g) to the Model Privacy Form.

172 While the Agencies are limiting the space allotted for this FAQ, we do not intend that institutions will constrain the width of the left column (with the questions) so as to make this page difficult to read. We remind institutions that design experts recommend using sufficient white space to set off features such as headings, bullets, and key information used by consumers to quickly scan a document. We note further that the ratio of the column widths of the questions to the responses in the model form is approximately 1:2.

173 The option of creating a jointly provided notice is not limited only to financial holding companies, as one commenter observed. Instruction B.1 to the Model Privacy Form has been modified to clarify that point.

2. Either (a) identify the entities jointly providing the notice; or (b) for institutions with a lengthy list of entities jointly providing the notice, identify the general types of entities in the response and identify the entities[174] at the end of the form following the "Other important information" box, or, if that box is not incorporated into the form, following the "Definitions" or on an additional page. The list at the end of the form must be printed in minimum 8-point font and may appear in a multi-column format.

The Agencies have deleted the FAQ on how often consumers are provided notices on an institution's sharing practices due to space constraints.[175]

A number of commenters objected to the response to the question about how personal information is protected. Some objected to the phrase "comply with federal laws."[176] The Agencies note that this phrase closely tracks current Sample Clause A-7 and is already widely used by many institutions. Several objected to the phrase "secured buildings and files," preferring "physical safeguards."[177] As explained in the Kleimann Report, the Agencies developed this text to help consumers better understand the practical meaning of physical security.[178] The Agencies have determined to retain the FAQ as proposed, with one modification. In response to commenters who asked to include more specific information,[179] such as information about cookies or online practices or limiting employee access to personal information, the Agencies are allowing institutions to add more detail, limited to describing their safeguards practices, up to a maximum of thirty (30) additional words. This doubles the space allotted for the safeguards response and provides flexibility to institutions to customize the safeguards description. The optional information must appear after the standard response for this FAQ.

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174 See section __.9(f) of the privacy rule.

175 While the testing found it to be helpful background, this information is not required by the privacy rule.

176 See, e.g., comment letters of Consumer Bankers Ass'n (May 29, 2007); MasterCard Worldwide (May 29, 2007).

177 See comment letters of American Council of Life Insurers (May 29, 2007); American Insurance Ass'n (May 29, 2007).

178 Kleimann Report, supra note 32, at 125-26.

179 See, e.g., comment letters of Iowa State Bank and Trust (May 22, 2007); PayPal (May 29, 2007); Wachovia Corporation (May 25, 2007).

A number of industry commenters objected to the inflexible nature of the description of the sources from which personal information is collected, stating that in many cases the proposed descriptions do not correlate to their practices or the practices of their particular industry.[180] As with the description of the types of information collected and shared on page one, the Agencies are providing a menu of terms from which institutions can select to fill in the bulleted lists.[181] The list is designed to include the range of information sources typically used by a variety of institutions subject to the GLB Act and the FCRA, including those in the insurance, securities, and investment advisory businesses, as well as those companies subject to FTC jurisdiction. Finally, institutions that collect information from their affiliates and/or from credit bureaus must use as the last sentence of this response: "We also collect your personal information from others, such as credit bureaus, affiliates, or other companies." Institutions that do not collect personal information from their affiliates or credit bureaus but do collect personal information from other companies must include the following statement: "We also collect your personal information from other companies." Only institutions that do not collect any personal information from affiliates, credit bureaus, or other companies can omit both statements.

A number of industry commenters objected to the FAQ about limiting sharing, arguing variously that this is not required and that they should only have to include in the response those bullets that apply to their sharing practices.[182] The Agencies have determined to retain this FAQ with a revision to the bulleted list, as it helps consumers better understand what rights they have under Federal law and reinforces the message that information sharing may be limited but not stopped completely. The second bullet was revised to more closely track the provisions of the affiliate marketing rule. Finally, the Agencies have provided an optional sentence for institutions to elect to include at

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180 See, e.g., comment letters of American Council of Life Insurers (May 29, 2007); American Bankers Ass'n (May 25, 2007); Consumer Bankers Ass'n (May 29, 2007); Mastercard Worldwide (May 29, 2007); Wells Fargo & Company (May 29, 2007); National Ass'n of Mutual Insurance Cos. (May 29, 2007); National Automobile Dealers Ass'n (May 29, 2007).

181 See Instruction C.3(a)(3) to the Model Privacy Form. See supra note 117.

182 See, e.g., comment letters of American Council of Life Insurers (May 25, 2007); National Ass'n of Mutual Insurance Cos. (May 29, 2007).

the end, as applicable, "See below for more on your rights under state law," a reference to the state-specific privacy law information that an institution may include in the "Other important information" box.

As discussed earlier, a number of commenters asked how an opt-out election can be applied to joint accountholders.[183] This is addressed by a new FAQ on page two. Two optional responses are provided for institutions to use: The first states that an opt-out election by any joint accountholder will be applied to everyone on the account. The second provides that the opt-out election will be applied to everyone on the account unless the customer elects to have the opt-out apply only to him. Institutions must select one or the other as the response to this question.[184]

2. <u>Definitions</u>

In the final model privacy form, the definition of "everyday business purposes" has been deleted as superfluous, and the description of everyday business purposes has been consolidated in the disclosure table on page one. The other three definitions remain as proposed, with one modification.

The Agencies make the following further clarification in response to some commenters.[185] First, if an institution has no affiliates or does not share with its affiliates, it does not have to describe the categories of affiliates in this definition. Applicable responses in such conditions are, respectively: "**[name of financial institution]** has no affiliates" or "**[name of financial institution]** does not share with our affiliates."

Similarly, if an institution does not share for joint marketing or with nonaffiliated third parties outside of the section __.14 and __.15 exceptions, applicable responses are: "**[name of financial institution]** doesn't jointly market" or "**[name of financial institution]** does not share with nonaffiliates so they can market to you."

183 <u>See</u>, <u>e.g.</u>, comment letters of American Bankers Ass'n (May 29, 2007); Discover Bank (May 29, 2007); Mastercard Worldwide (May 29, 2007); Huntington National Bank (May 25, 2007).

184 <u>See also</u> <u>supra</u> discussion section III.I.8.

185 <u>See</u>, <u>e.g.</u>, comment letters of Mastercard Worldwide (May 29, 2007); Huntington National Bank (May 25, 2007); Consumer Bankers Ass'n (May 29, 2007); Wells Fargo & Company (May 29, 2007).

The Instructions have been modified with respect to an institution's sharing with its affiliates so that an institution must provide only an illustrative list of affiliates with which it shares, and not a complete list. As proposed, when an institution shares with nonaffiliates or with other financial institutions to do joint marketing, the institution must describe the categories of entities with which it shares.[186] While the Instructions provide illustrative examples of categories, institutions must provide examples consistent with their practices. The Instructions provide guidance on these points.[187]

3. State and international law provisions

To accommodate commenters' requests to incorporate state and international law provisions in the notice,[188] the Agencies have added a new optional box at the end of the final model form called "Other important information." The size of the box is not limited (except where space constraints apply in the Online Form Builder, described below), and institutions may use a third page, as necessary, for the information in this box. To qualify for the safe harbor,[189] institutions that elect to use this box can only use it for the following: (1) information about state and/or international privacy law requirements, as applicable; or (2) an acknowledgment form to create a record of having provided the notice. Certain institutions, for example, are required to include

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186 See sections __.6(a)(3), __.6(a)(5), __.6(c)(3), and __.6(c)(4) of the privacy rule. The joint marketing provisions apply to joint marketing agreements with other financial institutions, but not to other types of arrangements with section __.13 service providers.

187 See Instruction C.3(b) to the Model Privacy Form.

188 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); American Council of Life Insurers (May 29, 2007); Bank of America Corporation (May 29, 1007); Citigroup Inc. (May 30, 2007); Consumer Bankers Ass'n (May 29, 2007); Consumer Mortgage Coalition (May 29, 2007); Countrywide Home Loans, Inc. (May 29, 2007); Discover Bank (May 29, 2007); Financial Services Institute (May 29, 2007); Iowa Student Loan (May 22, 2007); KeyCorp (May 25, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007); National Retail Federation (May 29, 2007); National Ass'n of Mutual Insurance Cos. (May 29, 2007); Sovereign Bank (May 21, 2007); Wells Fargo (May 29, 2007); World's Foremost Bank (May 25, 2007); Direct Marketing Ass'n (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007); World Financial Capital Bank (May 25, 2007); World Financial Network National Bank (May 29, 20007).

189 The 10-point minimum font size applies to the contents of the "Other important information box." In addition, while the safe harbor extends to including this box at the end of the model form, it does not extend to the content of the box. Institutions are responsible for ensuring that any statements made in this box are accurate.

specific affiliate sharing information for Vermont residents or to meet other requirements under California law. Some insurance commenters noted that approximately 16 states have privacy laws that require insurers to provide notice of "access and correction" rights.[190] Commenters noted that other states require disclosures about medical information.[191] Some large institutions noted that they are required to provide international law information. Such information may be included in this new box. In addition, one association commenter, representing automobile dealers, specifically requested a place on the form to allow its members to obtain signatures from customers acknowledging that they had received a copy of the notice.[192]

K. Other Issues

1. Highlighting material changes in privacy practices

We sought comment on whether the model privacy form should highlight material changes in the notice. A number of industry commenters opposed this suggestion, citing consumer confusion.[193] Some stated that the GLB Act requires revised notices when the institution's policy has changed.[194] One advocacy group supported adding an extra column to the notice table highlighting specific changes made since the previous notice.[195]

After considering these comments, the Agencies determined that the simplest way to help consumers identify how recently the notice was changed is to include a "revised [month/year]" notation in the upper right-hand corner of page one of the notice.

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190 See, e.g., comment letters of American Insurance Ass'n (May 29, 2007); Great-West Life & Annuity Insurance Co. (May 29, 2007).

191 See, e.g., comment letters of American Council of Life Insurers (May 29, 2007); American Insurance Ass'n (May 29, 2007); Huntington National Bank (May 25, 2007).

192 See comment letter of National Automobile Dealers Ass'n (May 29, 2007).

193 See, e.g., comment letters of American Council of Life Insurers (May 29, 2007); Consumer Bankers Ass'n (May 29, 2007); Citigroup Inc. (May 30, 2007); Mastercard Worldwide (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007).

194 See comment letters of American Council of Life Insurers (May 29, 2007); Citigroup Inc. (May 30, 2007).

195 See, e.g., comment letters of Center for Democracy and Technology (May 29, 2007); see also New York State Consumer Protection Board (May 29, 2007).

The revised date, in minimum 8-point font, is the date the policy was last revised.[196] Of course, institutions can signal material changes in their policies by, for example, use of a cover letter that describes any changes.

2. Safe Harbor

A number of industry commenters expressed concern that the safe harbor provisions do not fully extend to the GLB Act requirements or do not extend to FCRA disclosures.[197] These commenters seek broader safe harbor treatment for the use of the model form, notwithstanding the statutory provision that use of the model form will satisfy the notice requirements of the GLB Act and the privacy rule.

The Agencies agree that the model form satisfies the requirements for the content of the notice required by the GLB Act, including sections __.6 and __.7 of the privacy rule; FCRA section 603(d) as described in section __.6 of the privacy rule; and section __.23 of the affiliate marketing rule. The Agencies note that the safe harbor applies to use of the model form, but does not and cannot extend to the institution-specific information that is inserted in the model form. Proper use of the model form to comply with the privacy rule requires that institutions accurately answer the questions about their information collection and sharing practices, as well as provide to consumers, as applicable, a reasonable means and opportunity to limit sharing and honor any opt-out requests submitted.

3. Online Form Builder

Commenters generally supported the Agencies' proposal to provide a downloadable, fillable version of the model form that institutions could use to create their own customized notice.[198] Many smaller institutions were particularly supportive, noting that it simplifies adoption and reduces their development costs.

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196 Adoption of the model form, with no change in policies or practices, would not constitute a revised notice, although institutions may elect to consider the format change as a revision, at their option. However, inserting the new affiliate marketing opt-out in the model form would be a revision of the institution's policies and practices.

197 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); California Bankers Ass'n (May 25, 2007); Consumer Bankers Ass'n (May 29, 2007).

198 See, e.g., comment letters of American Insurance Ass'n (May 29, 2007); Center for Democracy and Technology (May 29, 2007); Citrus and Chemical Bank (May 24, 2007); Credit Union National Ass'n (May 29, 2007); Independent Community Bankers of

In response, the Agencies will be providing on each of their Websites a link to an Online Form Builder accessible by any institution so that the institution can readily create a unique, customized privacy notice using the model form template. The Agencies anticipate that a temporary Online Form Builder will be available in late 2009 and that a more robust version will be available to institutions in late 2010.

4. Web-based design

Many industry and advocacy group commenters supported development of an optional Web-based design, especially as more and more consumers are engaging in online activities such as online banking.[199] Some commenters asked the Agencies to test a design for usability. Some industry commenters cautioned that the Agencies should leave this task to industry as institutions are more knowledgeable and better equipped to address such a task.[200]

The Board and FTC have agreed to jointly undertake the development through consumer research of a Web-based version of the final model form. That research work will proceed independent of this rulemaking, will be reviewed by all the other Agencies, and will be made publicly available for use by all institutions. It is anticipated that the work will be completed in late 2009.

5. Electronic Delivery

A number of commenters objected to limiting the electronic posting of the model form to a PDF format.[201] Those expressing a view stated that providing the form in HTML is more compatible with their systems and easier for consumers to download and view.

America (May 29, 2007); PayPal (May 29, 2007); Portage National Bank (May 1, 2007); Sovereign Bank (May 21, 2007).

199 See, e.g., comment letters of Center for Democracy and Technology (May 29, 2007); Investment Company Institute (May 29, 2007); MasterCard Worldwide (May 29, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007); PayPal (May 29, 2007); Target National Bank (May 24, 2007).

200 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); American Council of Life Insurers (May 29, 2007); The Financial Services Roundtable and BITS (May 29, 2007); Huntington National Bank (May 25, 2007); National Retail Federation (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007); Wachovia Corporation (May 25, 2007).

201 See, e.g., comment letters of Huntington National Bank (May 25, 2007); MasterCard Worldwide (May 29, 2007); PayPal (May 29, 2007); Securities Industry and Financial Markets Ass'n (May 29, 2007); Wachovia Corporation (May 25, 2007).

The Agencies agree that institutions can provide the notice electronically in either PDF or HTML format. Where consumers agree to electronic receipt of the notice, institutions can send the notice by email either by attaching the notice or providing a link to the notice.

6. Other comments

Some commenters asked if the model form can be adopted for other languages.[202] The Agencies believe that this would be beneficial to an institution's non-English speaking customers and note that institutions currently provide such notices, consistent with the privacy rule.

Many industry commenters wanted the flexibility to add other information to the form. For example, they asked to include information on the benefits of sharing; privacy tips and identity theft information; information about fraud prevention; and marketing.[203] Some commenters asked that additional information such as seal information be included in the model form.[204]

The Agencies considered these suggestions and decided not to permit the inclusion of additional information in the final model form. While an institution may believe this information is useful or important, we believe that the addition of such information to the model form defeats the purpose of providing a clear and usable notice about information sharing practices and consumer rights. The Agencies do not preclude an institution from providing such information in other, supplemental materials, if the institution wishes to do so.

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202 See, e.g., comment letters of First Bank Americano (May 2, 2007); First Hawaiian Bank (May 29, 2007); National Retail Federation (May 29, 2007).

203 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); Bank of America Corporation (May 29, 2007); Comerica Bank (May 25, 2007); Consumer Bankers Ass'n (May 29, 2007); Citigroup Inc. (May 30, 2007); First Hawaiian Bank (May 29, 2007); California Bankers Ass'n (May , 2007); Farmers & Merchants Bank (May 29, 2007); Financial Services Roundtable and BITS (May 29, 2007); Huntington National Bank (May 25, 2007); KeyCorp (May 25, 2007); Target National Bank (May 24, 2007); Wachovia Corporation (May 25, 2007); Wells Fargo & Company (May 29, 2007).

204 See comment letters of PayPal (May 29, 2007); TrustE (May 30, 2007).

One commenter proposed requiring institutions that use the model form to also have a longer notice that complies with the privacy rule.[205] One notice is sufficient if that notice complies with the law and the privacy rule.

Commenters also raised a number of other issues that are beyond the scope of this rulemaking. These include making the default opt-in rather than opt-out; eliminating the annual notice requirement; preempting state law requirements; and establishing an opt-out repository similar to the FTC's National "Do Not Call" Registry.[206]

IV. THE SAMPLE CLAUSES

As proposed, the Agencies are eliminating the Sample Clauses appended to the privacy rule along with the safe harbor or for SEC-regulated entities, guidance, currently afforded entities.[207] Many industry commenters opposed the proposal.[208] Some commenters asked that we retain certain of the Sample Clauses, such as A-1, A-3, and A-7, the use of which does not implicate an opt-out.[209] Institutions expressed concern that elimination of the Sample Clauses and corresponding safe harbor would expose

205 See comment letter of TRUSTe (May 30, 2007).

206 See, e.g., comment letters of America's Community Bankers (May 29, 2007); Bank of Edison (March 21, 2007); Bank of Frankewing (May 18, 2007); Central National Bank of Enid (May 24, 2007); FamilyFirst Bank (May 8, 2007); Florence Savings Bank (April 30, 2007); Glenview State Bank (May 2, 2007); Hometown Bank (May 8, 2007); Portage National Bank (May 1, 2007).

207 The Sample Clauses were originally provided in the privacy rule to illustrate the level of detail for notices to meet the rule requirements and to minimize the compliance burden. See 65 FR 33646, 33677 (May 24, 2000) (FTC); 65 FR 35162, 35185 (June 1, 2000) (banking agencies); 65 FR 40334, 40357 (June 29, 2000) (SEC); 66 FR 21236, 21238 (Apr. 27, 2001) (CFTC).

208 See, e.g., comment letters of American Bankers Ass'n (May 25, 2007); American Council of Life Insurers (May 29, 2007); American Insurance Ass'n (May 29, 2007); Bank of America Corporation (May 29, 2007); Consumer Bankers Ass'n (May 29, 2007); Citigroup Inc. (May 30, 2007); Direct Marketing Ass'n (May 29, 2007); Investment Adviser Ass'n (May 29, 2007); National Ass'n of Mutual Insurance Cos. (May 29, 2007); National Automobile Dealers Ass'n (May 29, 2007); National Business Coalition on E-Commerce and Privacy (May 30, 2007); T. Rowe Price Associates, Inc. (May 29, 2007); Visa U.S.A., Inc. (May 29, 2007); Wisconsin Bankers Ass'n (May 29, 2007).

209 See, e.g., comment letter of National Automobile Dealers Ass'n (May 29, 2007). Sample Clause A-1 describes the categories of information that an institution collects. Sample Clause A-3 includes the phrase "as permitted by law" to describe the sharing that institutions are permitted to do under sections __.14 and __.15 without triggering an opt-out. Sample Clause A-7 generally states that an institution uses safeguard measures to protect the handling of the personal information it obtains.

them to liability.[210] A few commenters asked the Agencies to improve the current Sample Clauses as an interim measure.[211] Several institutions requested that the Agencies at a minimum provide for a transition period that is longer than one year, if the Agencies determine to eliminate the Sample Clauses.[212]

Notwithstanding these comments, the Agencies are eliminating the Sample Clauses and related safe harbor (or guidance) from the privacy rule, following a transition period of one year.[213] The initial public and media complaints about the incomprehensibility of the privacy notices,[214] the plain language experts' guidance at the Get Noticed Workshop, and the launch of this Notice Project all examined the problems with institutions' privacy notices, including their extensive use of the Sample Clauses, and the need to develop a usable consumer notice. These same factors led the Agencies to propose eliminating the Sample Clauses. One commenter agreed that the research showed the clauses "were found wanting."[215] An association whose members generally found the model form to be more consumer-friendly than the Sample Clauses asked only that the Agencies provide a sufficient transition period before eliminating the Sample Clauses.[216]

In addition, the quantitative testing supports the Agencies' proposal to eliminate the Sample Clauses and related safe harbor. The Levy-Hastak Report confirms that a notice composed solely of the Sample Clauses promotes ease of scanning to perform simple tasks – because the notice is short and not because it is understandable – but the Sample Clauses do not do well on comprehension measures. Moreover, the testing

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210 See, e.g., comment letters of Visa U.S.A., Inc. (May 29, 2007); Citigroup Inc. (May 30, 2007); Huntington National Bank (May 25, 2009).

211 See, e.g., comment letter of Capital One Financial Corporation (May 29, 2007).

212 See, e.g., comment letters of Direct Marketing Ass'n (May 29, 2007); Investment Adviser Ass'n (May 29, 2007.

213 The Agencies are also making conforming amendments to sections __.2, __.6, and __.7 of the privacy rule and to the Appendix with one small change from the Proposed Rule.

214 See, e.g., Public Citizen Petition, supra note 24 at 4-9; Press Release of House Committee on Financial Services, supra note 74.

215 See comment letter of Capital One Financial Corporation (May 29, 2007).

216 See comment letter of Independent Community Bankers Ass'n (May 29, 2007).

showed that current notices – in which the Sample Clauses are typically embedded – do poorly on all measures.

The Levy-Hastak Report examined the results when study participants were asked to choose between two banks based solely on the content of the notice and to give reason(s) why they selected a particular bank. Participants who saw the Sample Clause Notice were more likely to select the higher sharing bank because it offered an opt-out.[217] When these participants were matched with their general attitudinal preferences toward sharing, the Levy-Hastak Report found that they generally favored less sharing.[218] According to the Levy-Hastak Report, the data suggested that study participants who gave as the reason for their choice the availability of opt-outs "may have mistakenly believed that this would lead them to choosing a lower sharing bank."[219] In other words, participants who saw the Sample Clause Notice and selected the higher sharing bank because it offered opt-outs did not understand that a bank offering no opt-out did so because it shared less. This finding confirmed reports by small institutions.[220]

Further, the NAIC Study,[221] conducted in March 2005, examined several different insurance disclosure forms with participants in three focus groups. One was a generic form based on the sample clauses adopted in the NAIC Model Privacy Rule and similar in content to the Sample Clause Notice used in the Agencies' quantitative testing. The NAIC Study highlighted a key finding that is consistent with the Agencies' research findings. Among the study participants, there was general misunderstanding of and concern about the language in the form, in particular the phrase "as permitted by law" found in Sample Clause A-3. Participants in all three focus groups asked: (1) what does this phrase mean?; (2) what is the law and what does it permit?; and (3) what if the law

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217 The Levy-Hastak Report also found that study participants who saw the Current Notice were significantly more likely to give reasons not based on any information in the notice, for example, that Bank X offered a lower interest rate. These same participants were also less likely than those who saw the other notices to give cogent reasons for choosing the lower sharing bank. Levy-Hastak Report at 9.

218 Id. at 15.

219 Id. at 10.

220 See supra note 133 and related text.

221 See NAIC Study, supra note 141.

changes? Participants who viewed this form did not know what to do with it and wanted some way to contact the company to get answers to their questions.

Also, in the development of the model form, Kleimann found that consumers did not understand the language in Sample Clause A-7 regarding the safeguarding of personal information. Through consumer testing, the description was revised to improve consumer comprehension.

Finally, while many smaller institutions are most likely to engage in limited sharing and so would rely on the three Sample Clauses, A-1, A-3, and A-7, many of these institutions support the model form. They have stated that such a form would make it easier for them to demonstrate that they are less likely to share personal information, and it would allow for easier comparison of their sharing practices with those of other institutions.[222] One large association commented that an informal survey of its community bank members found that "many are likely to use the model forms" and that "[m]ost found the new forms more consumer-friendly than the existing sample clauses."[223]

To ease the compliance burden for those institutions that currently have privacy notices based on the Sample Clauses, the Agencies are implementing a transition period that begins thirty (30) days after the date of publication and ends on December 31, 2010. Financial institutions will not be able to rely on the safe harbor by using the Sample Clauses in notices delivered or posted on or after January 1, 2011.[224] 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) during the transition period, will have a safe harbor for one year after delivery or posting. Privacy notices using the Sample Clauses that are delivered or posted electronically after the transition period will

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222 See, e.g., comment letters of Florence Savings Bank (April 30, 2007), Community Bankers of America (May 29, 2007), Iowa State Bank and Trust Co. (May 22, 2007), Credit Union National Ass'n (May 29, 2007); see also supra note 133 and related text.

223 See comment letter of Independent Community Bankers of America (May 29, 2007).

224 Institutions relying on the Sample Clauses appended to the SEC's privacy rule will not be able to rely on them for guidance in notices delivered or posted on or after January 1, 2011.

not be eligible for a safe harbor. Since institutions are required to send notices annually to their customers, they may continue to rely on the safe harbor for annual notices that are delivered to consumers (either in paper form or by electronic delivery such as email) within the transition period until the next annual privacy notice is due one year later.[225] The Sample Clauses will be removed from codification one year after the transition period ends. The SEC, whose privacy rule provides only guidance and not a safe harbor for financial institutions that use the Sample Clauses, will also remove the Sample Clauses from codification one year after the transition period ends.[226]

While the final model form would provide a legal safe harbor, institutions could continue to use other types of notices that vary from the model form, including notices that use the Sample Clauses, so long as these notices comply with the privacy rule.

The Agencies are also amending section __.6(b) of the privacy rule. The FTC is deleting the second sentence of section 313.6(b) and substituting the following new sentence, based on the model form research: "When describing the categories with respect to those parties, it is sufficient to state that you make disclosures to other nonaffiliated companies for your everyday business purposes, such as to process transactions, maintain account(s), respond to court orders and legal investigations, and report to credit bureaus." The remaining Agencies (Board, CFTC, FDIC, NCUA, OCC, OTS, and SEC) are revising the second sentence of section __.6(b) to read as follows, based in part on the model form research: "When describing the categories with respect to those parties, it is sufficient to state that you make disclosures to other nonaffiliated companies: (1) For your everyday business purposes, such as [include all

225 For example, if an institution provides a notice using the Sample Clauses on or before December 31, 2010, it could continue to rely on the safe harbor for one additional year until its next annual notice is due. If an institution provides a notice using the Sample Clauses on or after January 1, 2011, however, it could not rely on the safe harbor. Privacy notices using the Sample Clauses posted on an institution's Website to meet the annual notice requirements of section __.9(c) of the privacy rule would no longer be able to rely on the safe harbor beginning on January 1, 2011.

226 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.

that apply] to process transactions, maintain account(s), respond to court orders and legal investigations, or report to credit bureaus; or (2) As permitted by law."[227]

V. EFFECTIVE DATE

The Agencies proposed that most of the provisions of the final rule would take effect on the date of publication.[228] That approach would have allowed institutions that chose to use the model privacy form to receive the safe harbor for doing so immediately upon its publication. The Agencies received no comments on providing an immediate effective date for this portion of the rule. The only comments the Agencies received concerning the effective date of the rule pertained to removal of the Sample Clauses and related Appendix, as discussed in section IV.

The final rule makes most of the provisions effective 30 days after publication. This approach allows institutions to receive, with only a minimal delay, a safe harbor for using the model privacy form and the additional, alternative language that may be used to comply with section __.6(b) of the privacy rule. The Agencies believe that few, if any, institutions would choose to implement those changes in fewer than 30 days. The 30-day delay will give institutions and the Agencies time to implement the changes properly.

VI. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Regulatory Flexibility Act ("RFA")[229] requires the Agencies to provide an Initial Regulatory Flexibility Analysis ("IRFA") with a proposed rule and a Final Regulatory Flexibility Analysis ("FRFA") with a final rule, unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. See 5 U.S.C. 603-605. An IRFA was published by the Agencies in their March 20, 2007, Proposed Rule regarding amendments to the rules implementing the privacy provisions of the GLB Act. The Agencies have prepared the following FRFA in accordance with 5 U.S.C. 604.

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227 Institutions using option (1) in this revised sentence to section __.6(b) are required to include all applicable examples. See 12 CFR 40.6(b) (OCC); 12 CFR 216.6(b) (Board); 12 CFR 322.6(b) (FDIC); 12 CFR 573.6(b) (OTS); 12 CFR 716.6(b) (NCUA); 17 CFR 160.6(b) (CFTC); 17 CFR 248.6(b) (SEC).

228 Proposed Rule, supra note 4, at section IV.

229 5 U.S.C. 601-612.

A. Need For and Objectives of Rule Amendments

The goal of the rule amendments is to satisfy the requirements of section 728 of the Regulatory Relief Act, which requires that the Agencies develop a model form that is comprehensible, clear and conspicuous, and succinct. The Act also requires that the model form enable consumers to easily identify a financial institution's sharing practices and compare those practices with others. The model form that the Agencies are adopting today will, if properly used, serve as a safe harbor for satisfying the privacy rules' requirements regarding content of privacy notices.

As indicated in section I of the preamble to this final rule, the amendments to Appendix A of the Agencies' privacy rules are adopted pursuant to the authority set forth in § 503 (as amended by section 728 of the Regulatory Relief Act) and § 504 of the GLB Act.[230]

B. Significant Issues Raised by Public Comment

The Agencies requested comments on the IRFA. We specifically requested comments on the number of small entities that would be affected by the rules' amendments, the existence or nature of the impact of the amendments on small entities, how to quantify the impact of the amendments, and possible alternatives to the amendments. Commenters were also asked whether a downloadable version of the model form would be useful for financial institutions, particularly small entities that would like to take advantage of the proposed safe harbor.

Only one commenter directly addressed the IRFA.[231] That commenter disagreed with the Agencies' analysis that some financial institutions that may wish to transition to the proposed model form might incur some small incremental costs in making the transition, but did not provide any explanation of why the analysis is incorrect or

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230 The SEC is also adopting the amendments under 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(a) of the Investment Advisers Act of 1940 [15 U.S.C. 80b-11(a)].

The CFTC also is adopting 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)].

231 Comment letter of National Business Coalition on E-Commerce and Privacy (May 30, 2007).

estimates regarding logistical costs that the commenter asserted would be significant. Several associations whose members include small entities, however, expressed support for the objectives of the proposed model notice.[232] In addition, one association (many of whose members are small entities) found that many of its members that participated in an informal survey are likely to use the model forms and most found the forms more consumer-friendly than the Sample Clauses.[233] Some commenters suggested that the model form is oriented to large, multi-affiliate financial institutions and does not accommodate smaller institutions.[234] These commenters stated that the information collection policies described in the model form accurately reflect the practices of certain large financial institutions but are misleading to the extent they are beyond the scope of smaller financial institutions that do not offer banking-related products and services. In response to these and similar comments, the Agencies have revised the model form to allow financial institutions to select from a menu of specific disclosures to customize the descriptions of their information collection policies.[235]

Several commenters also requested that the Agencies retain the safe harbor regarding the Sample Clauses, noting that many small entities' privacy notices currently incorporate the Sample Clauses. One commenter explained that it would be burdensome and unnecessary for small entities to change their privacy notices, especially small entities that do not share personal information other than to service their clients' accounts.[236] Another commenter argued that elimination of the safe harbor for the Sample Clauses would transform the model form from an optional elective to a burdensome regulatory requirement, particularly for small entities.[237] We note, however, that the research found that there was general misunderstanding of and

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232 See, e.g., joint comment letter of American Bankers Ass'n, America's Community Bankers, Consumer Bankers Ass'n, and The Financial Services Roundtable (May 29, 2007).

233 See comment letter of Independent Community Bankers of America (May 29, 2007).

234 See, e.g., comment letters of Financial Services Institute (May 29, 2007); Financial Planning Ass'n (May 30, 2007).

235 See supra sections III.I.2 and III.J.1; see also infra, Instructions C.2(b) and C.3(a)(3) and (4) to the Model Privacy Form.

236 See, e.g., comment letter of Investment Adviser Ass'n (May 29, 2007).

237 See, e.g., comment letter of National Automobile Dealers Ass'n (May 29, 2007).

concern among consumers about language in the notice based on the Sample Clauses.[238] Nevertheless, partly in response to these comments, the Agencies are allowing financial institutions one year in which they can continue to rely on the Sample Clauses for safe harbor or guidance when providing notices. In addition, as noted above, while the Agencies are eliminating the Sample Clauses and related safe harbor (or, for the SEC, guidance), institutions may continue to use notices containing these clauses, so long as these notices comply with the privacy rule.

Finally, we received a limited number of comments indicating that a downloadable fillable model form may be helpful, especially to small entities.[239] In response to these comments, the Agencies will make available an Online Form Builder. We expect the availability of this form will, in part, minimize the burden on small businesses of developing, using, and customizing the model form for their individual needs.

C. Small Entities Subject to the Rules

The amendments to Appendix A and conforming amendments to sections __.2, __.6, and __.7 of the Agencies' privacy rules may potentially affect financial institutions, including financial institutions that are small businesses or small organizations, that choose to rely on the model privacy form as a safe harbor.

1. *OCC.* The OCC estimates that 690 insured national banks, uninsured national banks and trust companies, and foreign branches and agencies are small entities for purpose of the RFA.

2. *Board.* The Board estimates that 432 state member banks are small entities for purposes of the RFA.

3. *FDIC.* The FDIC estimates that 3115 state nonmember banks are small entities for purposes of the RFA.

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238 See supra section IV and discussion at notes 217-219 and related text. See also Public Citizen Petition, supra note 24, at 9 ("The paragraph employs ambiguous phrases such as 'other information' (what other information?), 'unless otherwise permitted by law' (in actuality, the law almost always permits disclosure) ...").

239 See, e.g., comment letters of Financial Planning Ass'n (May 30, 2007); Center for Democracy and Technology (May 29, 2007).

4. *OTS*. The OTS estimates that 377 small savings associations are small entities for purposes of the RFA.

5. *NCUA*. The RFA 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 3,168 federally-insured, state-chartered credit unions are small entities for purposes of the RFA.

6. *FTC*. Determining a precise estimate of the number of small entities that are financial institutions within the meaning of the 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*. Section 5g of the CEA, 7 U.S.C. § 7b-2, provides that any futures commission merchant, commodity trading advisor, commodity pool operator, or introducing broker that is subject to the jurisdiction of the CFTC with respect to any financial activity, shall be treated as a financial institution for purposes of Title V of the GLB Act, regardless of size and including commodity trading advisors and commodity pool operators that are exempt from the CEA's registration requirements. The CFTC has previously established certain definitions of "small entities" and determined that futures commission merchants and commodity pool operators are not small for purposes of the Regulatory Flexibility Act. Policy Statement and Establishment of Definitions of "Small Entities," 47 Fed. Reg. 18,618 (Apr. 30, 1982). This rule applies to commodity trading advisors and introducing brokers of all sizes. Because use of the model privacy form is voluntary, and because its use is a form of substituted compliance with Part 160 and not a new mandatory burden, CFTC believes that the rule will not have a significant economic impact on a substantial number of small entities.

8. *SEC.* The SEC estimates that 915 broker-dealers, 212 investment companies registered with the Commission, and 781 investment advisers registered with the Commission are small entities for purposes of the RFA.[240]

Because use of the model privacy form will be entirely voluntary, the Agencies cannot estimate how many small financial institutions will use it. 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 rules, will 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 rules. We anticipate that a financial institution that uses the model form for its privacy notice will need little review by legal counsel because the rules do not permit institutions to vary the form if they wish to obtain the benefit of a safe harbor, except as necessary within narrow parameters to identify their information collection, sharing, and opt-out policies. Finally, the Agencies are providing an Online Form Builder that will enable institutions to directly create a customized model form and thus will facilitate compliance.

D. Reporting, Recordkeeping, and Other Compliance Requirements

The amendments to the privacy rules do not 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

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240 For purposes of the RFA, 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 business or small organization. 17 CFR 240.0-10(c). 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(a). 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(a).

case of the CFTC). The amendments adopted today will not affect these requirements and financial institutions will be under no obligation to modify their current privacy notices as a result of the amendments. Instead, the amendments provide 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 rules.

Nonetheless, some of the financial institutions that rely on the Sample Clauses in the current privacy rules' appendixes may wish to transition to the model form and may incur some additional costs in making this transition.[241] The Agencies expect, however, that the availability of a standardized model form will minimize these costs because the form's standardized formatting and language will make it easier for institutions to prepare and revise their privacy notices.

E. Action by the Agencies to Minimize Effects on Small Entities

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 amendments, we considered the following alternatives:

1. *Different reporting or compliance standards.* As noted above, the Regulatory Relief Act requires the Agencies to develop "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 adopting only one model form, which includes alternative language in some places that allows a financial institution to describe its particular information collection and sharing practices. The specific model form that the Agencies are adopting today was developed as part of a careful and thorough consumer testing process designed to produce a clear, comprehensible, and comparable notice. The model form emerged as the most effective of several notice formats considered as part of this testing.

241 To the extent that institutions review their privacy policies annually for compliance, we estimate that the costs associated with this annual review, including professional costs, will be approximately the same as the costs to complete the model form.

2. *Clarification, consolidation, or simplification of reporting and compliance requirements*. The Agencies believe that the model form will 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 model form will 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, further clarifying, consolidating, or simplifying the model notice would compromise the research findings.

3. *Performance rather than design standards*. Section 728 of the Regulatory Relief Act specifically requires that the Agencies develop a model form. The model form is an alternative means of providing a privacy notice that institutions may choose to use. The privacy rules do not mandate the format of privacy notices; thus neither the privacy rules nor the amendments 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 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 that of enabling comparison across notices.

VII. PAPERWORK REDUCTION ACT

The final privacy rules governing the privacy of consumer financial information contain disclosures that are considered collections of information under the Paperwork Reduction Act (PRA).[242] Before the Agencies issued their privacy rules, they obtained approval from OMB for the collections. OMB control numbers for the collections appear below. The amendments adopted today 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.

242 44 U.S.C. 3501-3520.

Board: Control number 7100-0294.

FDIC: Control number 3064–0136.

OTS: Control number 1550-0103.

NCUA: Control number 3133-0163

FTC: Control number 3084-0121.

SEC: Control number 3235-0537.

CFTC: Control number 3038-0055.

VIII. OCC AND OTS EXECUTIVE ORDER 12866 DETERMINATION

The OCC and OTS have determined that their respective portions of the final rule are not a significant regulatory action under Executive Order 12866. We have concluded that the changes made by this rule will not have an annual effect on the economy of $100 million or more, and does not meet any of the other standards for a significant action set forth in E.O. 12866.

IX. OCC AND OTS EXECUTIVE ORDER 13132 DETERMINATION

The OCC and OTS have determined that their respective portions of the final rule do not have any federalism implications, as required by Executive Order 13132.

X. OCC AND OTS UNFUNDED MANDATES REFORM ACT OF 1995 DETERMINATION

Section 202 of the Unfunded Mandates Reform Act of 1995, Public Law 104-4 (UMRA), requires that an agency prepare a budgetary impact statement before promulgating a rule that includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector of $100 million or more (adjusted annually for inflation) in any one year. The inflation adjusted threshold is $133 million or more. If a budgetary impact statement is required, section 205 of the UMRA also requires an agency to identify and consider a reasonable number of regulatory alternatives before promulgating a rule. The OCC and OTS have each determined that their respective portions of the final rule will not result in expenditures by State, local, and tribal governments, in the aggregate, or by the private sector, of $133 million or more in any one year. Accordingly, the final rule is not subject to section 202 of the UMRA.

XI. 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 adopting today will replace the Sample Clauses included as guidance in Regulation S-P's Appendix A (17 CFR 248, Appendix A) with a model privacy form that financial institutions can choose to provide to consumers. The 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]."

The SEC identified certain costs and benefits arising from these amendments and requested comments on all aspects of the associated cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis. The SEC also sought comments on the accuracy of its cost and benefit estimates and requested commenters to identify, discuss, analyze, and supply relevant data that would allow the SEC to improve its estimates. Finally, the SEC requested comments regarding the potential impact of the proposals on the U.S. economy on an annual basis.

A. Benefits

The goal of the rules is to satisfy the requirements of section 728 of the Regulatory Relief Act, which requires that the Agencies develop a model form that is comprehensible, clear and conspicuous, and succinct. The Act also requires that the model form enable consumers easily to identify a financial institution's sharing practices and compare those practices with others. The model form that the Agencies are adopting today will, if properly used, serve as a safe harbor for satisfying the privacy rule's requirements regarding the content of privacy notices.

The SEC requested comments on all aspects of the benefits of the amendments as proposed. The SEC requested specific comments on available metrics to quantify these benefits and any other benefits commenters could identify, and requested commenters to identify sources of empirical data that could be used for such metrics. The SEC did not receive any comments in response to these requests.

Use of the model form is voluntary, so a financial institution can determine for itself its costs and benefits in deciding whether using the model form would be suitable for its business and customers. However, new financial institutions will likely benefit from using the model privacy form because of the savings in time and resources that would otherwise be spent developing their own notices.

The SEC also anticipates that financial institutions regulated by the SEC may benefit from the model privacy form's standardized formatting and language. The SEC believes 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 model privacy form rather than revise their existing notices.

Similarly, the SEC expects that revisions to an institution's privacy policies will 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 will need little, if any, ongoing review by legal counsel because an institution cannot vary the form except within stated parameters as necessary to identify certain specific information collection, sharing, and opt-out policies.

Before today's amendments, Appendix A of Regulation S-P contained Sample Clauses that the SEC interpreted as providing guidance, as opposed to a legal safe harbor. Institutions will therefore 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.[243]

Consumers should also benefit from the model form through increased comprehension of and enhanced comparability among privacy policies. The model form was developed in an extensive consumer research testing process that sought to maximize consumers' ability to comprehend, use, and compare privacy notices. The model form emerged as the most effective of several notice formats considered as part of this testing. The SEC therefore anticipates that if financial institutions make

243 A number of commenters expressed concern that the safe harbor provisions might not fully extend to all GLB Act requirements or FCRA disclosures. See, e.g., comment letter of Citigroup Inc. (May 30, 2007). Several commenters further suggested the safe harbor should encompass state and private enforcement. See, e.g., comment letters of Consumer Bankers Ass'n (May 29, 2007); Financial Services Institute (May 29, 2007). In response to these comments, the Agencies have clarified the scope of the safe harbor. See supra section III.K.2.

widespread use of the model form, consumers' comprehension and their ability to use and compare privacy policies will 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

Since the model form is optional, the SEC cannot estimate the number of institutions that will adopt it. Accordingly, we cannot estimate total overall costs to use the model form by broker-dealers, investment advisers registered with the SEC, and investment companies that may use the model form. However, in the Proposed Rule, the SEC provided estimates of certain types of costs that could result from the proposed amendments.

The SEC also sought comments on its cost estimates and the assumptions behind the estimates, as well as whether any of those costs would differ if the form were downloadable from a Website. The majority of the comments we received predicted significant cost increases in preparation, distribution, and processing of privacy notices. Many commenters noted that the prohibition on double-sided printing and requirement of a separate third page for mail-in opt-outs, if any, would greatly increase printing costs and would result in significant environmental waste due to increased paper usage.[244] Numerous commenters also raised concerns that the 8½ x 11-inch paper size requirement, coupled with the prohibition on incorporation of the model notice into other documents, essentially mandated a separate mailing for the model notice.[245] Commenters concluded that separate mailing of privacy notices would result in significant postage costs and increase the likelihood that consumers would misplace or fail to read the notice because it no longer accompanied important documents.[246]

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244 See, e.g., comment letters of Investment Adviser Ass'n (May 29, 2007) (estimating additional printing and mailing costs for larger investment advisory firms of $100,000 to more than $300,000 per mailing); Securities Industry and Financial Markets Ass'n (May 29, 2007) (estimating additional printing costs of $7.5 million per billion notices).

245 See, e.g., comment letters of Investment Adviser Ass'n (May 29, 2007); Citigroup Inc. (May 30, 2007).

246 See, e.g., comment letters of Financial Services Roundtable and BITS (May 29, 2007) (estimating cost to financial services industry of printing and mailing model form of

Several commenters suggested that these costs could result in lowered adoption rates for the model form.[247] Based on these comments, the Agencies have revised the amendments to allow for double-sided printing and incorporation of the mail-in opt-out on the bottom of the first page, waiver of a mandatory 8½ x 11-inch paper size, and incorporation of the model notice into other documents. We believe these accommodations will result in greatly reducing the implementation costs commenters associated with adopting the model form.

We do not expect that financial institutions will incur additional disclosure costs in using the model privacy form because the notice requirements of Regulation S-P have been effective since July 1, 2001, and are not altered by the amendments. Moreover, financial institutions will be under no obligation to adopt the model form or modify their current privacy notices. Presumably, financial institutions will not adopt the model form without first determining that associated costs are justified by the benefits.

We anticipate that financial institutions that elect to use the model privacy form could incur some small, incremental developmental costs in making the transition from their current notices to the model form. These costs could include staff time to review the model form and its instructions and complete the model form. We expect these will be minimal because the language and format in the form are standardized and financial institutions can only customize very limited sections of the model privacy form. Institution-specific information is limited to contact information, selection from a menu of terms relating to information collection, "yes" or "no" answers and brief descriptions, as necessary, of the types of entities with which the institution shares personal information. Furthermore, the model form can be downloaded from a Website so preparation costs should be minimal.

Similarly, we believe that a financial institution that adopts the model privacy form would need little, if any, initial or annual review by legal counsel because almost all the disclosures in the form are already mandated under the current disclosure regime. One

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approximately $400 million per billion notices); Citigroup Inc. (May 30, 2007) (consumers "are more likely to open and read mail that contains an 'important' communication such as a billing statement than an unidentified standalone communication").

247 See, e.g., comment letter of Capital One Financial Corporation (May 29, 2007).

commenter disagreed and suggested that legal counsel at each financial institution will spend at least 50 hours initially and annually ensuring that the model form accurately reflects the institution's privacy practices.[248] These estimates seem high because institutions already know their information collection and sharing practices and there is very little discretion the institution has in choosing from among a menu of terms to disclose that information on the model form. Even if those estimates are accurate, however, we believe that those legal costs would likely have been incurred with respect to any model form unless it conformed exactly to the institution's current form.

Transition costs may also include administrative, logistical, and training costs. For example, several commenters highlighted one-time costs stemming from rewriting notices, republishing brochures or notices, and revising or reprinting documents that incorporate current notices.[249] We anticipate these costs will be minimal, if any, in part because the Agencies are allowing financial institutions a transition period of one year during which they can continue to rely on the Sample Clauses for safe harbor or guidance. Although an institution may choose to replace a current privacy notice with a model privacy notice, this should not require substantial rewriting because there are few drafting choices in the model form. In addition, the SEC believes it is unlikely that many financial institutions have stockpiles of more than one year's worth of privacy notices or documents that incorporate privacy notices on hand for distribution. Several commenters also raised concerns regarding increased customer service demands and the necessity for financial institutions to proactively take steps to address customer confusion. For example, one commenter noted that financial institutions would face one-time costs associated with revising or preparing explanatory material for training employees regarding the model form, such as scripts and responses for call centers.[250] Since the amendments do not affect Regulation S-P's substantive requirements, we anticipate that any substantive questions about the institutions' privacy practices should already be addressed by existing explanatory materials. We anticipate any new

[248] See comment letter of Securities Industry and Financial Markets Ass'n (May 29, 2007).

[249] See comment letter of T. Rowe Price Associates, Inc. (May 29, 2007).

[250] See comment letter of Investment Adviser Ass'n (May 29, 2007).

explanatory material will be limited to questions regarding the revised format of the model form, which due to its standardized nature should be relatively simple to address.

Insofar as the Sample Clauses in current Regulation S-P may have some value to some financial institutions, their phase-out under the amendments to the rules may create some costs to those institutions. However, we expect those costs to be minimal. As discussed above, the Agencies are giving financial institutions a transition period of one year during which they can continue to rely on the Sample Clauses for guidance or a safe harbor, which should allow time to minimize the transition costs for any institutions that adopt the model privacy form. Moreover, as noted above, elimination of the Sample Clauses as guidance does not mean that institutions that continue to use these clauses are in violation of the SEC's privacy rule. Institutions may continue to use notices containing these clauses so long as these notices comply with the privacy rule.

Lastly, customers may experience certain costs associated with adoption of the model form. Several commenters suggested that the model form sacrifices greater consumer understanding about information sharing practices in exchange for a simplified notice format.[251] Another commenter speculated that adoption of the model form would result in customer confusion and potential loss of customer trust due to the misimpression that financial institutions are changing their privacy policies.[252] One commenter concluded that consumer confusion resulting from overly simplified disclosures would lead to unacceptably high opt-out rates and discourage use of the model form by financial institutions.[253] As discussed above, the model form was developed in an extensive consumer research testing process that sought to maximize consumers' ability to comprehend, use, and compare privacy notices. The model form emerged as the most effective of several notice formats considered as part of this testing. Consequently, the SEC believes that any customer confusion that results from adoption of the model form will be minimal. Furthermore, we expect that any such confusion will be rapidly dissipated if financial institutions make widespread use of the model privacy form and consumers become more familiar with its contents.

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251 See, e.g., comment letter of Bank of America Corporation (May 29, 2007).

252 See comment letter of Visa U.S.A. Inc. (May 29, 2007).

253 See comment letter of Financial Services Institute (May 29, 2007).

Although the SEC cannot determine aggregate costs because of the unknown number of financial institutions that will adopt the model form, we expect each financial institution choosing to adopt the model form to incur minimal, if any, costs. As discussed above, we do not anticipate that financial institutions will incur additional disclosure costs in using the model privacy form because the substantive notice requirements of Regulation S-P have been effective since July 1, 2001, and are not altered by the amendments. We expect notice development and transition costs to be minimal because the language and format in the model form are standardized and financial institutions can only customize a few sections of the model form by selecting from among a menu of specific terms. Furthermore, the model form can be downloaded from a Website so preparation costs should be minimal. Moreover, the Agencies are giving financial institutions one year in which they can continue to rely on the Sample Clauses for safe harbor or guidance, which should allow time to minimize the transition costs for any institution that adopts the model privacy form.

Similarly, the SEC expects any aggregate costs to consumers that may result from adoption of the model form to be minimal, if any. As discussed above, the model form emerged as the most effective of several notice formats in an extensive consumer research testing process that sought to maximize consumers' ability to comprehend, use, and compare privacy notices. We anticipate that any initial costs to consumers in the form of confusion or reduced understanding will be short-lived as increasing numbers of financial institutions use the model privacy form and consumers become more familiar with its contents and can use the form to compare notices more easily.

XII. 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 will have on competition.[254] Section 23(a)(2) also prohibits the SEC from adopting any rule that will impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Securities Exchange Act.

As discussed above, the amendments to Regulation S-P, including the model form, are designed to comply with section 728 of the Regulatory Relief Act, mandating

254 See 15 U.S.C. 78w(a)(2).

that the Agencies develop a model form that is comprehensible, clear and conspicuous, and succinct. SEC-regulated institutions will 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 amendments to have a significant impact on competition. Use of the model form will be voluntary, permitting a financial institution to determine whether using the model form will enhance its competitive position. All brokers and dealers, investment companies, and registered investment advisers will be able to use the model form and take advantage of the safe harbor. Other financial institutions will be able to use the form and take advantage of the safe harbor under comparable rules adopted 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 amendments. Therefore, all financial institutions will have the same opportunity to use the model form and rely on the safe harbor.

Further, if financial institutions choose to use the model form, the amendments could promote competition by enabling consumers more easily to understand and compare competing institutions' privacy policies. The SEC also anticipates that the model form's standardized formatting may 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 impact on competition caused by the amendments would not be significant.

XIII. NCUA: THE TREASURY AND GENERAL GOVERNMENT APPROPRIATIONS ACT, 1999-ASSESSMENT OF FEDERAL REGULATIONS AND POLICIES ON FAMILIES

The NCUA has determined that this rule will 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).

XIV. 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 regulation outweigh its costs. Nor does it require that each 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 model form as a totality. The form provides a non-mandatory 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 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.

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 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:

A. Revise paragraphs (b) and (f), and add paragraph (g) to read as set forth below.

B. Effective January 1, 2012, remove paragraph (g).

§ 40.6 Information to be included in privacy notices.

* * * * *

(b) Description of nonaffiliated third parties subject to exceptions. If you disclose nonpublic personal information to third parties as authorized under §§ 40.14 and 40.15, you are not required to list those exceptions in the initial or annual privacy notices required by §§ 40.4 and 40.5. When describing the categories with respect to those parties, it is sufficient to state that you make disclosures to other nonaffiliated companies:

(1) For your everyday business purposes, such as [include all that apply] to process transactions, maintain account(s), respond to court orders and legal investigations, or report to credit bureaus; or

(2) As permitted by law.

* * * * *

(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 December 31, 2010, 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 to part 40 as Appendix B to part 40.

6. Add new Appendix A to part 40 to read as follows:

APPENDIX A TO PART 40-MODEL PRIVACY FORM

A. The model privacy form.

Version 1: Model Form With No Opt-Out.

Rev. [insert date]

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 are *no longer* our customer, we continue to share your information as described in this notice.
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

Questions?	Call [phone number] or go to [website]

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Who we are

Who is providing this notice?	[insert]

What we do

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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]

Definitions

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 information]*

Other important information

[insert other important information]

Version 2: Model Form with Opt-Out by Telephone and/or Online.

Rev. [insert date]

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]

How?

All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing

- Call [phone number]—our menu will prompt you through your choice(s) or
- Visit us online: [website]

Please note:

If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice.

However, you can contact us at any time to limit our sharing.

Questions?

Call [phone number] or go to [website]

Page 2

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 3: Model Form with Mail-In Opt-Out Form.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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 [illegible] share?	Can you limit this sharing?
For our everyday business purposes— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) ■ Visit us online: [website] or ■ Mail the form below **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

Mail-in Form

Leave Blank OR [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ❑ Apply my choices only to me]	Mark any/all you want to limit: ❑ 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. ❑ Do not share my personal information with nonaffiliates to market their products and services to me.	
	Name	**Mail to:** [Name of Financial Institution] [Address1] [Address2] [City], [ST] [ZIP]
	Address	
	City, State, Zip	
	[illegible]	

Page 2

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 4. Optional Mail-in Form.

Mail-in Form		
Leave Blank OR [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ❑ Apply my choices only to me]	Mark any/all you want to limit: ❑ 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. ❑ Do not share my personal information with nonaffiliates to market their products and services to me.	
	Name	
	Address	
	City, State, Zip	
	[illegible]	

Mail To: [Name of Financial Institution], [Address1]
[Address2], [City], [ST] [ZIP]

B. General Instructions

1. How the model privacy form is used.

(a) The model form may be used, at the option of a financial institution, including a group of financial institutions that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in §§ 40.6 and 40.7 of this part.

(b) The model form is a standardized form, including page layout, content, format, style, pagination, and shading. Institutions seeking to obtain the safe harbor through use of the model form may modify it only as described in these Instructions.

(c) 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.

(d) The word “customer” may be replaced by the word “member” whenever it appears in the model form, as appropriate.

2. The contents of the model privacy form.

The model form consists of two pages, which may be printed on both sides of a single sheet of paper, or may appear on two separate pages. Where an institution provides a long list of institutions at the end of the model form in accordance with Instruction C.3(a)(1), or provides additional information in accordance with Instruction C.3(c), and such list or additional information exceeds the space available on page two of the model form, such list or additional information may extend to a third page.

(a) *Page One*. The first page consists of the following components:

(1) Date last revised (upper right-hand corner).

(2) Title.

(3) Key frame (Why?, What?, How?).

(4) Disclosure table ("Reasons we can share your personal information").

(5) "To limit our sharing" box, as needed, for the financial institution's opt-out information.

(6) "Questions" box, for customer service contact information.

(7) Mail-in opt-out form, as needed.

(b) *Page Two*. The second page consists of the following components:

(1) Heading (Page 2).

(2) Frequently Asked Questions ("Who we are" and "What we do").

(3) Definitions.

(4) "Other important information" box, as needed.

3. The format of the model privacy form.

The format of 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. While a number of factors together produce easily readable type font, institutions are required to use a minimum of 10-point font (unless otherwise expressly permitted in these Instructions) 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 paper in portrait orientation, the size of which must be sufficient to meet the layout and minimum font size requirements, with sufficient white space on the top, bottom, and sides of the content.

(d) *Color.* The model form must be printed on white or light color paper (such as cream) with black or other contrasting ink color. 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. Logos may also be printed in color.

(e) *Languages.* The model form may be translated into languages other than English.

C. Information Required in the Model Privacy Form

The information in the model form may be modified only as described below:

1. Name of the institution or group of affiliated institutions providing the notice.

Insert the name of the financial institution providing the notice or a common identity of affiliated institutions jointly providing the notice on the form wherever **[name of financial institution]** appears.

2. Page one.

(a) *Last revised date.* The financial institution must insert in the upper right-hand corner the date on which the notice was last revised. The information shall appear in minimum 8-point font as "rev. [month/year]" using either the name or number of the month, such as "rev. July 2009" or "rev. 7/09".

(b) *General instructions for the "What?" box.*

(1) The bulleted list identifies the types of personal information that the institution collects and shares. All institutions must use the term "Social Security number" in the first bullet.

(2) Institutions must use five (5) of the following terms to complete the bulleted list: income; account balances; payment history; transaction history; transaction or loss history; credit history; credit scores; assets; investment experience; credit-based insurance scores; insurance claim history; medical information; overdraft history; purchase history; account transactions; risk tolerance; medical-related debts; credit card or other debt; mortgage rates and payments; retirement assets; checking account information; employment information; wire transfer instructions.

(c) *General instructions for the disclosure table.* The left column lists reasons for sharing or using personal information. Each reason correlates to a specific legal provision described in paragraph C.2(d) of this Instruction. In the middle column, each institution must provide a "Yes" or "No" response that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. In the right column, each institution must provide in each box one of the following three (3) responses, as applicable, that reflects whether a consumer can limit such sharing: "Yes" if it is required to or voluntarily provides an opt-out; "No" if it does not provide an opt-out; or "We don't share" if it answers "No" in the middle column. Only the sixth row ("For our affiliates to market to you") may be omitted at the option of the institution. See paragraph C.2(d)(6) of this Instruction.

(d) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* This reason incorporates sharing information under §§ 40.14 and 40.15 and with service providers pursuant to § 40.13 of this part

other than the purposes specified in paragraphs C.2(d)(2) or C.2(d)(3) of these Instructions.

(2) *For our marketing purposes.* This reason incorporates sharing information with service providers by an institution for its own marketing pursuant to § 40.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(3) *For joint marketing with other financial companies.* This reason incorporates sharing information under joint marketing agreements between two or more financial institutions and with any service provider used in connection with such agreements pursuant to § 40.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This reason incorporates sharing information specified in sections 603(d)(2)(A)(i) and (ii) of the FCRA. An institution that shares for this reason may choose to provide an opt-out.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This reason incorporates sharing information pursuant to section 603(d)(2)(A)(iii) of the FCRA. An institution that shares for this reason must provide an opt-out.

(6) *For our affiliates to market to you.* This reason incorporates sharing information specified in section 624 of the FCRA. This reason may be omitted from the disclosure table when: the institution does not have affiliates (or does not disclose personal information to its affiliates); the institution's affiliates do not use personal information in a manner that requires an opt-out; or the institution provides the affiliate marketing

notice separately. Institutions that include this reason must provide an opt-out of indefinite duration. An institution that is required to provide an affiliate marketing opt-out, but does not include that opt-out in the model form under this part, must comply with section 624 of the FCRA and 12 CFR Part 41, Subpart C, with respect to the initial notice and opt-out and any subsequent renewal notice and opt-out. An institution not required to provide an opt-out under this subparagraph may elect to include this reason in the model form.

(7) *For nonaffiliates to market to you.* This reason incorporates sharing described in §§ 40.7 and 40.10(a) of this part. An institution that shares personal information for this reason must provide an opt-out.

(e) *To limit our sharing*: A financial institution must include this section of the model form only if it provides an opt-out. The word "choice" may be written in either the singular or plural, as appropriate. Institutions must select one or more of the applicable opt-out methods described: telephone, such as by a toll-free number; a Website; or use of a mail-in opt-out form. Institutions may include the words "toll-free" before telephone, as appropriate. An institution that allows consumers to opt out online must provide either a specific Web address that takes consumers directly to the opt-out page or a general Web address that provides a clear and conspicuous direct link to the opt-out page. The opt-out choices made available to the consumer who contacts the institution through these methods must correspond accurately to the "Yes" responses in the third column of the disclosure table. In the part titled "Please note" institutions may insert a number that is 30 or greater in the space marked "[30]." Instructions on voluntary or

state privacy law opt-out information are in paragraph C.2(g)(5) of these Instructions.

(f) *Questions box.* Customer service contact information must be inserted as appropriate, where **[phone number]** or **[website]** appear. Institutions may elect to provide either a phone number, such as a toll-free number, or a Web address, or both. Institutions may include the words "toll-free" before the telephone number, as appropriate.

(g) *Mail-in opt-out form.* Financial institutions must include this mail-in form only if they state in the "To limit our sharing" box that consumers can opt out by mail. The mail-in form must provide opt-out options that correspond accurately to the "Yes" responses in the third column in the disclosure table. Institutions that require customers to provide only name and address may omit the section identified as "[account #]." Institutions that require additional or different information, such as a random opt-out number or a truncated account number, to implement an opt-out election should modify the "[account #]" reference accordingly. This includes institutions that require customers with multiple accounts to identify each account to which the opt-out should apply. An institution must enter its opt-out mailing address: in the far right of this form (see version 3); or below the form (see version 4). The reverse side of the mail-in opt-out form must not include any content of the model form.

(1) *Joint accountholder.* Only institutions that provide their joint accountholders the choice to opt out for only one accountholder, in accordance with paragraph C.3(a)(5) of these Instructions, must include in the far left column of the mail-in form the following statement: "If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. □ Apply my choice(s) only

to me." The word "choice" may be written in either the singular or plural, as appropriate. Financial institutions that provide insurance products or services, provide this option, and elect to use the model form may substitute the word "policy" for "account" in this statement. Institutions that do not provide this option may eliminate this left column from the mail-in form.

(2) *FCRA Section 603(d)(2)(A)(iii) opt-out.* If the institution shares personal information pursuant to section 603(d)(2)(A)(iii) of the FCRA, it must include in the mail-in opt-out form the following statement: "□ Do not share information about my creditworthiness with your affiliates for their everyday business purposes."

(3) *FCRA Section 624 opt-out.* If the institution incorporates section 624 of the FCRA in accord with paragraph C.2(d)(6) of these Instructions, it must include in the mail-in opt-out form the following statement: "□ Do not allow your affiliates to use my personal information to market to me."

(4) *Nonaffiliate opt-out.* If the financial institution shares personal information pursuant to § 40.10(a) of this part, it must include in the mail-in opt-out form the following statement: "□ Do not share my personal information with nonaffiliates to market their products and services to me."

(5) *Additional opt-outs.* Financial institutions that use the disclosure table to provide opt-out options beyond those required by Federal law must provide those opt-outs in this section of the model form. A financial institution that chooses to offer an opt-out for its own marketing in the mail-in opt-out form must include one of the two following statements: "□ Do not share my personal information to market to me." or "□ Do not use my personal information to

market to me." A financial institution that chooses to offer an opt-out for joint marketing must include the following statement: "□ Do not share my personal information with other financial institutions to jointly market to me."

(h) *Barcodes.* A financial institution may elect to include a barcode and/or "tagline" (an internal identifier) in 6-point font at the bottom of page one, as needed for information internal to the institution, so long as these do not interfere with the clarity or text of the form.

3. Page two.

(a) *General Instructions for the Questions.* Certain of the Questions may be customized as follows:

(1) *"Who is providing this notice?"* This question may be omitted where only one financial institution provides the model form and that institution is clearly identified in the title on page one. Two or more financial institutions that jointly provide the model form must use this question to identify themselves as required by § 40.9(f) of this part. Where the list of institutions exceeds four (4) lines, the institution must describe in the response to this question the general types of institutions jointly providing the notice and must separately identify those institutions, in minimum 8-point font, directly following the "Other important information" box, or, if that box is not included in the institution's form, directly following the "Definitions." The list may appear in a multi-column format.

(2) *"How does **[name of financial institution]** protect my personal information?"* The financial institution may only provide additional information pertaining to its safeguards practices following the designated response to this question. Such information may include information about the institution's use of cookies or other measures it uses to

safeguard personal information. Institutions are limited to a maximum of 30 additional words.

(3) *"How does **[name of financial institution]** collect my personal information?"* Institutions must use five (5) of the following terms to complete the bulleted list for this question: open an account; deposit money; pay your bills; apply for a loan; use your credit or debit card; seek financial or tax advice; apply for insurance; pay insurance premiums; file an insurance claim; seek advice about your investments; buy securities from us; sell securities to us; direct us to buy securities; direct us to sell your securities; make deposits or withdrawals from your account; enter into an investment advisory contract; give us your income information; provide employment information; give us your employment history; tell us about your investment or retirement portfolio; tell us about your investment or retirement earnings; apply for financing; apply for a lease; provide account information; give us your contact information; pay us by check; give us your wage statements; provide your mortgage information; make a wire transfer; tell us who receives the money; tell us where to send the money; show your government-issued ID; show your driver's license; order a commodity futures or option trade. Institutions that collect personal information from their affiliates and/or credit bureaus must include after the bulleted list the following statement: "We also collect your personal information from others, such as credit bureaus, affiliates, or other companies." Institutions that do not collect personal information from their affiliates or credit bureaus but do collect information from other companies must include the following statement instead: "We also collect your personal information from other companies."

Only institutions that do not collect any personal information from affiliates, credit bureaus, or other companies can omit both statements.

(4) *"Why can't I limit all sharing?"* Institutions that describe state privacy law provisions in the *"Other important information"* box must use the bracketed sentence: "See below for more on your rights under state law." Other institutions must omit this sentence.

(5) *"What happens when I limit sharing for an account I hold jointly with someone else?"* Only financial institutions that provide opt-out options must use this question. Other institutions must omit this question. Institutions must choose one of the following two statements to respond to this question: "Your choices will apply to everyone on your account." or "Your choices will apply to everyone on your account–unless you tell us otherwise." Financial institutions that provide insurance products or services and elect to use the model form may substitute the word "policy" for "account" in these statements.

(b) *General Instructions for the Definitions.*

The financial institution must customize the space below the responses to the three definitions in this section. This specific information must be in italicized lettering to set off the information from the standardized definitions.

(1) *Affiliates.* As required by § 40.6(a)(3) of this part, where [***affiliate information***] appears, the financial institution must:

(i) If it has no affiliates, state: "[***name of financial institution***] *has no affiliates*";

(ii) If it has affiliates but does not share personal information, state: "*[**name of financial institution**] does not share with our affiliates*"; or

(iii) If it shares with its affiliates, state, as applicable: *"Our affiliates include companies with a* ***[common corporate identity of financial institution]*** *name; financial companies such as* ***[insert illustrative list of companies]****; nonfinancial companies, such as* ***[insert illustrative list of companies;]*** *and others, such as* ***[insert illustrative list]****."*

(2) *Nonaffiliates.* As required by § 40.6(c)(3) of this part, where [***nonaffiliate information***] appears, the financial institution must:

(i) If it does not share with nonaffiliated third parties, state: "[***name of financial institution***] *does not share with nonaffiliates so they can market to you*"; or

(ii) If it shares with nonaffiliated third parties, state, as applicable: "*Nonaffiliates we share with can include* ***[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]****.*"

(3) *Joint Marketing.* As required by § 40.13 of this part, where [***joint marketing***] appears, the financial institution must:

(i) If it does not engage in joint marketing, state: *"****[name of financial institution]*** *doesn't jointly market*"; or

(ii) If it shares personal information for joint marketing, state, as applicable: "*Our joint marketing partners include* ***[list categories of companies such as credit card companies***]."

(c) *General instructions for the "Other important information" box.* This box is optional. The space provided for information in this box is not limited. Only the following types of information can appear in this box.

(1) State and/or international privacy law information; and/or

(2) Acknowledgment of receipt form.

7. Amend newly redesignated Appendix B to Part 40 as follows:

A. Adding a new sentence to the beginning of the introductory text as set forth below.

B. Effective January 1, 2012, remove Appendix B to part 40.

APPENDIX B TO PART 40-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided before January 1, 2011.

* * * * *

Federal Reserve System

12 CFR Chapter II

Authority and Issuance

For the reasons set forth in the joint preamble, the Board amends part 216 of chapter II of title 12 of the Code of Federal Regulations as follows:

PART 216-PRIVACY OF CONSUMER FINANCIAL INFORMATION

8. The authority citation for part 216 continues to read as follows:

Authority: 15 U.S.C. 6801 et seq.

9. 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.

10. In § 216.6:

A. Revise paragraphs (b) and (f), and add paragraph (g) to read as set forth below.

B. Effective January 1, 2012, remove paragraph (g).

§ 216.6 Information to be included in privacy notices.

* * * * *

(b) Description of nonaffiliated third parties subject to exceptions. If you disclose nonpublic personal information to third parties as authorized under §§ 216.14 and 216.15, you are not required to list those exceptions in the initial or annual privacy notices required by §§ 216.4 and 216.5. When describing the categories with respect to those parties, it is sufficient to state that you make disclosures to other nonaffiliated companies:

(1) For your everyday business purposes, such as [include all that apply] to process transactions, maintain account(s), respond to court orders and legal investigations, or report to credit bureaus; or

(2) As permitted by law.

* * * * *

(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 December 31, 2010, to the extent applicable, constitutes compliance with this part.

11. 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].

12. Redesignate Appendix A to part 216 as Appendix B to part 216.

13. Add new Appendix A to part 216 to read as follows:

APPENDIX A TO PART 216-MODEL PRIVACY FORM

A. The model privacy form.

Version 1: Model Form With No Opt-Out.

Rev. [insert date]

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 are *no longer* our customer, we continue to share your information as described in this notice.
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

Questions?	Call [phone number] or go to [website]

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 2: Model Form with Opt-Out by Telephone and/or Online.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) or ■ Visit us online: [website] **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 3: Model Form with Mail-In Opt-Out Form.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) ■ Visit us online: [website] or ■ Mail the form below **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

Mail-in Form

Leave Blank **OR** [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ☐ Apply my choices only to me]	Mark any/all you want to limit: ☐ 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. ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Name		**Mail to:** [Name of Financial Institution] [Address1] [Address2] [City], [ST] [ZIP]
	Address		
	City, State, Zip		
	Account #		

Page 2

Who we are	
Who is providing this notice?	[insert]
What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]
Definitions	
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 information]*

Other important information

[insert other important information]

Version 4. Optional Mail-in Form.

Mail-in Form		
Leave Blank OR [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ❑ Apply my choices only to me]	Mark any/all you want to limit: ❑ 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. ❑ Do not share my personal information with nonaffiliates to market their products and services to me.	
	Name	
	Address	
	City, State, Zip	
	[Account #]	

Mail To: [Name of Financial Institution], [Address1]
[Address2], [City], [ST] [ZIP]

B. General Instructions

1. How the model privacy form is used.

(a) The model form may be used, at the option of a financial institution, including a group of financial institutions that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in §§ 216.6 and 216.7 of this part.

(b) The model form is a standardized form, including page layout, content, format, style, pagination, and shading. Institutions seeking to obtain the safe harbor through use of the model form may modify it only as described in these Instructions.

(c) 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.

(d) The word "customer" may be replaced by the word "member" whenever it appears in the model form, as appropriate.

2. The contents of the model privacy form.

The model form consists of two pages, which may be printed on both sides of a single sheet of paper, or may appear on two separate pages. Where an institution provides a long list of institutions at the end of the model form in accordance with Instruction C.3(a)(1), or provides additional information in accordance with Instruction C.3(c), and such list or additional information exceeds the space available on page two of the model form, such list or additional information may extend to a third page.

(a) *Page One*. The first page consists of the following components:

(1) Date last revised (upper right-hand corner).

(2) Title.

(3) Key frame (Why?, What?, How?).

(4) Disclosure table ("Reasons we can share your personal information").

(5) "To limit our sharing" box, as needed, for the financial institution's opt-out information.

(6) "Questions" box, for customer service contact information.

(7) Mail-in opt-out form, as needed.

(b) *Page Two*. The second page consists of the following components:

(1) Heading (Page 2).

(2) Frequently Asked Questions ("Who we are" and "What we do").

(3) Definitions.

(4) "Other important information" box, as needed.

3. The format of the model privacy form.

The format of 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. While a number of factors together produce easily readable type font, institutions are required to use a minimum of 10-point font (unless otherwise expressly permitted in these Instructions) 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 paper in portrait orientation, the size of which must be sufficient to meet the layout and minimum font size requirements, with sufficient white space on the top, bottom, and sides of the content.

(d) *Color.* The model form must be printed on white or light color paper (such as cream) with black or other contrasting ink color. 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. Logos may also be printed in color.

(e) *Languages.* The model form may be translated into languages other than English.

C. Information Required in the Model Privacy Form

The information in the model form may be modified only as described below:

1. Name of the institution or group of affiliated institutions providing the notice.

Insert the name of the financial institution providing the notice or a common identity of affiliated institutions jointly providing the notice on the form wherever **[name of financial institution]** appears.

2. Page one.

(a) *Last revised date.* The financial institution must insert in the upper right-hand corner the date on which the notice was last revised. The information shall appear in minimum 8-point font as "rev. [month/year]" using either the name or number of the month, such as "rev. July 2009" or "rev. 7/09".

(b) *General instructions for the "What?" box.*

(1) The bulleted list identifies the types of personal information that the institution collects and shares. All institutions must use the term "Social Security number" in the first bullet.

(2) Institutions must use five (5) of the following terms to complete the bulleted list: income; account balances; payment history; transaction history; transaction or loss history; credit history; credit scores; assets; investment experience; credit-based insurance scores; insurance claim history; medical information; overdraft history; purchase history; account transactions; risk tolerance; medical-related debts; credit card or other debt; mortgage rates and payments; retirement assets; checking account information; employment information; wire transfer instructions.

(c) *General instructions for the disclosure table.* The left column lists reasons for sharing or using personal information. Each reason correlates to a specific legal provision described in paragraph C.2(d) of this Instruction. In the middle column, each institution must provide a "Yes" or "No" response that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. In the right column, each institution must provide in each box one of the following three (3) responses, as applicable, that reflects whether a consumer can limit such sharing: "Yes" if it is required to or voluntarily provides an opt-out; "No" if it does not provide an opt-out; or "We don't share" if it answers "No" in the middle column. Only the sixth row ("For our affiliates to market to you") may be omitted at the option of the institution. <u>See</u> paragraph C.2(d)(6) of this Instruction.

(d) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* This reason incorporates sharing information under §§ 216.14 and 216.15 and with service providers pursuant to § 216.13 of

this part other than the purposes specified in paragraphs C.2(d)(2) or C.2(d)(3) of these Instructions.

(2) *For our marketing purposes.* This reason incorporates sharing information with service providers by an institution for its own marketing pursuant to § 216.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(3) *For joint marketing with other financial companies.* This reason incorporates sharing information under joint marketing agreements between two or more financial institutions and with any service provider used in connection with such agreements pursuant to § 216.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This reason incorporates sharing information specified in sections 603(d)(2)(A)(i) and (ii) of the FCRA. An institution that shares for this reason may choose to provide an opt-out.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This reason incorporates sharing information pursuant to section 603(d)(2)(A)(iii) of the FCRA. An institution that shares for this reason must provide an opt-out.

(6) *For our affiliates to market to you.* This reason incorporates sharing information specified in section 624 of the FCRA. This reason may be omitted from the disclosure table when: the institution does not have affiliates (or does not disclose personal information to its affiliates); the institution's affiliates do not use personal information in a manner that requires an opt-out; or the institution provides the affiliate marketing

notice separately. Institutions that include this reason must provide an opt-out of indefinite duration. An institution that is required to provide an affiliate marketing opt-out, but does not include that opt-out in the model form under this part, must comply with section 624 of the FCRA and 12 CFR Part 222, Subpart C, with respect to the initial notice and opt-out and any subsequent renewal notice and opt-out. An institution not required to provide an opt-out under this subparagraph may elect to include this reason in the model form.

(7) *For nonaffiliates to market to you.* This reason incorporates sharing described in §§ 216.7 and 216.10(a) of this part. An institution that shares personal information for this reason must provide an opt-out.

(e) *To limit our sharing*: A financial institution must include this section of the model form only if it provides an opt-out. The word "choice" may be written in either the singular or plural, as appropriate. Institutions must select one or more of the applicable opt-out methods described: telephone, such as by a toll-free number; a Website; or use of a mail-in opt-out form. Institutions may include the words "toll-free" before telephone, as appropriate. An institution that allows consumers to opt out online must provide either a specific Web address that takes consumers directly to the opt-out page or a general Web address that provides a clear and conspicuous direct link to the opt-out page. The opt-out choices made available to the consumer who contacts the institution through these methods must correspond accurately to the "Yes" responses in the third column of the disclosure table. In the part titled "Please note" institutions may insert a number that is 30 or greater in the space marked "[30]." Instructions on voluntary or

state privacy law opt-out information are in paragraph C.2(g)(5) of these Instructions.

(f) *Questions box.* Customer service contact information must be inserted as appropriate, where **[phone number]** or **[website]** appear. Institutions may elect to provide either a phone number, such as a toll-free number, or a Web address, or both. Institutions may include the words "toll-free" before the telephone number, as appropriate.

(g) *Mail-in opt-out form.* Financial institutions must include this mail-in form <u>only</u> if they state in the "To limit our sharing" box that consumers can opt out by mail. The mail-in form must provide opt-out options that correspond accurately to the "Yes" responses in the third column in the disclosure table. Institutions that require customers to provide only name and address may omit the section identified as "[account #]." Institutions that require additional or different information, such as a random opt-out number or a truncated account number, to implement an opt-out election should modify the "[account #]" reference accordingly. This includes institutions that require customers with multiple accounts to identify each account to which the opt-out should apply. An institution must enter its opt-out mailing address: in the far right of this form (<u>see</u> version 3); or below the form (<u>see</u> version 4). The reverse side of the mail-in opt-out form must not include any content of the model form.

(1) *Joint accountholder.* Only institutions that provide their joint accountholders the choice to opt out for only one accountholder, in accordance with paragraph C.3(a)(5) of these Instructions, must include in the far left column of the mail-in form the following statement: "If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. □ Apply my choice(s) only

to me." The word "choice" may be written in either the singular or plural, as appropriate. Financial institutions that provide insurance products or services, provide this option, and elect to use the model form may substitute the word "policy" for "account" in this statement. Institutions that do not provide this option may eliminate this left column from the mail-in form.

(2) *FCRA Section 603(d)(2)(A)(iii) opt-out*. If the institution shares personal information pursuant to section 603(d)(2)(A)(iii) of the FCRA, it must include in the mail-in opt-out form the following statement: "□ Do not share information about my creditworthiness with your affiliates for their everyday business purposes."

(3) *FCRA Section 624 opt-out*. If the institution incorporates section 624 of the FCRA in accord with paragraph C.2(d)(6) of these Instructions, it must include in the mail-in opt-out form the following statement: "□ Do not allow your affiliates to use my personal information to market to me."

(4) *Nonaffiliate opt-out*. If the financial institution shares personal information pursuant to § 216.10(a) of this part, it must include in the mail-in opt-out form the following statement: "□ Do not share my personal information with nonaffiliates to market their products and services to me."

(5) *Additional opt-outs*. Financial institutions that use the disclosure table to provide opt-out options beyond those required by Federal law must provide those opt-outs in this section of the model form. A financial institution that chooses to offer an opt-out for its own marketing in the mail-in opt-out form must include one of the two following statements: "□ Do not share my personal information to market to me." or "□ Do not use my personal information to

market to me." A financial institution that chooses to offer an opt-out for joint marketing must include the following statement: "□ Do not share my personal information with other financial institutions to jointly market to me."

(h) *Barcodes.* A financial institution may elect to include a barcode and/or "tagline" (an internal identifier) in 6-point font at the bottom of page one, as needed for information internal to the institution, so long as these do not interfere with the clarity or text of the form.

3. Page two.

(a) *General Instructions for the Questions.* Certain of the Questions may be customized as follows:

(1) *"Who is providing this notice?"* This question may be omitted where only one financial institution provides the model form and that institution is clearly identified in the title on page one. Two or more financial institutions that jointly provide the model form must use this question to identify themselves as required by § 216.9(f) of this part. Where the list of institutions exceeds four (4) lines, the institution must describe in the response to this question the general types of institutions jointly providing the notice and must separately identify those institutions, in minimum 8-point font, directly following the "Other important information" box, or, if that box is not included in the institution's form, directly following the "Definitions." The list may appear in a multi-column format.

(2) *"How does **[name of financial institution]** protect my personal information?"* The financial institution may only provide additional information pertaining to its safeguards practices following the designated response to this question. Such information may include information about the institution's use of cookies or other measures it uses to

safeguard personal information. Institutions are limited to a maximum of 30 additional words.

(3) *"How does* ***[name of financial institution]*** *collect my personal information?"* Institutions must use five (5) of the following terms to complete the bulleted list for this question: open an account; deposit money; pay your bills; apply for a loan; use your credit or debit card; seek financial or tax advice; apply for insurance; pay insurance premiums; file an insurance claim; seek advice about your investments; buy securities from us; sell securities to us; direct us to buy securities; direct us to sell your securities; make deposits or withdrawals from your account; enter into an investment advisory contract; give us your income information; provide employment information; give us your employment history; tell us about your investment or retirement portfolio; tell us about your investment or retirement earnings; apply for financing; apply for a lease; provide account information; give us your contact information; pay us by check; give us your wage statements; provide your mortgage information; make a wire transfer; tell us who receives the money; tell us where to send the money; show your government-issued ID; show your driver's license; order a commodity futures or option trade. Institutions that collect personal information from their affiliates and/or credit bureaus must include after the bulleted list the following statement: "We also collect your personal information from others, such as credit bureaus, affiliates, or other companies." Institutions that do not collect personal information from their affiliates or credit bureaus but do collect information from other companies must include the following statement instead: "We also collect your personal information from other companies."

Only institutions that do not collect any personal information from affiliates, credit bureaus, or other companies can omit both statements.

(4) *"Why can't I limit all sharing?"* Institutions that describe state privacy law provisions in the "*Other important information"* box must use the bracketed sentence: "See below for more on your rights under state law." Other institutions must omit this sentence.

(5) *"What happens when I limit sharing for an account I hold jointly with someone else?"* Only financial institutions that provide opt-out options must use this question. Other institutions must omit this question. Institutions must choose one of the following two statements to respond to this question: "Your choices will apply to everyone on your account." or "Your choices will apply to everyone on your account–unless you tell us otherwise." Financial institutions that provide insurance products or services and elect to use the model form may substitute the word "policy" for "account" in these statements.

(b) *General Instructions for the Definitions.*

The financial institution must customize the space below the responses to the three definitions in this section. This specific information must be in italicized lettering to set off the information from the standardized definitions.

(1) *Affiliates.* As required by § 216.6(a)(3) of this part, where [***affiliate information***] appears, the financial institution must:

(i) If it has no affiliates, state: "[***name of financial institution***] *has no affiliates*";

(ii) If it has affiliates but does not share personal information, state: "*[**name of financial institution**] does not share with our affiliates*"; or

(iii) If it shares with its affiliates, state, as applicable: *"Our affiliates include companies with a* ***[common corporate identity of financial institution]*** *name; financial companies such as* ***[insert illustrative list of companies]****; nonfinancial companies, such as* ***[insert illustrative list of companies;]*** *and others, such as* ***[insert illustrative list]****."*

(2) *Nonaffiliates.* As required by § 216.6(c)(3) of this part, where [***nonaffiliate information***] appears, the financial institution must:

(i) If it does not share with nonaffiliated third parties, state: "[***name of financial institution***] *does not share with nonaffiliates so they can market to you*"; or

(ii) If it shares with nonaffiliated third parties, state, as applicable: "*Nonaffiliates we share with can include* ***[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]****.*"

(3) *Joint Marketing.* As required by § 216.13 of this part, where [***joint marketing***] appears, the financial institution must:

(i) If it does not engage in joint marketing, state: "***[name of financial institution]*** *doesn't jointly market*"; or

(ii) If it shares personal information for joint marketing, state, as applicable: "*Our joint marketing partners include* ***[list categories of companies such as credit card companies***]."

(c) *General instructions for the "Other important information" box.* This box is optional. The space provided for information in this box is not limited. Only the following types of information can appear in this box.

(1) State and/or international privacy law information; and/or

(2) Acknowledgment of receipt form.

14. Amend newly redesignated Appendix B to part 216 as follows:

A. Adding a new sentence to the beginning of the introductory text as set forth below.

B. Effective January 1, 2012, remove Appendix B to part 216.

APPENDIX B TO PART 216-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided before January 1, 2011.

* * * * *

Federal Deposit Insurance Corporation

12 CFR Chapter III

Authority and Issuance

For the reasons set forth in the joint preamble, part 332 of chapter III of title 12 of the Code of Federal Regulations is revised as follows:

PART 332-PRIVACY OF CONSUMER FINANCIAL INFORMATION

15. 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.

16. 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.

17. In § 332.6:

A. Revise paragraphs (b) and (f), and add paragraph (g) to read as set forth below.

B. Effective January 1, 2012, remove paragraph (g).

§ 332.6 Information to be included in privacy notices.

* * * * *

(b) Description of nonaffiliated third parties subject to exceptions. If you disclose nonpublic personal information to third parties as authorized under §§ 332.14 and 332.15, you are not required to list those exceptions in the initial or annual privacy notices required by §§ 332.4 and 332.5. When describing the categories with respect to those parties, it is sufficient to state that you make disclosures to other nonaffiliated companies:

(1) For your everyday business purposes, such as [include all that apply] to process transactions, maintain account(s), respond to court orders and legal investigations, or report to credit bureaus; or

(2) As permitted by law.

*   *   *   *   *

(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 December 31, 2010, to the extent applicable, constitutes compliance with this part.

18. 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].

19. Redesignate Appendix A to part 332 as Appendix B to part 332.

20. Add new Appendix A to part 332 to read as follows:

APPENDIX A TO PART 332-MODEL PRIVACY FORM

A. The model privacy form.

Version 1: Model Form With No Opt-Out.

Rev. [insert date]

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 are *no longer* our customer, we continue to share your information as described in this notice.
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

Questions?	Call [phone number] or go to [website]

Page 2

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 2: Model Form with Opt-Out by Telephone and/or Online.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) or ■ Visit us online: [website] **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 3: Model Form with Mail-In Opt-Out Form.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) ■ Visit us online: [website] or ■ Mail the form below **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

✂

Mail-in Form

Leave Blank OR [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ☐ Apply my choices only to me]	Mark any/all you want to limit: ☐ 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. ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Name		**Mail to:** [Name of Financial Institution] [Address1] [Address2] [City], [ST] [ZIP]
	Address		
	City, State, Zip		
	[Account #]		

Page 2

Who we are	
Who is providing this notice?	[insert]
What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]
Definitions	
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 information]*
Other important information	
[insert other important information]	

Version 4. Optional Mail-in Form.

Mail-in Form		
Leave Blank **OR** [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ❑ Apply my choices only to me]	Mark any/all you want to limit: ❑ 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. ❑ Do not share my personal information with nonaffiliates to market their products and services to me.	
	Name	
	Address	
	City, State, Zip	
	[Account #]	

Mail To: [Name of Financial Institution], [Address1]
[Address2], [City], [ST] [ZIP]

B. General Instructions

1. How the model privacy form is used.

(a) The model form may be used, at the option of a financial institution, including a group of financial institutions that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in §§ 332.6 and 332.7 of this part.

(b) The model form is a standardized form, including page layout, content, format, style, pagination, and shading. Institutions seeking to obtain the safe harbor through use of the model form may modify it only as described in these Instructions.

(c) 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.

(d) The word “customer” may be replaced by the word “member” whenever it appears in the model form, as appropriate.

2. The contents of the model privacy form.

The model form consists of two pages, which may be printed on both sides of a single sheet of paper, or may appear on two separate pages. Where an institution provides a long list of institutions at the end of the model form in accordance with Instruction C.3(a)(1), or provides additional information in accordance with Instruction C.3(c), and such list or additional information exceeds the space available on page two of the model form, such list or additional information may extend to a third page.

(a) *Page One.* The first page consists of the following components:

(1) Date last revised (upper right-hand corner).

(2) Title.

(3) Key frame (Why?, What?, How?).

(4) Disclosure table ("Reasons we can share your personal information").

(5) "To limit our sharing" box, as needed, for the financial institution's opt-out information.

(6) "Questions" box, for customer service contact information.

(7) Mail-in opt-out form, as needed.

(b) *Page Two.* The second page consists of the following components:

(1) Heading (Page 2).

(2) Frequently Asked Questions ("Who we are" and "What we do").

(3) Definitions.

(4) "Other important information" box, as needed.

3. The format of the model privacy form.

The format of 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. While a number of factors together produce easily readable type font, institutions are required to use a minimum of 10-point font (unless otherwise expressly permitted in these Instructions) 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 paper in portrait orientation, the size of which must be sufficient to meet the layout and minimum font size requirements, with sufficient white space on the top, bottom, and sides of the content.

(d) *Color.* The model form must be printed on white or light color paper (such as cream) with black or other contrasting ink color. 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. Logos may also be printed in color.

(e) *Languages.* The model form may be translated into languages other than English.

C. Information Required in the Model Privacy Form

The information in the model form may be modified only as described below:

1. Name of the institution or group of affiliated institutions providing the notice.

Insert the name of the financial institution providing the notice or a common identity of affiliated institutions jointly providing the notice on the form wherever [**name of financial institution**] appears.

2. Page one.

(a) *Last revised date.* The financial institution must insert in the upper right-hand corner the date on which the notice was last revised. The information shall appear in minimum 8-point font as "rev. [month/year]" using either the name or number of the month, such as "rev. July 2009" or "rev. 7/09".

(b) *General instructions for the "What?" box.*

(1) The bulleted list identifies the types of personal information that the institution collects and shares. All institutions must use the term "Social Security number" in the first bullet.

(2) Institutions must use five (5) of the following terms to complete the bulleted list: income; account balances; payment history; transaction history; transaction or loss history; credit history; credit scores; assets; investment experience; credit-based insurance scores; insurance claim history; medical information; overdraft history; purchase history; account transactions; risk tolerance; medical-related debts; credit card or other debt; mortgage rates and payments; retirement assets; checking account information; employment information; wire transfer instructions.

(c) *General instructions for the disclosure table.* The left column lists reasons for sharing or using personal information. Each reason correlates to a specific legal provision described in paragraph C.2(d) of this Instruction. In the middle column, each institution must provide a "Yes" or "No" response that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. In the right column, each institution must provide in each box one of the following three (3) responses, as applicable, that reflects whether a consumer can limit such sharing: "Yes" if it is required to or voluntarily provides an opt-out; "No" if it does not provide an opt-out; or "We don't share" if it answers "No" in the middle column. Only the sixth row ("For our affiliates to market to you") may be omitted at the option of the institution. See paragraph C.2(d)(6) of this Instruction.

(d) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* This reason incorporates sharing information under §§ 332.14 and 332.15 and with service providers pursuant to § 332.13 of

this part other than the purposes specified in paragraphs C.2(d)(2) or C.2(d)(3) of these Instructions.

(2) *For our marketing purposes.* This reason incorporates sharing information with service providers by an institution for its own marketing pursuant to § 332.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(3) *For joint marketing with other financial companies.* This reason incorporates sharing information under joint marketing agreements between two or more financial institutions and with any service provider used in connection with such agreements pursuant to § 332.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This reason incorporates sharing information specified in sections 603(d)(2)(A)(i) and (ii) of the FCRA. An institution that shares for this reason may choose to provide an opt-out.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This reason incorporates sharing information pursuant to section 603(d)(2)(A)(iii) of the FCRA. An institution that shares for this reason must provide an opt-out.

(6) *For our affiliates to market to you.* This reason incorporates sharing information specified in section 624 of the FCRA. This reason may be omitted from the disclosure table when: the institution does not have affiliates (or does not disclose personal information to its affiliates); the institution's affiliates do not use personal information in a manner that requires an opt-out; or the institution provides the affiliate marketing

notice separately. Institutions that include this reason must provide an opt-out of indefinite duration. An institution that is required to provide an affiliate marketing opt-out, but does not include that opt-out in the model form under this part, must comply with section 624 of the FCRA and 12 CFR Part 334, Subpart C, with respect to the initial notice and opt-out and any subsequent renewal notice and opt-out. An institution not required to provide an opt-out under this subparagraph may elect to include this reason in the model form.

(7) *For nonaffiliates to market to you.* This reason incorporates sharing described in §§ 332.7 and 332.10(a) of this part. An institution that shares personal information for this reason must provide an opt-out.

(e) *To limit our sharing*: A financial institution must include this section of the model form only if it provides an opt-out. The word "choice" may be written in either the singular or plural, as appropriate. Institutions must select one or more of the applicable opt-out methods described: telephone, such as by a toll-free number; a Website; or use of a mail-in opt-out form. Institutions may include the words "toll-free" before telephone, as appropriate. An institution that allows consumers to opt out online must provide either a specific Web address that takes consumers directly to the opt-out page or a general Web address that provides a clear and conspicuous direct link to the opt-out page. The opt-out choices made available to the consumer who contacts the institution through these methods must correspond accurately to the "Yes" responses in the third column of the disclosure table. In the part titled "Please note" institutions may insert a number that is 30 or greater in the space marked "[30]." Instructions on voluntary or

state privacy law opt-out information are in paragraph C.2(g)(5) of these Instructions.

(f) *Questions box.* Customer service contact information must be inserted as appropriate, where **[phone number]** or **[website]** appear. Institutions may elect to provide either a phone number, such as a toll-free number, or a Web address, or both. Institutions may include the words "toll-free" before the telephone number, as appropriate.

(g) *Mail-in opt-out form.* Financial institutions must include this mail-in form only if they state in the "To limit our sharing" box that consumers can opt out by mail. The mail-in form must provide opt-out options that correspond accurately to the "Yes" responses in the third column in the disclosure table. Institutions that require customers to provide only name and address may omit the section identified as "[account #]." Institutions that require additional or different information, such as a random opt-out number or a truncated account number, to implement an opt-out election should modify the "[account #]" reference accordingly. This includes institutions that require customers with multiple accounts to identify each account to which the opt-out should apply. An institution must enter its opt-out mailing address: in the far right of this form (see version 3); or below the form (see version 4). The reverse side of the mail-in opt-out form must not include any content of the model form.

(1) *Joint accountholder.* Only institutions that provide their joint accountholders the choice to opt out for only one accountholder, in accordance with paragraph C.3(a)(5) of these Instructions, must include in the far left column of the mail-in form the following statement: "If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. □ Apply my choice(s) only

to me." The word "choice" may be written in either the singular or plural, as appropriate. Financial institutions that provide insurance products or services, provide this option, and elect to use the model form may substitute the word "policy" for "account" in this statement. Institutions that do not provide this option may eliminate this left column from the mail-in form.

(2) *FCRA Section 603(d)(2)(A)(iii) opt-out.* If the institution shares personal information pursuant to section 603(d)(2)(A)(iii) of the FCRA, it must include in the mail-in opt-out form the following statement: "□ Do not share information about my creditworthiness with your affiliates for their everyday business purposes."

(3) *FCRA Section 624 opt-out.* If the institution incorporates section 624 of the FCRA in accord with paragraph C.2(d)(6) of these Instructions, it must include in the mail-in opt-out form the following statement: "□ Do not allow your affiliates to use my personal information to market to me."

(4) *Nonaffiliate opt-out.* If the financial institution shares personal information pursuant to § 332.10(a) of this part, it must include in the mail-in opt-out form the following statement: "□ Do not share my personal information with nonaffiliates to market their products and services to me."

(5) *Additional opt-outs.* Financial institutions that use the disclosure table to provide opt-out options beyond those required by Federal law must provide those opt-outs in this section of the model form. A financial institution that chooses to offer an opt-out for its own marketing in the mail-in opt-out form must include one of the two following statements: "□ Do not share my personal information to market to me." <ins>or</ins> "□ Do not use my personal information to

market to me." A financial institution that chooses to offer an opt-out for joint marketing must include the following statement: "□ Do not share my personal information with other financial institutions to jointly market to me."

(h) *Barcodes.* A financial institution may elect to include a barcode and/or "tagline" (an internal identifier) in 6-point font at the bottom of page one, as needed for information internal to the institution, so long as these do not interfere with the clarity or text of the form.

3. Page two.

(a) *General Instructions for the Questions.* Certain of the Questions may be customized as follows:

(1) *"Who is providing this notice?"* This question may be omitted where only one financial institution provides the model form and that institution is clearly identified in the title on page one. Two or more financial institutions that jointly provide the model form must use this question to identify themselves as required by § 332.9(f) of this part. Where the list of institutions exceeds four (4) lines, the institution must describe in the response to this question the general types of institutions jointly providing the notice and must separately identify those institutions, in minimum 8-point font, directly following the "Other important information" box, or, if that box is not included in the institution's form, directly following the "Definitions." The list may appear in a multi-column format.

(2) *"How does **[name of financial institution]** protect my personal information?"* The financial institution may only provide additional information pertaining to its safeguards practices following the designated response to this question. Such information may include information about the institution's use of cookies or other measures it uses to

notice separately. Institutions that include this reason must provide an opt-out of indefinite duration. An institution that is required to provide an affiliate marketing opt-out, but does not include that opt-out in the model form under this part, must comply with section 624 of the FCRA and 12 CFR Part 717, Subpart C, with respect to the initial notice and opt-out and any subsequent renewal notice and opt-out. An institution not required to provide an opt-out under this subparagraph may elect to include this reason in the model form.

(7) *For nonaffiliates to market to you*. This reason incorporates sharing described in §§ 716.7 and 716.10(a) of this part. An institution that shares personal information for this reason must provide an opt-out.

(e) *To limit our sharing*: A financial institution must include this section of the model form only if it provides an opt-out. The word "choice" may be written in either the singular or plural, as appropriate. Institutions must select one or more of the applicable opt-out methods described: telephone, such as by a toll-free number; a Website; or use of a mail-in opt-out form. Institutions may include the words "toll-free" before telephone, as appropriate. An institution that allows consumers to opt out online must provide either a specific Web address that takes consumers directly to the opt-out page or a general Web address that provides a clear and conspicuous direct link to the opt-out page. The opt-out choices made available to the consumer who contacts the institution through these methods must correspond accurately to the "Yes" responses in the third column of the disclosure table. In the part titled "Please note" institutions may insert a number that is 30 or greater in the space marked "[30]." Instructions on voluntary or

state privacy law opt-out information are in paragraph C.2(g)(5) of these Instructions.

(f) *Questions box.* Customer service contact information must be inserted as appropriate, where **[phone number]** or **[website]** appear. Institutions may elect to provide either a phone number, such as a toll-free number, or a Web address, or both. Institutions may include the words "toll-free" before the telephone number, as appropriate.

(g) *Mail-in opt-out form.* Financial institutions must include this mail-in form only if they state in the "To limit our sharing" box that consumers can opt out by mail. The mail-in form must provide opt-out options that correspond accurately to the "Yes" responses in the third column in the disclosure table. Institutions that require customers to provide only name and address may omit the section identified as "[account #]." Institutions that require additional or different information, such as a random opt-out number or a truncated account number, to implement an opt-out election should modify the "[account #]" reference accordingly. This includes institutions that require customers with multiple accounts to identify each account to which the opt-out should apply. An institution must enter its opt-out mailing address: in the far right of this form (see version 3); or below the form (see version 4). The reverse side of the mail-in opt-out form must not include any content of the model form.

(1) *Joint accountholder.* Only institutions that provide their joint accountholders the choice to opt out for only one accountholder, in accordance with paragraph C.3(a)(5) of these Instructions, must include in the far left column of the mail-in form the following statement: "If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. □ Apply my choice(s) only

to me." The word "choice" may be written in either the singular or plural, as appropriate. Financial institutions that provide insurance products or services, provide this option, and elect to use the model form may substitute the word "policy" for "account" in this statement. Institutions that do not provide this option may eliminate this left column from the mail-in form.

(2) *FCRA Section 603(d)(2)(A)(iii) opt-out.* If the institution shares personal information pursuant to section 603(d)(2)(A)(iii) of the FCRA, it must include in the mail-in opt-out form the following statement: "□ Do not share information about my creditworthiness with your affiliates for their everyday business purposes."

(3) *FCRA Section 624 opt-out.* If the institution incorporates section 624 of the FCRA in accord with paragraph C.2(d)(6) of these Instructions, it must include in the mail-in opt-out form the following statement: "□ Do not allow your affiliates to use my personal information to market to me."

(4) *Nonaffiliate opt-out.* If the financial institution shares personal information pursuant to § 716.10(a) of this part, it must include in the mail-in opt-out form the following statement: "□ Do not share my personal information with nonaffiliates to market their products and services to me."

(5) *Additional opt-outs.* Financial institutions that use the disclosure table to provide opt-out options beyond those required by Federal law must provide those opt-outs in this section of the model form. A financial institution that chooses to offer an opt-out for its own marketing in the mail-in opt-out form must include one of the two following statements: "□ Do not share my personal information to market to me." or "□ Do not use my personal information to

market to me." A financial institution that chooses to offer an opt-out for joint marketing must include the following statement: "□ Do not share my personal information with other financial institutions to jointly market to me."

(h) *Barcodes.* A financial institution may elect to include a barcode and/or "tagline" (an internal identifier) in 6-point font at the bottom of page one, as needed for information internal to the institution, so long as these do not interfere with the clarity or text of the form.

3. **Page two.**

(a) *General Instructions for the Questions.* Certain of the Questions may be customized as follows:

(1) *"Who is providing this notice?"* This question may be omitted where only one financial institution provides the model form and that institution is clearly identified in the title on page one. Two or more financial institutions that jointly provide the model form must use this question to identify themselves as required by § 716.9(f) of this part. Where the list of institutions exceeds four (4) lines, the institution must describe in the response to this question the general types of institutions jointly providing the notice and must separately identify those institutions, in minimum 8-point font, directly following the "Other important information" box, or, if that box is not included in the institution's form, directly following the "Definitions." The list may appear in a multi-column format.

(2) *"How does **[name of financial institution]** protect my personal information?"* The financial institution may only provide additional information pertaining to its safeguards practices following the designated response to this question. Such information may include information about the institution's use of cookies or other measures it uses to

safeguard personal information. Institutions are limited to a maximum of 30 additional words.

(3) *"How does **[name of financial institution]** collect my personal information?"* Institutions must use five (5) of the following terms to complete the bulleted list for this question: open an account; deposit money; pay your bills; apply for a loan; use your credit or debit card; seek financial or tax advice; apply for insurance; pay insurance premiums; file an insurance claim; seek advice about your investments; buy securities from us; sell securities to us; direct us to buy securities; direct us to sell your securities; make deposits or withdrawals from your account; enter into an investment advisory contract; give us your income information; provide employment information; give us your employment history; tell us about your investment or retirement portfolio; tell us about your investment or retirement earnings; apply for financing; apply for a lease; provide account information; give us your contact information; pay us by check; give us your wage statements; provide your mortgage information; make a wire transfer; tell us who receives the money; tell us where to send the money; show your government-issued ID; show your driver's license; order a commodity futures or option trade. Institutions that collect personal information from their affiliates and/or credit bureaus must include after the bulleted list the following statement: "We also collect your personal information from others, such as credit bureaus, affiliates, or other companies." Institutions that do not collect personal information from their affiliates or credit bureaus but do collect information from other companies must include the following statement instead: "We also collect your personal information from other companies."

Only institutions that do not collect any personal information from affiliates, credit bureaus, or other companies can omit both statements.

(4) *"Why can't I limit all sharing?"* Institutions that describe state privacy law provisions in the "*Other important information"* box must use the bracketed sentence: "See below for more on your rights under state law." Other institutions must omit this sentence.

(5) *"What happens when I limit sharing for an account I hold jointly with someone else?"* Only financial institutions that provide opt-out options must use this question. Other institutions must omit this question. Institutions must choose one of the following two statements to respond to this question: "Your choices will apply to everyone on your account." or "Your choices will apply to everyone on your account–unless you tell us otherwise." Financial institutions that provide insurance products or services and elect to use the model form may substitute the word "policy" for "account" in these statements.

(b) *General Instructions for the Definitions.*

The financial institution must customize the space below the responses to the three definitions in this section. This specific information must be in italicized lettering to set off the information from the standardized definitions.

(1) *Affiliates.* As required by § 716.6(a)(3) of this part, where [***affiliate information***] appears, the financial institution must:

(i) If it has no affiliates, state: "[***name of financial institution***] *has no affiliates*";

(ii) If it has affiliates but does not share personal information, state: "*[**name of financial institution**] does not share with our affiliates*"; or

(iii) If it shares with its affiliates, state, as applicable: *"Our affiliates include companies with a* ***[common corporate identity of financial institution]*** *name; financial companies such as* ***[insert illustrative list of companies]****; nonfinancial companies, such as* ***[insert illustrative list of companies;]*** *and others, such as* ***[insert illustrative list]****."*

(2) *Nonaffiliates.* As required by § 716.6(c)(3) of this part, where [***nonaffiliate information***] appears, the financial institution must:

(i) If it does not share with nonaffiliated third parties, state: "[***name of financial institution***] *does not share with nonaffiliates so they can market to you*"; or

(ii) If it shares with nonaffiliated third parties, state, as applicable: "*Nonaffiliates we share with can include* ***[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]****.*"

(3) *Joint Marketing.* As required by § 716.13 of this part, where [***joint marketing***] appears, the financial institution must:

(i) If it does not engage in joint marketing, state: "***[name of financial institution]*** *doesn't jointly market*"; or

(ii) If it shares personal information for joint marketing, state, as applicable: "*Our joint marketing partners include* ***[list categories of companies such as credit card companies***]."

(c) *General instructions for the "Other important information" box.* This box is optional. The space provided for information in this box is not limited. Only the following types of information can appear in this box.

(1) State and/or international privacy law information; and/or

(2) Acknowledgment of receipt form.

35. Amend newly redesignated Appendix B to part 716 as follows:

A. Adding a new sentence to the beginning of the introductory text as set forth below.

B. Effective January 1, 2012, remove Appendix B to part 716.

APPENDIX B TO PART 716-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided before January 1, 2011.

* * * * *

Federal Trade Commission

16 CFR Chapter 1

For the reasons set forth in the joint preamble, the Federal Trade Commission amends part 313 of chapter 1 of title 16 of the Code of Federal Regulations as follows:

PART 313—PRIVACY OF CONSUMER FINANCIAL INFORMATION

36. The authority citation for part 313 continues to read as follows:

Authority: 15 U.S.C. 6801 et seq.

37. Revise § 313.2 to read as follows:

§ 313.2 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 §§ 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.

38. In § 313.6:

A. Revise paragraphs (b) and (f), and add paragraph (g) to read as set forth below.

B. Effective January 1, 2012, remove paragraph (g).

§ 313.6 Information to be included in privacy notices.

* * * * *

(b) Description of nonaffiliated third parties subject to exceptions. If you disclose nonpublic personal information to third parties as authorized under §§ 313.14 and 313.15, you are not required to list those exceptions in the initial or annual privacy notices required by §§ 313.4 and 313.5. When describing the categories with respect to those parties, it is sufficient to state that you make disclosures to other nonaffiliated companies for your everyday business purposes, such as to process transactions, maintain account(s), respond to court orders and legal investigations, or report to credit bureaus.

* * * * *

(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 and description of nonaffiliated third parties subject to exceptions.

(1) 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 December 31, 2010, to the extent applicable, constitutes compliance with this part.

(2) Description of nonaffiliated third parties subject to exceptions. For a privacy notice provided on or before December 31, 2010, if you disclose nonpublic personal information to third parties as authorized under §§ 313.14 and 313.15, when describing the categories with respect to those parties, it is sufficient to state, as an alternative to the language in the second sentence of paragraph (b) of this section, that you make disclosures to other nonaffiliated third parties as permitted by law.

39. 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].

40. Redesignate Appendix A to part 313 as Appendix B to part 313.

41. Add new Appendix A to part 313 to read as follows:

APPENDIX A TO PART 313-MODEL PRIVACY FORM

A. The model privacy form.

Version 1: Model Form With No Opt-Out.

Rev. [insert date]

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 are *no longer* our customer, we continue to share your information as described in this notice.

How?

All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

Questions? Call [phone number] or go to [website]

Page 2

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]

Definitions	
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 information]*

Other important information

[insert other important information]

Version 2: Model Form with Opt-Out by Telephone and/or Online.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) or ■ Visit us online: [website] **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

Page 2

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 3: Model Form with Mail-In Opt-Out 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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) ■ Visit us online: [website] or ■ Mail the form below **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

✂

Mail-in Form

Leave Blank OR [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ❑ Apply my choices only to me]	Mark any/all you want to limit: ❑ 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. ❑ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Name		**Mail to:** [Name of Financial Institution] [Address1] [Address2] [City], [ST] [ZIP]
	Address		
	City, State, Zip		
	[Account #]		

Page 2

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 4. Optional Mail-in Form.

Mail-in Form		
Leave Blank **OR** [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ❑ Apply my choices only to me]	Mark any/all you want to limit: ❑ 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. ❑ Do not share my personal information with nonaffiliates to market their products and services to me.	
	Name	
	Address	
	City, State, Zip	
	[Account #]	

Mail To: [Name of Financial Institution], [Address1]
[Address2], [City], [ST] [ZIP]

B. General Instructions

1. How the model privacy form is used.

(a) The model form may be used, at the option of a financial institution, including a group of financial institutions that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in §§ 313.6 and 313.7 of this part.

(b) The model form is a standardized form, including page layout, content, format, style, pagination, and shading. Institutions seeking to obtain the safe harbor through use of the model form may modify it only as described in these Instructions.

(c) 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.

(d) The word "customer" may be replaced by the word "member" whenever it appears in the model form, as appropriate.

2. The contents of the model privacy form.

The model form consists of two pages, which may be printed on both sides of a single sheet of paper, or may appear on two separate pages. Where an institution provides a long list of institutions at the end of the model form in accordance with Instruction C.3(a)(1), or provides additional information in accordance with Instruction C.3(c), and such list or additional information exceeds the space available on page two of the model form, such list or additional information may extend to a third page.

(a) *Page One*. The first page consists of the following components:

(1) Date last revised (upper right-hand corner).

(2) Title.

(3) Key frame (Why?, What?, How?).

(4) Disclosure table ("Reasons we can share your personal information").

(5) "To limit our sharing" box, as needed, for the financial institution's opt-out information.

(6) "Questions" box, for customer service contact information.

(7) Mail-in opt-out form, as needed.

(b) *Page Two.* The second page consists of the following components:

(1) Heading (Page 2).

(2) Frequently Asked Questions ("Who we are" and "What we do").

(3) Definitions.

(4) "Other important information" box, as needed.

3. The format of the model privacy form.

The format of 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. While a number of factors together produce easily readable type font, institutions are required to use a minimum of 10-point font (unless otherwise expressly permitted in these Instructions) 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 paper in portrait orientation, the size of which must be sufficient to meet the layout and minimum font size requirements, with sufficient white space on the top, bottom, and sides of the content.

(d) *Color.* The model form must be printed on white or light color paper (such as cream) with black or other contrasting ink color. 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. Logos may also be printed in color.

(e) *Languages.* The model form may be translated into languages other than English.

C. Information Required in the Model Privacy Form

The information in the model form may be modified only as described below:

1. Name of the institution or group of affiliated institutions providing the notice.

Insert the name of the financial institution providing the notice or a common identity of affiliated institutions jointly providing the notice on the form wherever **[name of financial institution]** appears.

2. Page one.

(a) *Last revised date.* The financial institution must insert in the upper right-hand corner the date on which the notice was last revised. The information shall appear in minimum 8-point font as "rev. [month/year]" using either the name or number of the month, such as "rev. July 2009" or "rev. 7/09".

(b) *General instructions for the "What?" box.*

(1) The bulleted list identifies the types of personal information that the institution collects and shares. All institutions must use the term "Social Security number" in the first bullet.

(2) Institutions must use five (5) of the following terms to complete the bulleted list: income; account balances; payment history; transaction history; transaction or loss history; credit history; credit scores; assets; investment experience; credit-based insurance scores; insurance claim history; medical information; overdraft history; purchase history; account transactions; risk tolerance; medical-related debts; credit card or other debt; mortgage rates and payments; retirement assets; checking account information; employment information; wire transfer instructions.

(c) *General instructions for the disclosure table.* The left column lists reasons for sharing or using personal information. Each reason correlates to a specific legal provision described in paragraph C.2(d) of this Instruction. In the middle column, each institution must provide a "Yes" or "No" response that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. In the right column, each institution must provide in each box one of the following three (3) responses, as applicable, that reflects whether a consumer can limit such sharing: "Yes" if it is required to or voluntarily provides an opt-out; "No" if it does not provide an opt-out; or "We don't share" if it answers "No" in the middle column. Only the sixth row ("For our affiliates to market to you") may be omitted at the option of the institution. See paragraph C.2(d)(6) of this Instruction.

(d) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* This reason incorporates sharing information under §§ 313.14 and 313.15 and with service providers pursuant to § 313.13 of

this part other than the purposes specified in paragraphs C.2(d)(2) or C.2(d)(3) of these Instructions.

(2) *For our marketing purposes.* This reason incorporates sharing information with service providers by an institution for its own marketing pursuant to § 313.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(3) *For joint marketing with other financial companies.* This reason incorporates sharing information under joint marketing agreements between two or more financial institutions and with any service provider used in connection with such agreements pursuant to § 313.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This reason incorporates sharing information specified in sections 603(d)(2)(A)(i) and (ii) of the FCRA. An institution that shares for this reason may choose to provide an opt-out.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This reason incorporates sharing information pursuant to section 603(d)(2)(A)(iii) of the FCRA. An institution that shares for this reason must provide an opt-out.

(6) *For our affiliates to market to you.* This reason incorporates sharing information specified in section 624 of the FCRA. This reason may be omitted from the disclosure table when: the institution does not have affiliates (or does not disclose personal information to its affiliates); the institution's affiliates do not use personal information in a manner that requires an opt-out; or the institution provides the affiliate marketing

notice separately. Institutions that include this reason must provide an opt-out of indefinite duration. An institution that is required to provide an affiliate marketing opt-out, but does not include that opt-out in the model form under this part, must comply with section 624 of the FCRA and 16 CFR Parts 680 and 698 with respect to the initial notice and opt-out and any subsequent renewal notice and opt-out. An institution not required to provide an opt-out under this subparagraph may elect to include this reason in the model form.

(7) *For nonaffiliates to market to you*. This reason incorporates sharing described in §§ 313.7 and 313.10(a) of this part. An institution that shares personal information for this reason must provide an opt-out.

(e) *To limit our sharing*: A financial institution must include this section of the model form only if it provides an opt-out. The word "choice" may be written in either the singular or plural, as appropriate. Institutions must select one or more of the applicable opt-out methods described: telephone, such as by a toll-free number; a Website; or use of a mail-in opt-out form. Institutions may include the words "toll-free" before telephone, as appropriate. An institution that allows consumers to opt out online must provide either a specific Web address that takes consumers directly to the opt-out page or a general Web address that provides a clear and conspicuous direct link to the opt-out page. The opt-out choices made available to the consumer who contacts the institution through these methods must correspond accurately to the "Yes" responses in the third column of the disclosure table. In the part titled "Please note" institutions may insert a number that is 30 or greater in the space marked "[30]." Instructions on voluntary or

state privacy law opt-out information are in paragraph C.2(g)(5) of these Instructions.

(f) *Questions box*. Customer service contact information must be inserted as appropriate, where **[phone number]** or **[website]** appear. Institutions may elect to provide either a phone number, such as a toll-free number, or a Web address, or both. Institutions may include the words "toll-free" before the telephone number, as appropriate.

(g) *Mail-in opt-out form*. Financial institutions must include this mail-in form only if they state in the "To limit our sharing" box that consumers can opt out by mail. The mail-in form must provide opt-out options that correspond accurately to the "Yes" responses in the third column in the disclosure table. Institutions that require customers to provide only name and address may omit the section identified as "[account #]." Institutions that require additional or different information, such as a random opt-out number or a truncated account number, to implement an opt-out election should modify the "[account #]" reference accordingly. This includes institutions that require customers with multiple accounts to identify each account to which the opt-out should apply. An institution must enter its opt-out mailing address: in the far right of this form (see version 3); or below the form (see version 4). The reverse side of the mail-in opt-out form must not include any content of the model form.

(1) *Joint accountholder*. Only institutions that provide their joint accountholders the choice to opt out for only one accountholder, in accordance with paragraph C.3(a)(5) of these Instructions, must include in the far left column of the mail-in form the following statement: "If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. □ Apply my choice(s) only

to me." The word "choice" may be written in either the singular or plural, as appropriate. Financial institutions that provide insurance products or services, provide this option, and elect to use the model form may substitute the word "policy" for "account" in this statement. Institutions that do not provide this option may eliminate this left column from the mail-in form.

(2) *FCRA Section 603(d)(2)(A)(iii) opt-out*. If the institution shares personal information pursuant to section 603(d)(2)(A)(iii) of the FCRA, it must include in the mail-in opt-out form the following statement: "□ Do not share information about my creditworthiness with your affiliates for their everyday business purposes."

(3) *FCRA Section 624 opt-out*. If the institution incorporates section 624 of the FCRA in accord with paragraph C.2(d)(6) of these Instructions, it must include in the mail-in opt-out form the following statement: "□ Do not allow your affiliates to use my personal information to market to me."

(4) *Nonaffiliate opt-out*. If the financial institution shares personal information pursuant to § 313.10(a) of this part, it must include in the mail-in opt-out form the following statement: "□ Do not share my personal information with nonaffiliates to market their products and services to me."

(5) *Additional opt-outs*. Financial institutions that use the disclosure table to provide opt-out options beyond those required by Federal law must provide those opt-outs in this section of the model form. A financial institution that chooses to offer an opt-out for its own marketing in the mail-in opt-out form must include one of the two following statements: "□ Do not share my personal information to market to me." <u>or</u> "□ Do not use my personal information to

market to me." A financial institution that chooses to offer an opt-out for joint marketing must include the following statement: "□ Do not share my personal information with other financial institutions to jointly market to me."

(h) *Barcodes.* A financial institution may elect to include a barcode and/or "tagline" (an internal identifier) in 6-point font at the bottom of page one, as needed for information internal to the institution, so long as these do not interfere with the clarity or text of the form.

3. Page two.

(a) *General Instructions for the Questions.* Certain of the Questions may be customized as follows:

(1) *"Who is providing this notice?"* This question may be omitted where only one financial institution provides the model form and that institution is clearly identified in the title on page one. Two or more financial institutions that jointly provide the model form must use this question to identify themselves as required by § 313.9(f) of this part. Where the list of institutions exceeds four (4) lines, the institution must describe in the response to this question the general types of institutions jointly providing the notice and must separately identify those institutions, in minimum 8-point font, directly following the "Other important information" box, or, if that box is not included in the institution's form, directly following the "Definitions." The list may appear in a multi-column format.

(2) *"How does **[name of financial institution]** protect my personal information?"* The financial institution may only provide additional information pertaining to its safeguards practices following the designated response to this question. Such information may include information about the institution's use of cookies or other measures it uses to

safeguard personal information. Institutions are limited to a maximum of 30 additional words.

(3) *"How does **[name of financial institution]** collect my personal information?"* Institutions must use five (5) of the following terms to complete the bulleted list for this question: open an account; deposit money; pay your bills; apply for a loan; use your credit or debit card; seek financial or tax advice; apply for insurance; pay insurance premiums; file an insurance claim; seek advice about your investments; buy securities from us; sell securities to us; direct us to buy securities; direct us to sell your securities; make deposits or withdrawals from your account; enter into an investment advisory contract; give us your income information; provide employment information; give us your employment history; tell us about your investment or retirement portfolio; tell us about your investment or retirement earnings; apply for financing; apply for a lease; provide account information; give us your contact information; pay us by check; give us your wage statements; provide your mortgage information; make a wire transfer; tell us who receives the money; tell us where to send the money; show your government-issued ID; show your driver's license; order a commodity futures or option trade. Institutions that collect personal information from their affiliates and/or credit bureaus must include after the bulleted list the following statement: "We also collect your personal information from others, such as credit bureaus, affiliates, or other companies." Institutions that do not collect personal information from their affiliates or credit bureaus but do collect information from other companies must include the following statement instead: "We also collect your personal information from other companies."

Only institutions that do not collect any personal information from affiliates, credit bureaus, or other companies can omit both statements.

(4) *"Why can't I limit all sharing?"* Institutions that describe state privacy law provisions in the "*Other important information*" box must use the bracketed sentence: "See below for more on your rights under state law." Other institutions must omit this sentence.

(5) *"What happens when I limit sharing for an account I hold jointly with someone else?"* Only financial institutions that provide opt-out options must use this question. Other institutions must omit this question. Institutions must choose one of the following two statements to respond to this question: "Your choices will apply to everyone on your account." or "Your choices will apply to everyone on your account–unless you tell us otherwise." Financial institutions that provide insurance products or services and elect to use the model form may substitute the word "policy" for "account" in these statements.

(b) *General Instructions for the Definitions.*

The financial institution must customize the space below the responses to the three definitions in this section. This specific information must be in italicized lettering to set off the information from the standardized definitions.

(1) *Affiliates.* As required by § 313.6(a)(3) of this part, where [***affiliate information***] appears, the financial institution must:

(i) If it has no affiliates, state: "[***name of financial institution***] *has no affiliates*";

(ii) If it has affiliates but does not share personal information, state: "*[**name of financial institution**] does not share with our affiliates*"; or

(iii) If it shares with its affiliates, state, as applicable: *"Our affiliates include companies with a [**common corporate identity of financial institution**] name; financial companies such as [**insert illustrative list of companies**]; nonfinancial companies, such as [**insert illustrative list of companies;**] and others, such as [**insert illustrative list**]."*

(2) *Nonaffiliates.* As required by § 313.6(c)(3) of this part, where [***nonaffiliate information***] appears, the financial institution must:

(i) If it does not share with nonaffiliated third parties, state: "[***name of financial institution***] *does not share with nonaffiliates so they can market to you*"; or

(ii) If it shares with nonaffiliated third parties, state, as applicable: "*Nonaffiliates we share with can include* [***list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations***]."

(3) *Joint Marketing.* As required by § 313.13 of this part, where [***joint marketing***] appears, the financial institution must:

(i) If it does not engage in joint marketing, state: "[***name of financial institution***] *doesn't jointly market*"; or

(ii) If it shares personal information for joint marketing, state, as applicable: "*Our joint marketing partners include* [***list categories of companies such as credit card companies***]."

(c) *General instructions for the "Other important information" box.* This box is optional. The space provided for information in this box is not limited. Only the following types of information can appear in this box.

(1) State and/or international privacy law information; and/or

(2) Acknowledgment of receipt form.

42. Amend newly redesignated Appendix B to part 313 as follows:

A. Adding a new sentence to the beginning of the introductory text as set forth below.

B. Effective January 1, 2012, remove Appendix B to part 313.

APPENDIX B TO PART 313—SAMPLE CLAUSES

This Appendix only applies to privacy notices provided before January 1, 2011.

* * * * *

Commodity Futures Trading Commission

17 CFR Chapter I

Authority and Issuance

For the reasons set forth in the joint preamble, part 160 of chapter I of title 17 of the Code of Federal Regulations is revised as follows:

PART 160-PRIVACY OF CONSUMER FINANCIAL INFORMATION

43. 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.

44. Revise § 160.2 to read as follows:

§ 160.2 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 §§ 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.

45. In § 160.6:

A. Revise paragraphs (b) and (f), and add paragraph (g) to read as set forth below.

B. Effective January 1, 2012, remove paragraph (g).

§ 160.6 Information to be included in privacy notices.

* * * * *

(b) Description of nonaffiliated third parties subject to exceptions. If you disclose nonpublic personal information to third parties as authorized under §§ 160.14 and 160.15, you are not required to list those exceptions in the initial or annual privacy notices required by §§ 160.4 and 160.5. When describing the categories with respect to those parties, it is sufficient to state that you make disclosures to other nonaffiliated companies:

(1) For your everyday business purposes, such as [include all that apply] to process transactions, maintain account(s), respond to court orders and legal investigations, or report to credit bureaus; or

(2) As permitted by law.

*   *   *   *   *

(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 December 31, 2010, to the extent applicable, constitutes compliance with this part.

46. 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].

47. Redesignate Appendix A to part 160 as Appendix B to part 160.

48. Add new Appendix A to part 160 to read as follows:

APPENDIX A TO PART 160-MODEL PRIVACY FORM

A. The model privacy form.

Version 1: Model Form With No Opt-Out.

Rev. [insert date]

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 are *no longer* our customer, we continue to share your information as described in this notice.

How?

All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

Questions? Call [phone number] or go to [website]

Page 2

Who we are

Who is providing this notice?	[insert]

What we do

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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]

Definitions

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 information]*

Other important information

[insert other important information]

Version 2: Model Form with Opt-Out by Telephone and/or Online.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	▪ Call [phone number]—our menu will prompt you through your choice(s) or ▪ Visit us online: [website] **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

Page 2

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 3: Model Form with Mail-In Opt-Out Form.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) ■ Visit us online: [website] or ■ Mail the form below **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

✂

Mail-in Form

Leave Blank OR [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ☐ Apply my choices only to me]	Mark any/all you want to limit: ☐ 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. ☐ Do not share my personal information with nonaffiliates to market their products and services to me.	
	Name	**Mail to:** [Name of Financial Institution] [Address1] [Address2] [City], [ST] [ZIP]
	Address	
	City, State, Zip	
	Account #	

Who we are	
Who is providing this notice?	[insert]
What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]
Definitions	
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 information]*

Other important information

[insert other important information]

Version 4. Optional Mail-in Form.

Mail-in Form

Leave Blank OR [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ❑ Apply my choices only to me]	Mark any/all you want to limit: ❑ 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. ❑ Do not share my personal information with nonaffiliates to market their products and services to me.
	Name
	Address
	City, State, Zip
	[illegible]

Mail To: [Name of Financial Institution], [Address1]
[Address2], [City], [ST] [ZIP]

B. General Instructions

1. How the model privacy form is used.

(a) The model form may be used, at the option of a financial institution, including a group of financial institutions that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in §§ 160.6 and 160.7 of this part.

(b) The model form is a standardized form, including page layout, content, format, style, pagination, and shading. Institutions seeking to obtain the safe harbor through use of the model form may modify it only as described in these Instructions.

(c) 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.

(d) The word "customer" may be replaced by the word "member" whenever it appears in the model form, as appropriate.

2. The contents of the model privacy form.

The model form consists of two pages, which may be printed on both sides of a single sheet of paper, or may appear on two separate pages. Where an institution provides a long list of institutions at the end of the model form in accordance with Instruction C.3(a)(1), or provides additional information in accordance with Instruction C.3(c), and such list or additional information exceeds the space available on page two of the model form, such list or additional information may extend to a third page.

(a) *Page One.* The first page consists of the following components:

(1) Date last revised (upper right-hand corner).

(2) Title.

(3) Key frame (Why?, What?, How?).

(4) Disclosure table ("Reasons we can share your personal information").

(5) "To limit our sharing" box, as needed, for the financial institution's opt-out information.

(6) "Questions" box, for customer service contact information.

(7) Mail-in opt-out form, as needed.

(b) *Page Two.* The second page consists of the following components:

(1) Heading (Page 2).

(2) Frequently Asked Questions ("Who we are" and "What we do").

(3) Definitions.

(4) "Other important information" box, as needed.

3. The format of the model privacy form.

The format of 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. While a number of factors together produce easily readable type font, institutions are required to use a minimum of 10-point font (unless otherwise expressly permitted in these Instructions) 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 paper in portrait orientation, the size of which must be sufficient to meet the layout and minimum font size requirements, with sufficient white space on the top, bottom, and sides of the content.

(d) *Color*. The model form must be printed on white or light color paper (such as cream) with black or other contrasting ink color. 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. Logos may also be printed in color.

(e) *Languages*. The model form may be translated into languages other than English.

C. Information Required in the Model Privacy Form

The information in the model form may be modified only as described below:

1. Name of the institution or group of affiliated institutions providing the notice.

Insert the name of the financial institution providing the notice or a common identity of affiliated institutions jointly providing the notice on the form wherever [**name of financial institution**] appears.

2. Page one.

(a) *Last revised date*. The financial institution must insert in the upper right-hand corner the date on which the notice was last revised. The information shall appear in minimum 8-point font as "rev. [month/year]" using either the name or number of the month, such as "rev. July 2009" or "rev. 7/09".

(b) *General instructions for the "What?" box.*

(1) The bulleted list identifies the types of personal information that the institution collects and shares. All institutions must use the term "Social Security number" in the first bullet.

(2) Institutions must use five (5) of the following terms to complete the bulleted list: income; account balances; payment history; transaction history; transaction or loss history; credit history; credit scores; assets; investment experience; credit-based insurance scores; insurance claim history; medical information; overdraft history; purchase history; account transactions; risk tolerance; medical-related debts; credit card or other debt; mortgage rates and payments; retirement assets; checking account information; employment information; wire transfer instructions.

(c) *General instructions for the disclosure table*. The left column lists reasons for sharing or using personal information. Each reason correlates to a specific legal provision described in paragraph C.2(d) of this Instruction. In the middle column, each institution must provide a "Yes" or "No" response that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. In the right column, each institution must provide in each box one of the following three (3) responses, as applicable, that reflects whether a consumer can limit such sharing: "Yes" if it is required to or voluntarily provides an opt-out; "No" if it does not provide an opt-out; or "We don't share" if it answers "No" in the middle column. Only the sixth row ("For our affiliates to market to you") may be omitted at the option of the institution. See paragraph C.2(d)(6) of this Instruction.

(d) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes.* This reason incorporates sharing information under §§ 160.14 and 160.15 and with service providers pursuant to § 160.13 of

this part other than the purposes specified in paragraphs C.2(d)(2) or C.2(d)(3) of these Instructions.

(2) *For our marketing purposes.* This reason incorporates sharing information with service providers by an institution for its own marketing pursuant to § 160.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(3) *For joint marketing with other financial companies.* This reason incorporates sharing information under joint marketing agreements between two or more financial institutions and with any service provider used in connection with such agreements pursuant to § 160.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This reason incorporates sharing information specified in sections 603(d)(2)(A)(i) and (ii) of the FCRA. An institution that shares for this reason may choose to provide an opt-out.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This reason incorporates sharing information pursuant to section 603(d)(2)(A)(iii) of the FCRA. An institution that shares for this reason must provide an opt-out.

(6) *For our affiliates to market to you.* This reason incorporates sharing information specified in section 624 of the FCRA. This reason may be omitted from the disclosure table when: the institution does not have affiliates (or does not disclose personal information to its affiliates); the institution's affiliates do not use personal information in a manner that requires an opt-out; or the institution provides the affiliate marketing

notice separately. Institutions that include this reason must provide an opt-out of indefinite duration. An institution not required to provide an opt-out under this subparagraph may elect to include this reason in the model form. Note: The CFTC's Regulations do not address the affiliate marketing rule.

(7) *For nonaffiliates to market to you.* This reason incorporates sharing described in §§ 160.7 and 160.10(a) of this part. An institution that shares personal information for this reason must provide an opt-out.

(e) *To limit our sharing*: A financial institution must include this section of the model form only if it provides an opt-out. The word "choice" may be written in either the singular or plural, as appropriate. Institutions must select one or more of the applicable opt-out methods described: telephone, such as by a toll-free number; a Website; or use of a mail-in opt-out form. Institutions may include the words "toll-free" before telephone, as appropriate. An institution that allows consumers to opt out online must provide either a specific Web address that takes consumers directly to the opt-out page or a general Web address that provides a clear and conspicuous direct link to the opt-out page. The opt-out choices made available to the consumer who contacts the institution through these methods must correspond accurately to the "Yes" responses in the third column of the disclosure table. In the part titled "Please note" institutions may insert a number that is 30 or greater in the space marked "[30]." Instructions on voluntary or state privacy law opt-out information are in paragraph C.2(g)(5) of these Instructions.

(f) *Questions box.* Customer service contact information must be inserted as appropriate, where **[phone number]** or **[website]** appear. Institutions may elect to provide either a phone number, such as a toll-free number, or a Web address, or both. Institutions may include the words "toll-free" before the telephone number, as appropriate.

(g) *Mail-in opt-out form.* Financial institutions must include this mail-in form only if they state in the "To limit our sharing" box that consumers can opt out by mail. The mail-in form must provide opt-out options that correspond accurately to the "Yes" responses in the third column in the disclosure table. Institutions that require customers to provide only name and address may omit the section identified as "[account #]." Institutions that require additional or different information, such as a random opt-out number or a truncated account number, to implement an opt-out election should modify the "[account #]" reference accordingly. This includes institutions that require customers with multiple accounts to identify each account to which the opt-out should apply. An institution must enter its opt-out mailing address: in the far right of this form (see version 3); or below the form (see version 4). The reverse side of the mail-in opt-out form must not include any content of the model form.

(1) *Joint accountholder.* Only institutions that provide their joint accountholders the choice to opt out for only one accountholder, in accordance with paragraph C.3(a)(5) of these Instructions, must include in the far left column of the mail-in form the following statement: "If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. □ Apply my choice(s) only to me." The word "choice" may be written in either the singular or plural, as appropriate. Financial institutions that provide insurance products or services, provide this option, and elect to use the model form may substitute the word "policy" for "account" in this statement. Institutions that do

not provide this option may eliminate this left column from the mail-in form.

(2) *FCRA Section 603(d)(2)(A)(iii) opt-out.* If the institution shares personal information pursuant to section 603(d)(2)(A)(iii) of the FCRA, it must include in the mail-in opt-out form the following statement: "□ Do not share information about my creditworthiness with your affiliates for their everyday business purposes."

(3) *FCRA Section 624 opt-out.* If the institution incorporates section 624 of the FCRA in accord with paragraph C.2(d)(6) of these Instructions, it must include in the mail-in opt-out form the following statement: "□ Do not allow your affiliates to use my personal information to market to me."

(4) *Nonaffiliate opt-out.* If the financial institution shares personal information pursuant to § 160.10(a) of this part, it must include in the mail-in opt-out form the following statement: "□ Do not share my personal information with nonaffiliates to market their products and services to me."

(5) *Additional opt-outs.* Financial institutions that use the disclosure table to provide opt-out options beyond those required by Federal law must provide those opt-outs in this section of the model form. A financial institution that chooses to offer an opt-out for its own marketing in the mail-in opt-out form must include one of the two following statements: "□ Do not share my personal information to market to me." <u>or</u> "□ Do not use my personal information to market to me." A financial institution that chooses to offer an opt-out for joint marketing must include the following statement: "□ Do not share my personal information with other financial institutions to jointly market to me."

(h) *Barcodes.* A financial institution may elect to include a barcode and/or "tagline" (an internal identifier) in 6-point font at the bottom of page one, as needed for information internal to the institution, so long as these do not interfere with the clarity or text of the form.

3. **Page two.**

(a) *General Instructions for the Questions.* Certain of the Questions may be customized as follows:

(1) *"Who is providing this notice?"* This question may be omitted where only one financial institution provides the model form and that institution is clearly identified in the title on page one. Two or more financial institutions that jointly provide the model form must use this question to identify themselves as required by § 160.9(f) of this part. Where the list of institutions exceeds four (4) lines, the institution must describe in the response to this question the general types of institutions jointly providing the notice and must separately identify those institutions, in minimum 8-point font, directly following the "Other important information" box, or, if that box is not included in the institution's form, directly following the "Definitions." The list may appear in a multi-column format.

(2) *"How does [**name of financial institution**] protect my personal information?"* The financial institution may only provide additional information pertaining to its safeguards practices following the designated response to this question. Such information may include information about the institution's use of cookies or other measures it uses to safeguard personal information. Institutions are limited to a maximum of 30 additional words.

(3) *"How does [**name of financial institution**] collect my personal information?"* Institutions must use five (5) of the following terms to complete the bulleted list for this question:

open an account; deposit money; pay your bills; apply for a loan; use your credit or debit card; seek financial or tax advice; apply for insurance; pay insurance premiums; file an insurance claim; seek advice about your investments; buy securities from us; sell securities to us; direct us to buy securities; direct us to sell your securities; make deposits or withdrawals from your account; enter into an investment advisory contract; give us your income information; provide employment information; give us your employment history; tell us about your investment or retirement portfolio; tell us about your investment or retirement earnings; apply for financing; apply for a lease; provide account information; give us your contact information; pay us by check; give us your wage statements; provide your mortgage information; make a wire transfer; tell us who receives the money; tell us where to send the money; show your government-issued ID; show your driver's license; order a commodity futures or option trade. Institutions that collect personal information from their affiliates and/or credit bureaus must include after the bulleted list the following statement: "We also collect your personal information from others, such as credit bureaus, affiliates, or other companies." Institutions that do not collect personal information from their affiliates or credit bureaus but do collect information from other companies must include the following statement instead: "We also collect your personal information from other companies." Only institutions that do not collect any personal information from affiliates, credit bureaus, or other companies can omit both statements.

(4) *"Why can't I limit all sharing?"* Institutions that describe state privacy law provisions in the "*Other important information"*

box must use the bracketed sentence: "See below for more on your rights under state law." Other institutions must omit this sentence.

(5) *"What happens when I limit sharing for an account I hold jointly with someone else?"* Only financial institutions that provide opt-out options must use this question. Other institutions must omit this question. Institutions must choose one of the following two statements to respond to this question: "Your choices will apply to everyone on your account." or "Your choices will apply to everyone on your account–unless you tell us otherwise." Financial institutions that provide insurance products or services and elect to use the model form may substitute the word "policy" for "account" in these statements.

(b) *General Instructions for the Definitions.*

The financial institution must customize the space below the responses to the three definitions in this section. This specific information must be in italicized lettering to set off the information from the standardized definitions.

(1) *Affiliates.* As required by § 160.6(a)(3) of this part, where [***affiliate information***] appears, the financial institution must:

(i) If it has no affiliates, state: "[***name of financial institution***] *has no affiliates*";

(ii) If it has affiliates but does not share personal information, state: "*[**name of financial institution**] does not share with our affiliates*"; or

(iii) If it shares with its affiliates, state, as applicable: *"Our affiliates include companies with a [**common corporate identity of financial institution**] name; financial companies such as [**insert illustrative list of companies**]; nonfinancial* *companies, such as **[insert illustrative list of companies;]** and others, such as **[insert illustrative list]**."*

(2) *Nonaffiliates.* As required by § 160.6(c)(3) of this part, where [***nonaffiliate information***] appears, the financial institution must:

(i) If it does not share with nonaffiliated third parties, state: "[***name of financial institution***] *does not share with nonaffiliates so they can market to you*"; or

(ii) If it shares with nonaffiliated third parties, state, as applicable: "*Nonaffiliates we share with can include **[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]**.*"

(3) *Joint Marketing.* As required by § 160.13 of this part, where [***joint marketing***] appears, the financial institution must:

(i) If it does not engage in joint marketing, state: "***[name of financial institution]*** *doesn't jointly market*"; or

(ii) If it shares personal information for joint marketing, state, as applicable: "*Our joint marketing partners include **[list categories of companies such as credit card companies**].*"

(c) *General instructions for the "Other important information" box.* This box is optional. The space provided for information in this box is not limited. Only the following types of information can appear in this box.

(1) State and/or international privacy law information; and/or

(2) Acknowledgment of receipt form.

49. Amend newly redesignated Appendix B to part 160 as follows:

A. Adding a new sentence to the beginning of the introductory text as set forth below.

B. Effective January 1, 2012, remove Appendix B to part 160.

APPENDIX B TO PART 160-SAMPLE CLAUSES

This Appendix only applies to privacy notices provided before January 1, 2011.

* * * * *

Securities and Exchange Commission

Statutory Authority

The Commission is amending 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 Amendments

For the reasons set forth in the preamble, the Commission is amending Title 17, Chapter II of the Code of Federal Regulations as follows:

PART 248—REGULATIONS S-P AND S-AM

50. The authority citation for Part 248 continues to read as follows:

Authority: 15 U.S.C. 78q, 78q-1, 78w, 78mm, 80a-30, 80a-37, 80b-4, 80b-11, 1681s-3 and note, 1681w(a)(1), 6801-6809, and 6825.

51. Revise § 248.2 to read as follows:

Subpart A – Regulation S-P: Privacy of Consumer Financial Information and Safeguarding Personal Information

* * * * *

§ 248.2 Model privacy form: rule of construction.

(a) Model privacy form. Use of the model privacy form in Appendix A to Subpart A of this part, consistent with the instructions in Appendix A to Subpart A, constitutes compliance with the notice content requirements of §§ 248.6 and 248.7 of this part, although use of the model privacy form 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.

52. In § 248.6:

A. Revise paragraphs (b) and (f), and add paragraph (g) to read as set forth below.

B. Effective January 1, 2012, remove paragraph (g).

§ 248.6 Information to be included in privacy notices.

* * * * *

(b) Description of nonaffiliated third parties subject to exceptions. If you disclose nonpublic personal information to third parties as authorized under §§ 248.14 and 248.15, you are not required to list those exceptions in the initial or annual privacy notices required by §§ 248.4 and 248.5. When describing the categories with respect to those parties, it is sufficient to state that you make disclosures to other nonaffiliated companies:

(1) For your everyday business purposes such as [include all that apply] to process transactions, maintain account(s), respond to court orders and legal investigations, or report to credit bureaus; or

(2) As permitted by law.

* * * * *

(f) Model privacy form. Pursuant to § 248.2(a) and Appendix A to Subpart 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 to Subpart A of this part.
The sample clauses in Appendix B to Subpart A of this part provide guidance concerning the rule's application in ordinary circumstances in a privacy notice provided on or before December 31, 2010. The facts and circumstances of each individual situation, however, will determine whether compliance with a sample clause constitutes compliance with this part.

53. In § 248.7, add paragraph (i) to read as follows:

§ 248.7 Form of opt-out notice to consumers; opt-out methods.

* * * * *

(i) Model privacy form. Pursuant to § 248.2(a) and Appendix A to Subpart A of this part, Form S-P meets the notice content requirements of this section.

54. Revise Appendix A to Subpart A to read as follows:

Appendix A to Subpart A – Forms

A. Any person may view and print this form at: http://www.sec.gov/about/forms/secforms.htm.

B. 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.

FORM S-P— Model Privacy Form.

A. The model privacy form.

Version 1: Model Form With No Opt-Out.

Rev. [insert date]

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 are *no longer* our customer, we continue to share your information as described in this notice.
How?	All financial companies need to share customers' personal information to run their everyday business. 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 [illegible] share?	Can you limit this sharing?
For our everyday business purposes— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

Questions?	Call [phone number] or go to [website]

Who we are	
Who is providing this notice?	[insert]

What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]

Definitions	
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 information]*

Other important information
[insert other important information]

Version 2: Model Form with Opt-Out by Telephone and/or Online.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) or ■ Visit us online: [website] **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

Page 2

Who we are	
Who is providing this notice?	[insert]
What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]
Definitions	
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 information]*
Other important information	
[insert other important information]	

Version 3: Model Form with Mail-In Opt-Out Form.

Rev. [insert date]

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]
How?	All financial companies need to share customers' personal information to run their everyday business. 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— such as to process your transactions, maintain your account(s), respond to court orders and legal investigations, or 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		

To limit our sharing	■ Call [phone number]—our menu will prompt you through your choice(s) ■ Visit us online: [website] or ■ Mail the form below **Please note:** If you are a *new* customer, we can begin sharing your information [30] days from the date we sent this notice. When you are *no longer* our customer, we continue to share your information as described in this notice. However, you can contact us at any time to limit our sharing.
Questions?	Call [phone number] or go to [website]

Mail-in Form

Leave Blank OR [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ☐ Apply my choices only to me]	Mark any/all you want to limit: ☐ 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. ☐ Do not share my personal information with nonaffiliates to market their products and services to me.		
	Name		**Mail to:** [Name of Financial Institution] [Address1] [Address2] [City], [ST] [ZIP]
	Address		
	City, State, Zip		
	[Account #]		

Who we are	
Who is providing this notice?	[insert]
What we do	
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. [insert]
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 other companies.] **OR** [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 only ■ sharing for affiliates' everyday business purposes—information about your creditworthiness ■ affiliates from using your information to market to you ■ sharing for nonaffiliates to market to you State laws and individual companies may give you additional rights to limit sharing. [See below for more on your rights under state law.]
What happens when I limit sharing for an account I hold jointly with someone else?	[Your choices will apply to everyone on your account.] **OR** [Your choices will apply to everyone on your account—unless you tell us otherwise.]
Definitions	
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 information]*
Other important information	
[insert other important information]	

Version 4. Optional Mail-in Form.

Mail-in Form		
Leave Blank **OR** [If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. ❑ Apply my choices only to me]	Mark any/all you want to limit: ❑ 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. ❑ Do not share my personal information with nonaffiliates to market their products and services to me.	
	Name	
	Address	
	City, State, Zip	
	[illegible]	

Mail To: [Name of Financial Institution], [Address1]
[Address2], [City], [ST] [ZIP]

B. General Instructions

1. How the model privacy form is used.

(a) The model form may be used, at the option of a financial institution, including a group of financial institutions that use a common privacy notice, to meet the content requirements of the privacy notice and opt-out notice set forth in §§ 248.6 and 248.7 of this part.

(b) The model form is a standardized form, including page layout, content, format, style, pagination, and shading. Institutions seeking to obtain the safe harbor through use of the model form may modify it only as described in these instructions.

(c) 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.

(d) The word "customer" may be replaced by the word "member" whenever it appears in the model form, as appropriate.

2. The contents of the model privacy form.

The model form consists of two pages, which may be printed on both sides of a single sheet of paper, or may appear on two separate pages. Where an institution provides a long list of institutions at the end of the model form in accordance with Instruction C.3(a)(1), or provides additional information in accordance with Instruction C.3(c), and such list or additional information exceeds the space available on page two of the model form, such list or additional information may extend to a third page.

(a) *Page One*. The first page consists of the following components:

(1) Date last revised (upper right-hand corner).

(2) Title.

(3) Key frame (Why?, What?, How?).

(4) Disclosure table ("Reasons we can share your personal information").

(5) "To limit our sharing" box, as needed, for the financial institution's opt-out information.

(6) "Questions" box, for customer service contact information.

(7) Mail-in opt-out form, as needed.

(b) *Page Two*. The second page consists of the following components:

(1) Heading (Page 2).

(2) Frequently Asked Questions ("Who we are" and "What we do").

(3) Definitions.

(4) "Other important information" box, as needed.

3. The format of the model privacy form.

The format of 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. While a number of factors together produce easily readable type font, institutions are required to use a minimum of 10-point font (unless otherwise expressly permitted in these Instructions) 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 paper in portrait orientation, the size of which must be sufficient to meet the layout and minimum font size requirements, with sufficient white space on the top, bottom, and sides of the content.

(d) *Color.* The model form must be printed on white or light color paper (such as cream) with black or other contrasting ink color. 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. Logos may also be printed in color.

(e) *Languages.* The model form may be translated into languages other than English.

C. Information Required in the Model Privacy Form

The information in the model form may be modified only as described below:

1. Name of the institution or group of affiliated institutions providing the notice.

Insert the name of the financial institution providing the notice or a common identity of affiliated institutions jointly providing the notice on the form wherever **[name of financial institution]** appears.

2. Page one.

(a) *Last revised date.* The financial institution must insert in the upper right-hand corner the date on which the notice was last revised. The information shall appear in minimum 8-point font as "rev. [month/year]" using either the name or number of the month, such as "rev. July 2009" or "rev. 7/09".

(b) *General instructions for the "What?" box.*

(1) The bulleted list identifies the types of personal information that the institution collects and shares. All institutions must use the term "Social Security number" in the first bullet.

(2) Institutions must use five (5) of the following terms to complete the bulleted list: income; account balances; payment history; transaction history; transaction or loss history; credit history; credit scores; assets; investment experience; credit-based insurance scores; insurance claim history; medical information; overdraft history; purchase history; account transactions; risk tolerance; medical-related debts; credit card or other debt; mortgage rates and payments; retirement assets; checking account information; employment information; wire transfer instructions.

(c) *General instructions for the disclosure table*. The left column lists reasons for sharing or using personal information. Each reason correlates to a specific legal provision described in paragraph C.2(d) of this Instruction. In the middle column, each institution must provide a "Yes" or "No" response that accurately reflects its information sharing policies and practices with respect to the reason listed on the left. In the right column, each institution must provide in each box one of the following three (3) responses, as applicable, that reflects whether a consumer can limit such sharing: "Yes" if it is required to or voluntarily provides an opt-out; "No" if it does not provide an opt-out; or "We don't share" if it answers "No" in the middle column. Only the sixth row ("For our affiliates to market to you") may be omitted at the option of the institution. See paragraph C.2(d)(6) of this Instruction.

(d) *Specific disclosures and corresponding legal provisions.*

(1) *For our everyday business purposes*. This reason incorporates sharing information under §§ 248.14 and 248.15 and with service providers pursuant to § 248.13 of

this part other than the purposes specified in paragraphs C.2(d)(2) or C.2(d)(3) of these Instructions.

(2) *For our marketing purposes.* This reason incorporates sharing information with service providers by an institution for its own marketing pursuant to § 248.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(3) *For joint marketing with other financial companies.* This reason incorporates sharing information under joint marketing agreements between two or more financial institutions and with any service provider used in connection with such agreements pursuant to § 248.13 of this part. An institution that shares for this reason may choose to provide an opt-out.

(4) *For our affiliates' everyday business purposes – information about transactions and experiences.* This reason incorporates sharing information specified in sections 603(d)(2)(A)(i) and (ii) of the FCRA. An institution that shares for this reason may choose to provide an opt-out.

(5) *For our affiliates' everyday business purposes – information about creditworthiness.* This reason incorporates sharing information pursuant to section 603(d)(2)(A)(iii) of the FCRA. An institution that shares for this reason must provide an opt-out.

(6) *For our affiliates to market to you.* This reason incorporates sharing information specified in section 624 of the FCRA. This reason may be omitted from the disclosure table when: the institution does not have affiliates (or does not disclose personal information to its affiliates); the institution's affiliates do not use personal information in a manner that requires an opt-out; or the institution provides the affiliate marketing

notice separately. Institutions that include this reason must provide an opt-out of indefinite duration. An institution that is required to provide an affiliate marketing opt-out, but does not include that opt-out in the model form under this part, must comply with section 624 of the FCRA and 17 CFR Part 248, Subpart B, with respect to the initial notice and opt-out and any subsequent renewal notice and opt-out. An institution not required to provide an opt-out under this subparagraph may elect to include this reason in the model form.

(7) *For nonaffiliates to market to you.* This reason incorporates sharing described in §§ 248.7 and 248.10(a) of this part. An institution that shares personal information for this reason must provide an opt-out.

(e) *To limit our sharing*: A financial institution must include this section of the model form only if it provides an opt-out. The word "choice" may be written in either the singular or plural, as appropriate. Institutions must select one or more of the applicable opt-out methods described: telephone, such as by a toll-free number; a Website; or use of a mail-in opt-out form. Institutions may include the words "toll-free" before telephone, as appropriate. An institution that allows consumers to opt out online must provide either a specific Web address that takes consumers directly to the opt-out page or a general Web address that provides a clear and conspicuous direct link to the opt-out page. The opt-out choices made available to the consumer who contacts the institution through these methods must correspond accurately to the "Yes" responses in the third column of the disclosure table. In the part titled "Please note" institutions may insert a number that is 30 or greater in the space marked "[30]." Instructions on voluntary or

state privacy law opt-out information are in paragraph C.2(g)(5) of these Instructions.

(f) *Questions box.* Customer service contact information must be inserted as appropriate, where **[phone number]** or **[website]** appear. Institutions may elect to provide either a phone number, such as a toll-free number, or a Web address, or both. Institutions may include the words "toll-free" before the telephone number, as appropriate.

(g) *Mail-in opt-out form.* Financial institutions must include this mail-in form only if they state in the "To limit our sharing" box that consumers can opt out by mail. The mail-in form must provide opt-out options that correspond accurately to the "Yes" responses in the third column in the disclosure table. Institutions that require customers to provide only name and address may omit the section identified as "[account #]." Institutions that require additional or different information, such as a random opt-out number or a truncated account number, to implement an opt-out election should modify the "[account #]" reference accordingly. This includes institutions that require customers with multiple accounts to identify each account to which the opt-out should apply. An institution must enter its opt-out mailing address: in the far right of this form (see version 3); or below the form (see version 4). The reverse side of the mail-in opt-out form must not include any content of the model form.

(1) *Joint accountholder.* Only institutions that provide their joint accountholders the choice to opt out for only one accountholder, in accordance with paragraph C.3(a)(5) of these Instructions, must include in the far left column of the mail-in form the following statement: "If you have a joint account, your choice(s) will apply to everyone on your account unless you mark below. □ Apply my choice(s) only

to me." The word "choice" may be written in either the singular or plural, as appropriate. Financial institutions that provide insurance products or services, provide this option, and elect to use the model form may substitute the word "policy" for "account" in this statement. Institutions that do not provide this option may eliminate this left column from the mail-in form.

(2) *FCRA Section 603(d)(2)(A)(iii) opt-out*. If the institution shares personal information pursuant to section 603(d)(2)(A)(iii) of the FCRA, it must include in the mail-in opt-out form the following statement: "□ Do not share information about my creditworthiness with your affiliates for their everyday business purposes."

(3) *FCRA Section 624 opt-out*. If the institution incorporates section 624 of the FCRA in accord with paragraph C.2(d)(6) of these Instructions, it must include in the mail-in opt-out form the following statement: "□ Do not allow your affiliates to use my personal information to market to me."

(4) *Nonaffiliate opt-out*. If the financial institution shares personal information pursuant to § 248.10(a) of this part, it must include in the mail-in opt-out form the following statement: "□ Do not share my personal information with nonaffiliates to market their products and services to me."

(5) *Additional opt-outs*. Financial institutions that use the disclosure table to provide opt-out options beyond those required by Federal law must provide those opt-outs in this section of the model form. A financial institution that chooses to offer an opt-out for its own marketing in the mail-in opt-out form must include one of the two following statements: "□ Do not share my personal information to market to me." <u>or</u> "□ Do not use my personal information to

market to me." A financial institution that chooses to offer an opt-out for joint marketing must include the following statement: "□ Do not share my personal information with other financial institutions to jointly market to me."

(h) *Barcodes.* A financial institution may elect to include a barcode and/or "tagline" (an internal identifier) in 6-point font at the bottom of page one, as needed for information internal to the institution, so long as these do not interfere with the clarity or text of the form.

3. **Page two.**

(a) *General Instructions for the Questions.* Certain of the Questions may be customized as follows:

(1) *"Who is providing this notice?"* This question may be omitted where only one financial institution provides the model form and that institution is clearly identified in the title on page one. Two or more financial institutions that jointly provide the model form must use this question to identify themselves as required by § 248.9(f) of this part. Where the list of institutions exceeds four (4) lines, the institution must describe in the response to this question the general types of institutions jointly providing the notice and must separately identify those institutions, in minimum 8-point font, directly following the "Other important information" box, or, if that box is not included in the institution's form, directly following the "Definitions." The list may appear in a multi-column format.

(2) *"How does **[name of financial institution]** protect my personal information?"* The financial institution may only provide additional information pertaining to its safeguards practices following the designated response to this question. Such information may include information about the institution's use of cookies or other measures it uses to

safeguard personal information. Institutions are limited to a maximum of 30 additional words.

(3) *"How does **[name of financial institution]** collect my personal information?"* Institutions must use five (5) of the following terms to complete the bulleted list for this question: open an account; deposit money; pay your bills; apply for a loan; use your credit or debit card; seek financial or tax advice; apply for insurance; pay insurance premiums; file an insurance claim; seek advice about your investments; buy securities from us; sell securities to us; direct us to buy securities; direct us to sell your securities; make deposits or withdrawals from your account; enter into an investment advisory contract; give us your income information; provide employment information; give us your employment history; tell us about your investment or retirement portfolio; tell us about your investment or retirement earnings; apply for financing; apply for a lease; provide account information; give us your contact information; pay us by check; give us your wage statements; provide your mortgage information; make a wire transfer; tell us who receives the money; tell us where to send the money; show your government-issued ID; show your driver's license; order a commodity futures or option trade. Institutions that collect personal information from their affiliates and/or credit bureaus must include after the bulleted list the following statement: "We also collect your personal information from others, such as credit bureaus, affiliates, or other companies." Institutions that do not collect personal information from their affiliates or credit bureaus but do collect information from other companies must include the following statement instead: "We also collect your personal information from other companies."

Only institutions that do not collect any personal information from affiliates, credit bureaus, or other companies can omit both statements.

(4) *"Why can't I limit all sharing?"* Institutions that describe state privacy law provisions in the *"Other important information"* box must use the bracketed sentence: "See below for more on your rights under state law." Other institutions must omit this sentence.

(5) *"What happens when I limit sharing for an account I hold jointly with someone else?"* Only financial institutions that provide opt-out options must use this question. Other institutions must omit this question. Institutions must choose one of the following two statements to respond to this question: "Your choices will apply to everyone on your account." or "Your choices will apply to everyone on your account–unless you tell us otherwise." Financial institutions that provide insurance products or services and elect to use the model form may substitute the word "policy" for "account" in these statements.

(b) *General Instructions for the Definitions.*

The financial institution must customize the space below the responses to the three definitions in this section. This specific information must be in italicized lettering to set off the information from the standardized definitions.

(1) *Affiliates.* As required by § 248.6(a)(3) of this part, where [***affiliate information***] appears, the financial institution must:

(i) If it has no affiliates, state: "[***name of financial institution***] *has no affiliates*";

(ii) If it has affiliates but does not share personal information, state: "*[**name of financial institution**] does not share with our affiliates*"; or

(iii) If it shares with its affiliates, state, as applicable: *"Our affiliates include companies with a* ***[common corporate identity of financial institution]*** *name; financial companies such as* ***[insert illustrative list of companies]****; nonfinancial companies, such as* ***[insert illustrative list of companies;]*** *and others, such as* ***[insert illustrative list]****."*

(2) *Nonaffiliates.* As required by § 248.6(c)(3) of this part, where [***nonaffiliate information***] appears, the financial institution must:

(i) If it does not share with nonaffiliated third parties, state: "[***name of financial institution***] *does not share with nonaffiliates so they can market to you*"; or

(ii) If it shares with nonaffiliated third parties, state, as applicable: "*Nonaffiliates we share with can include* ***[list categories of companies such as mortgage companies, insurance companies, direct marketing companies, and nonprofit organizations]***."

(3) *Joint Marketing.* As required by § 248.13 of this part, where [***joint marketing***] appears, the financial institution must:

(i) If it does not engage in joint marketing, state: "***[name of financial institution]*** *doesn't jointly market*"; or

(ii) If it shares personal information for joint marketing, state, as applicable: "*Our joint marketing partners include* ***[list categories of companies such as credit card companies***]."

(c) *General instructions for the "Other important information" box.* This box is optional. The space provided for information in this box is not limited. Only the following types of information can appear in this box.

(1) State and/or international privacy law information; and/or

(2) Acknowledgment of receipt form.

55. Amend Appendix B to Subpart A to part 248 as follows:

A. Adding a sentence to the beginning of the introductory text as set forth below.

B. Effective January 1, 2012, remove Appendix B to Subpart A to part 248.

Appendix B to Subpart A – Sample Clauses

This Appendix only applies to privacy notices provided before January 1, 2011.

* * * * *

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE ENTITLED “FINAL MODEL PRIVACY FORM UNDER THE GRAMM-LEACH-BLILEY ACT.”]

Dated: October 1, 2009

____

John C. Dugan

Comptroller of the Currency

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE ENTITLED "FINAL MODEL PRIVACY FORM UNDER THE GRAMM-LEACH-BLILEY ACT."]

By order of the Board of Governors of the Federal Reserve System, October 27, 2009.

____

Jennifer J. Johnson

Secretary of the Board

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE ENTITLED "FINAL MODEL PRIVACY FORM UNDER THE GRAMM-LEACH-BLILEY ACT."]

By Order of the Board of Directors

Dated at Washington, D.C., this 23rd day of October, 2009

Federal Deposit Insurance Corporation.

____

Robert E. Feldman

Executive Secretary

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE ENTITLED "FINAL MODEL PRIVACY FORM UNDER THE GRAMM-LEACH-BLILEY ACT."]

Dated: September 28, 2009

By the Office of Thrift Supervision.

John E. Bowman,
Acting Director.

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE ENTITLED "FINAL MODEL PRIVACY FORM UNDER THE GRAMM-LEACH-BLILEY ACT."]

By the National Credit Union Administration Board on November 10, 2009.

Mary Rupp

Secretary of the Board

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE ENTITLED “FINAL MODEL PRIVACY FORM UNDER THE GRAMM-LEACH-BLILEY ACT.”]

The Federal Trade Commission.

Dated: September 25, 2009

By Direction of the Commission

Donald S. Clark

Secretary

[THIS SIGNATURE PAGE PERTAINS TO THE FINAL RULE ENTITLED "FINAL MODEL PRIVACY FORM UNDER THE GRAMM-LEACH-BLILEY ACT."]

Dated: September 21, 2009

David A. Stawick,

Secretary of the Commodity Futures Trading Commission

[THIS SIGNATURE PAGE PERTAINS TO THE JOINT FINAL RULE ENTITLED "FINAL MODEL PRIVACY FORM UNDER THE GRAMM-LEACH-BLILEY ACT."]

By the Securities and Exchange Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy

Secretary

Dated: November 16, 2009

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

November 17, 2009

In the Matter of

Apponline.Com, Inc.,
Condor Gold Corp.,
EPL Technologies, Inc.,
General Credit Corp.,
Integra, Inc.,
Integrated Health Services, Inc.,
Log On America, Inc.,
Matlack Systems, Inc.,
Pixtech, Inc., and
Virtual Communities, 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 Apponline.Com, Inc. because it has not filed any periodic reports since the period ended March 31, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Condor Gold Corp. because it has not filed any periodic reports since the period ended August 31, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of EPL Technologies, Inc. because it has not filed any periodic reports since the period ended September 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of General Credit Corp. because it has not filed any periodic reports since the period ended September 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Integra, Inc. because it has not filed any periodic reports since the period ended March 31, 2002.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Integrated Health Services, Inc. because it has not filed any periodic reports since the period ended September 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Log On America, Inc. because it has not filed any periodic reports since the period ended December 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Matlack Systems, Inc. because it has not filed any periodic reports since the period ended March 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Pixtech, Inc. because it has not filed any periodic reports since the period ended September 30, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Virtual Communities, Inc. because it has not filed any periodic reports since the period ended September 30, 2000.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on November 17, 2009, through 11:59 p.m. EST on December 1, 2009.

By the Commission.

Elizabeth M. Murphy
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. 61014 / November 17, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13688

In the Matter of **Apponline.Com, Inc.,** **Astropower, Inc.,** **Condor Gold Corp.,** **EPL Technologies, Inc.,** **General Credit Corp.,** **Integra, Inc.,** **Integrated Health Services, Inc.,** **Log On America, Inc.,** **Matlack Systems, Inc.,** **Pixtech, Inc., and** **Virtual Communities, Inc.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Apponline.Com, Inc., Astropower, Inc., Condor Gold Corp., EPL Technologies, Inc., General Credit Corp., Integra, Inc., Integrated Health Services, Inc., Log On America, Inc., Matlack Systems, Inc., Pixtech, Inc., and Virtual Communities, Inc.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Apponline.Com, Inc. ("AOPL")[1] (CIK No. 353646) is a void Delaware corporation located in Melville, New York with a class of securities registered with the

[1]The short form of each issuer's name is also its stock symbol.

Commission pursuant to Exchange Act Section 12(g). AOPL is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2000, which reported a net loss of $3,751,698 for the prior three months. On July 19, 2000, AOPL filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of New York, which was converted to a Chapter 7 petition, and was terminated on July 22, 2009. As of November 10, 2009, the common stock of AOPL was quoted on the Pink Sheets, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. Astropower, Inc. ("APWRQ") (CIK No. 885672) is a dissolved Delaware corporation located in Wilmington, Delaware with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). APWRQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2002. On February 1, 2004, APWRQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was terminated on June 3, 2009.

3. Condor Gold Corp. ("CDRGF") (CIK No. 1140738) is an Ontario corporation located in Toronto, Ontario with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CDRGF is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended August 31, 2002, which reported a net loss of $48,148 for the prior nine months. In a Form 6-K filed on March 26, 2003, CDRGF converted from filing as a domestic issuer to filing as a foreign private issuer. As of November 10, 2009, the common stock of CDRGF was quoted on the Pink Sheets, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. EPL Technologies, Inc. ("EPTG") (CIK No. 945269) is a delinquent Colorado corporation located in Devon, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). EPTG is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2001, which reported a net loss of $12,236,000 for the prior nine months. As of November 10, 2009, the common stock of EPTG was quoted on the Pink Sheets, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. General Credit Corp. ("GNIZQ") (CIK No. 40511) is a dissolved New York corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GNIZQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2001, which reported a net loss of $2,172,865 for the prior nine months. On July 19, 2002, GNIZQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Southern District of New York which was dismissed on March 24, 2005. As of November 10, 2009, the common stock of GNIZQ was quoted on the Pink Sheets, had two market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. Integra, Inc. ("INGA") (CIK No. 915859) is a forfeited Delaware corporation located in King of Prussia, Pennsylvania with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). INGA is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2002, which reported a net loss of $547,000 for the prior three months. On July 26, 2002, INGA filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Eastern District of Pennsylvania, which was terminated on August 22, 2008. As of November 10, 2009, the common stock of INGA was quoted on the Pink Sheets, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

7. Integrated Health Services, Inc. ("IHSVQ") (CIK No. 785814) is a forfeited Delaware corporation located in Sparks, Maryland with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). IHSVQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2000, which reported a net loss of $63,248,000 for the prior nine months. On February 2, 2000, IHSVQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was terminated on October 30, 2008. As of November 10, 2009, the common stock of IHSVQ was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

8. Log On America, Inc. ("LOAX") (CIK No. 1074927) is a void Delaware corporation located in Providence, Rhode Island with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). LOAX is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2001, which reported a net loss of $35,923,024 for the prior year. On July 12, 2002, LOAX filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was converted to a Chapter 7 petition, and was still pending as of November 10, 2009. As of November 10, 2009, the common stock of LOAX was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

9. Matlack Systems, Inc. ("MLKIQ") (CIK No. 837339) is a forfeited Delaware corporation located in Wilmington, Delaware with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). MLKIQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2001, which reported a net loss of $11,434,000 for the prior six months. On March 29, 2001, MLKIQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware, which was converted to a Chapter 7 petition, and was still pending as of November 10, 2009. As of November 10, 2009, the common stock of MLKIQ was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

10. Pixtech, Inc. ("PIXTQ") (CIK No. 946144) is a void Delaware corporation located in Rousset, France with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PIXTQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2001, which reported a net loss of $20,217,000 for the prior nine months. On June 14, 2002, PIXTQ filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Northern District of

California, which was terminated on June 18, 2007. As of November 10, 2009, the common stock of PIXTQ was quoted on the Pink Sheets, had six market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

11. Virtual Communities, Inc. ("VCIX") (CIK No. 1028718) is a void Delaware corporation located in New York, New York with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). VCIX is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2000, which reported a net loss of $10,558,000 for the prior nine months. On December 6, 2001, the company suspended its business operations. As of November 10, 2009, the common stock of VCIX was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

13. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires domestic issuers to file quarterly reports. Rule 13a-16 requires foreign private issuers to furnish quarterly and other reports to the Commission under cover of Form 6-K if they make or are required to make the information public under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

14. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 thereunder.

III.

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

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

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

IV.

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

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

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

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Attachment

Appendix 1

Chart of Delinquent Filings

In the Matter of Apponline.Com, Inc., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Apponline.Com, Inc.					
	10-Q	06/30/00	08/14/00	Not filed	111
	10-Q	09/30/00	11/14/00	Not filed	108
	10-K	12/31/00	04/02/01	Not filed	103
	10-Q	03/31/01	05/15/01	Not filed	102
	10-Q	06/30/01	08/14/01	Not filed	99
	10-Q	09/30/01	11/14/01	Not filed	96
	10-K	12/31/01	04/01/02	Not filed	91
	10-Q	03/31/02	05/15/02	Not filed	90
	10-Q	06/30/02	08/14/02	Not filed	87
	10-Q	09/30/02	11/14/02	Not filed	84
	10-K	12/31/02	03/31/03	Not filed	80
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75
	10-Q	09/30/03	11/14/03	Not filed	72
	10-K	12/31/03	03/30/04	Not filed	68
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-K	12/31/04	03/31/05	Not filed	56
	10-Q	03/31/05	05/16/05	Not filed	54
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-K	12/31/05	03/31/06	Not filed	44
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36
	10-K	12/31/06	04/02/07	Not filed	31
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-K	12/31/07	03/31/08	Not filed	20
	10-Q	03/31/08	05/15/08	Not filed	18
	10-Q	06/30/08	08/14/08	Not filed	15

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Apponline.Com, Inc. *(continued)*	*10-Q*	09/30/08	11/14/08	Not filed	12
	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	37				
Astropower, Inc.	*10-K*	12/31/02	03/31/03	Not filed	80
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75
	10-Q	09/30/03	11/14/03	Not filed	72
	10-K	12/31/03	03/30/04	Not filed	68
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-K	12/31/04	03/31/05	Not filed	56
	10-Q	03/31/05	05/16/05	Not filed	54
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-K	12/31/05	03/31/06	Not filed	44
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36
	10-K	12/31/06	04/02/07	Not filed	31
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-K	12/31/07	03/31/08	Not filed	20
	10-Q	03/31/08	05/15/08	Not filed	18
	10-Q	06/30/08	08/14/08	Not filed	15
	10-Q	09/30/08	11/14/08	Not filed	12
	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	27				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Condor Gold Corp.					
	20-F	11/30/02	06/02/03	Not filed	77
	20-F	11/30/03	06/01/04	Not filed	65
	20-F	11/30/04	05/31/05	Not filed	54
	20-F	11/30/05	05/31/06	Not filed	42
	20-F	11/30/06	05/31/07	Not filed	30
	20-F	11/30/07	06/02/08	Not filed	17
	20-F	11/30/08	06/01/09	Not filed	5
Total Filings Delinquent	7				
EPL Technologies, Inc.					
	10-KSB	12/31/01	04/01/02	Not filed	91
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
EPL Technologies, Inc. *(continued)*	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	31				
General Credit Corp.					
	10-KSB	12/31/01	04/01/02	Not filed	91
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	31				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Integra, Inc.					
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	29				
Integrated Health Services, Inc.					
	10-K	12/31/00	04/02/01	Not filed	103
	10-Q	03/31/01	05/15/01	Not filed	102
	10-Q	06/30/01	08/14/01	Not filed	99
	10-Q	09/30/01	11/14/01	Not filed	96
	10-K	12/31/01	04/01/02	Not filed	91
	10-Q	03/31/02	05/15/02	Not filed	90
	10-Q	06/30/02	08/14/02	Not filed	87

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Integrated Health Services, Inc.	*10-Q*	09/30/02	11/14/02	Not filed	84
(continued)	*10-K*	12/31/02	03/31/03	Not filed	80
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75
	10-Q	09/30/03	11/14/03	Not filed	72
	10-K	12/31/03	03/30/04	Not filed	68
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-K	12/31/04	03/31/05	Not filed	56
	10-Q	03/31/05	05/16/05	Not filed	54
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-K	12/31/05	03/31/06	Not filed	44
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36
	10-K	12/31/06	04/02/07	Not filed	31
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-K	12/31/07	03/31/08	Not filed	20
	10-Q	03/31/08	05/15/08	Not filed	18
	10-Q	06/30/08	08/14/08	Not filed	15
	10-Q	09/30/08	11/14/08	Not filed	12
	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	35				
Log On America, Inc.					
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Log On America, Inc.	*10-QSB*	06/30/04	08/16/04	Not filed	63
(continued)	*10-QSB*	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	30				
Matlack Systems, Inc.					
	10-Q	06/30/01	08/14/01	Not filed	99
	10-K	09/30/01	12/31/01	Not filed	95
	10-Q	12/31/01	02/14/02	Not filed	93
	10-Q	03/31/02	05/15/02	Not filed	90
	10-Q	06/30/02	08/14/02	Not filed	87
	10-K	09/30/02	12/30/02	Not filed	83
	10-Q	12/31/02	02/14/03	Not filed	81
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75
	10-K	09/30/03	12/29/03	Not filed	71
	10-Q	12/31/03	02/17/04	Not filed	69
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-K	09/30/04	12/29/04	Not filed	59
	10-Q	12/31/04	02/14/05	Not filed	57
	10-Q	03/31/05	05/16/05	Not filed	54

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Matlack Systems, Inc.	*10-Q*	06/30/05	08/15/05	Not filed	51
(continued)	*10-K*	09/30/05	12/29/05	Not filed	47
	10-Q	12/31/05	02/14/06	Not filed	45
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-K	09/30/06	12/29/06	Not filed	35
	10-Q	12/31/06	02/14/07	Not filed	33
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-K	09/30/07	12/31/07	Not filed	23
	10-Q	12/31/07	02/14/08	Not filed	21
	10-Q	03/31/08	05/15/08	Not filed	18
	10-Q	06/30/08	08/14/08	Not filed	15
	10-K	09/30/08	12/29/08	Not filed	11
	10-Q	12/31/08	02/17/09	Not filed	9
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	33				
Pixtech, Inc.					
	10-K	12/31/01	04/01/02	Not filed	91
	10-Q	03/31/02	05/15/02	Not filed	90
	10-Q	06/30/02	08/14/02	Not filed	87
	10-Q	09/30/02	11/14/02	Not filed	84
	10-K	12/31/02	03/31/03	Not filed	80
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75
	10-Q	09/30/03	11/14/03	Not filed	72
	10-K	12/31/03	03/30/04	Not filed	68
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-K	12/31/04	03/31/05	Not filed	56
	10-Q	03/31/05	05/16/05	Not filed	54
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-K	12/31/05	03/31/06	Not filed	44
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Pixtech, Inc. ***(continued)***	*10-K*	12/31/06	04/02/07	Not filed	31
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-K	12/31/07	03/31/08	Not filed	20
	10-Q	03/31/08	05/15/08	Not filed	18
	10-Q	06/30/08	08/14/08	Not filed	15
	10-Q	09/30/08	11/14/08	Not filed	12
	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	31				
Virtual Communities, Inc.					
	10-KSB	12/31/00	04/02/01	Not filed	103
	10-QSB	03/31/01	05/15/01	Not filed	102
	10-QSB	06/30/01	08/14/01	Not filed	99
	10-QSB	09/30/01	11/14/01	Not filed	96
	10-KSB	12/31/01	04/01/02	Not filed	91
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Virtual Communities, Inc. *(continued)*	*10-QSB*	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
Total Filings Delinquent	35				

*Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, have been removed from the federal securities laws. *See* Release No. 34-56994 (Dec. 19, 2007). The removal took effect over a transition period that concluded on March 15, 2009. All reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB are now required to use Forms 10-Q and 10-K instead. Forms 10-QSB and 10-KSB will no longer be available, though issuers that meet the definition of a "smaller reporting company" (generally, a company that has less than $75 million in public equity float as of the end of its most recently completed second fiscal quarter) have the option of using new, scaled disclosure requirements that Regulation S-K now includes.

COMMODITY FUTURES TRADING COMMISSION

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-61020]

Joint Order to Exclude Indexes Composed of Certain Index Options from the Definition of Narrow-Based Security Index Pursuant to Section 1a(25)(B)(vi) of the Commodity Exchange Act and Section 3(a)(55)(C)(vi) of the Securities Exchange Act of 1934

AGENCIES: Commodity Futures Trading Commission and Securities and Exchange Commission.

ACTION: Joint Order.

SUMMARY: The Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC") (collectively, "Commissions") by joint order under the Commodity Exchange Act ("CEA") and the Securities Exchange Act of 1934 ("Exchange Act") are excluding certain security indexes from the definition of "narrow-based security index." Specifically, the Commissions are excluding from the definition of the term "narrow-based security index" certain volatility indexes composed of series of index options on broad-based security indexes.

EFFECTIVE DATE: November 17, 2009

FOR FURTHER INFORMATION CONTACT:

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SEC: Richard R. Holley III, Senior Special Counsel, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. Telephone (202) 551-5614.

SUPPLEMENTARY INFORMATION:

I. BACKGROUND

Futures contracts on single securities and on narrow-based security indexes (collectively, "security futures") are jointly regulated by the CFTC and the SEC.[1] To distinguish between security futures on narrow-based security indexes, which are jointly regulated by the Commissions, and futures contracts on broad-based security indexes, which are under the exclusive jurisdiction of the CFTC, the CEA and the Exchange Act each includes an objective definition of the term "narrow-based security index." A futures contract on an index that meets the definition of a narrow-based security index is a security future. A futures contract on an index that does not meet the definition of a narrow-based security index is a futures contract on a broad-based security index.[2]

Section 1a(25)(A) of the CEA[3] and Section 3(a)(55)(B) of the Exchange Act[4] provide that an index is a "narrow-based security index" if, among other things, it meets one of the following four criteria:

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1 See Section 1a(31) of the CEA and Section 3(a)(55)(A) of the Exchange Act, 7 U.S.C. 1a(31) and 15 U.S.C. 78c(a)(55)(A).

2 See 17 CFR 41.1(c).

3 7 U.S.C. 1a(25)(A).

4 15 U.S.C. 78c(a)(55)(B).

(i) the index has nine or fewer component securities;

(ii) any component security of the index comprises more than 30 percent of the index's weighting;

(iii) the five highest weighted component securities of the index in the aggregate comprise more than 60 percent of the index's weighting; or

(iv) the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting have an aggregate dollar value of average daily trading volume of less than $50,000,000 (or in the case of an index with 15 or more component securities, $30,000,000), except that if there are two or more securities with equal weighting that could be included in the calculation of the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting, such securities shall be ranked from lowest to highest dollar value of average daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security.

The first three criteria evaluate the composition and weighting of the securities in the index. The fourth criterion evaluates the liquidity of an index's component securities.

Section 1a(25)(B)(vi) of the CEA[5] and Section 3(a)(55)(C)(vi) of the Exchange Act[6] provide that, notwithstanding the above criteria, an index is not a narrow-based security index if a contract of sale for future delivery on the index is traded on or subject to the rules of a board of trade and meets such requirements as are jointly established by rule, regulation, or order by the Commissions. Pursuant to that authority, the Commissions may jointly exclude an index from the definition of the term "narrow-based security index."

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5 7 U.S.C. 1a(25)(B)(vi).

6 15 U.S.C. 78c(a)(55)(C)(vi).

Using this authority, on March 25, 2004, the Commissions issued a joint order excluding volatility indexes that satisfy certain conditions from the definition of "narrow-based security index".[7]

II. DISCUSSION

The statutory definition of the term "narrow-based security index" is designed to distinguish among indexes composed of individual stocks. As a result, certain aspects of that definition are designed to take into account the trading patterns of individual stocks rather than those of other types of exchange-traded securities, such as security index options. However, the Commissions believe that the definition is not limited to indexes on individual stocks. In fact, Section 1a(25)(B)(vi) of the CEA[8] and Section 3(a)(55)(C)(vi) of the Exchange Act[9] give the Commissions joint authority to make determinations with respect to security indexes that do not meet the specific statutory criteria.

The Commissions believed, when issuing the 2004 Joint Order excluding certain volatility indexes from the definition of "narrow-based security index," that certain volatility indexes were appropriately classified as broad-based because they measure the magnitude of changes in the level of an underlying index that is a broad-based security index. Further, the Commissions noted that they believed that futures contracts on volatility indexes that satisfied the conditions set forth in the 2004 Joint Order should not be readily susceptible to manipulation.

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7 See Securities Exchange Act Release No. 49469 (March 25, 2004), 69 FR 16900 (March 31, 2004) ("2004 Joint Order"). Following the issuance of the 2004 Joint Order, the CBOE Futures Exchange, LLC listed for trading futures contacts on the CBOE Volatility Index ("VIX").

8 7 U.S.C. 1a(25)(B)(vi).

9 15 U.S.C. 78c(a)(55)(C)(vi).

The Commisions believed that those conditions reduce the ability to manipulate the price of the futures contracts through manipulation of the options comprising the volatility index.

Eurex[10] has requested that the Commissions exclude the VDAX-NEW® volatility index from the definition of "narrow-based security index."[11] According to Eurex, this volatility index meets all the conditions set forth in the 2004 Joint Order, except the sixth condition, which requires that "[o]ptions on the Underlying Broad-Based Security Index… [be] listed and traded on a national securities exchange registered under section 6(a) of the Exchange Act."[12] The Commissions note that a volatility index based on index options traded on a foreign exchange, such as the VDAX-NEW®, would be unable to satisfy this condition.

In the 2004 Joint Order the Commissions stated, with respect to the sixth condition, that:

> Given the novelty of volatility indexes, the Commissions believe at this time that it is appropriate to limit the component securities to those index options that are listed for trading on a national securities exchange where the Commissions know pricing information is current, accurate and publicly available.[13]

In response to Eurex's request, the Commissions believe that certain volatility indexes should be excluded from the definition of "narrow-based security index" if the index options used to calculate the magnitude of change in the level of the underlying broad-based security index are listed for trading on an exchange and pricing information for the underlying broad-based security index, and options on such index, is computed and disseminated in real-time though major market data vendors. For purposes of this Order, the Commissions would consider such pricing information to be current, accurate, and publicly available.

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10 Eurex Deutschland is operated by Eurex Frankfurt AG (hereinafter "Eurex Deutschland" and "Eurex Frankfurt AG" together are referred to as "Eurex").

11 See Letter from Paul M. Architzel, Alston & Bird, LLP, to Nancy Morris, Secretary, SEC, and Eileen Donovan, Acting Secretary, CFTC, dated December 18, 2006.

12 See 2004 Joint Order, supra note 7, 69 FR at 16901.

13 See id.

The Commissions believe that, when pricing information for the index underlying a volatility index and for the index options that compose the volatility index is current, accurate, and publicly available, it would minimize the ability to manipulate the index options used to calculate the volatility index. As a result, futures contracts on such a volatility index would not be readily susceptible to manipulation.

Therefore, the Commissions believe that an alternative to the sixth condition in the 2004 Joint Order, which requires that the component securities of a volatility index (i.e., options on the underlying broad-based index) be listed for trading on a national securities exchange registered pursuant to Exchange Act Section 6(a), would be appropriate in certain circumstances. The Commissions believe that it is appropriate to permit the component securities of a volatility index to be listed for trading on any exchange, provided that pricing information for the underlying broad-based security index, and the options on such index that compose the volatility index, is current, accurate, and publicly available. Specifically, the new sixth condition would require such pricing information to be computed and disseminated in real-time through major market data vendors.

In addition to the alternative sixth condition discussed above, a volatility index would have to satisfy the other conditions in the 2004 Joint Order, which are set forth below.[14] The Commissions also reaffirm the rationale for those conditions stated in the 2004 Joint Order.

Accordingly,

IT IS ORDERED, pursuant to Section 1a(25)(B)(vi) of the CEA and Section 3(a)(55)(C)(vi) of the Exchange Act, that an index is not a narrow-based security index and is therefore a broad-based security index, if:

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[14] The Commissions note that nothing in this joint order should be construed as repealing or otherwise revoking the 2004 Joint Order.

(1) The index measures the magnitude of changes in the level of an underlying broad-based security index that is not a narrow-based security index as that term is defined in Section 1a(25) of the CEA and Section 3(a)(55) of the Exchange Act over a defined period of time, which magnitude is calculated using the prices of options on the underlying broad-based security index and represents (a) an annualized standard deviation of percent changes in the level of the underlying broad-based security index, (b) an annualized variance of percent changes in the level of the underlying broad-based security index, or (c) on a non-annualized basis, either the standard deviation or the variance of percent changes in the level of the underlying broad-based security index;

(2) The volatility index has more than nine component securities, all of which are options on the underlying broad-based security index;

(3) No component security of the volatility index comprises more than 30% of the volatility index's weighting;

(4) The five highest weighted component securities of the volatility index in the aggregate do not comprise more than 60% of the volatility index's weighting;

(5) The average daily trading volume of the lowest weighted component securities in the underlying broad-based security index upon which the volatility index is calculated (those comprising, in the aggregate, 25% of the underlying broad-based security index's weighting) has a dollar value of more than $50,000,000 (or $30,000,000 in the case of an underlying broad-based security index with 15 or more component securities), except if there are two or more securities with equal weighting that could be included in the calculation of the lowest weighted component securities comprising, in the aggregate, 25% of the underlying broad-based security index's weighting, such securities shall be ranked from lowest to highest dollar value of average

daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security;

(6) The index options used to calculate the magnitude of change in the level of the underlying broad-based security index are listed for trading on an exchange and pricing information for the underlying broad-based security index, and options on such index, is computed and disseminated in real-time through major market data vendors; and

(7) The aggregate average daily trading volume in options on the underlying broad-based security index is at least 10,000 contracts calculated as of the preceding 6 full calendar months.

By the Commodity Futures Trading Commission.

David A. Stawick
Secretary

November 17, 2009

By the Securities and Exchange Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

November 17, 2009

COMMODITY FUTURES TRADING COMMISSION

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61027)

Joint Order Modifying the Listing Standards Requirements under Section 6(h) of the Securities Exchange Act of 1934 and the Criteria under Section 2(a)(1) of the Commodity Exchange Act

The Securities Exchange Act of 1934 ("Exchange Act") and the Commodity Exchange Act ("CEA") set forth the types of securities on which security futures[1] can be based. The Exchange Act provides that it is unlawful for any person to effect transactions in security futures that are not listed on a national securities exchange or a national securities association registered pursuant to Section 15A of the Exchange Act.[2] The Exchange Act further provides that such exchange or association is permitted to trade only security futures that conform with listing standards filed with the Securities and Exchange Commission ("SEC") and that meet the criteria specified in Section 2(a)(1)(D)(i) of the CEA.[3] Section 2(a)(1)(D)(i) of the CEA permits the Commodity Futures Trading Commission ("CFTC") to designate a board of trade as a contract market with respect to, or to register as a derivatives transaction execution facility to list or execute, transactions in security futures if the board of trade and the applicable contract meet the criteria specified in that section. Similarly, the Exchange Act requires that the listing standards filed with the SEC by an exchange or association meet specified requirements.[4]

Among other things, the Exchange Act and the CEA require that any security underlying a security future, including each component security of a narrow-based security index, except as

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1 Security futures are futures contracts on single securities and narrow-based security indexes. See Section 3(a)(55)(A) of the Exchange Act, 15 U.S.C. 3(a)(55)(A), and Section 1a(31) of the CEA, 7 U.S.C. 1a(31).

2 Section 6(h)(1) of the Exchange Act, 15 U.S.C. 78f(h)(1).

3 Section 6(h)(2) of the Exchange Act, 15 U.S.C. 78f(h)(2). See also 7 U.S.C. 2(a)(1)(D)(i).

4 Section 6(h)(3) of the Exchange Act, 15 U.S.C. 78f(h)(3).

otherwise provided in a rule, regulation, or order, be registered pursuant to Section 12 of the Exchange Act.[5] In 2006, the SEC and CFTC (together, the "Commissions") adopted SEC Rule 6h-2[6] and an amendment to CEA Rule 41.21,[7] respectively, to permit security futures to be based on individual debt securities or narrow-based indexes composed of such securities.[8] However, because most debt securities are not registered under Section 12 of the Exchange Act,[9] few security futures based on debt securities can be listed.

In addition, the Exchange Act[10] and the CEA[11] require that security futures be based upon common stock and such other equity securities as the Commissions may jointly determine to be appropriate. Pursuant to this authority, the Commissions previously issued joint orders to permit depository shares[12] and shares of Exchange-Traded Funds, Trust Issued Receipts, and shares of registered closed-end management investment companies[13] to underlie security futures (together,

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5 Section 6(h)(3)(A) of the Exchange Act, 15 U.S.C. 78f(h)(3)(A), and Section 2(a)(1)(D)(i)(I) of the CEA, 7 U.S.C. 2(a)(1)(D)(i)(I).

6 17 CFR 240.6h-2.

7 17 CFR 41.21.

8 See Securities Exchange Act Release No. 54106 (July 6, 2006) 71 FR 39534 (July 13, 2006) ("2006 Rulemaking").

9 In this regard, the Commissions note that, in a 2005 request for exemptive relief to permit its members, brokers, and dealers to trade certain unregistered debt securities, the New York Stock Exchange ("NYSE") estimated that, out of over 22,000 publicly offered corporate bond issues having a par value in excess of $3 trillion, only 8% of the $3 trillion par value of these debt securities was registered under the Exchange Act. See Securities Exchange Act Release No. 51998 (July 8, 2005), 70 FR 40748 (July 14, 2005). The SEC granted the NYSE's request for exemptive relief, subject to certain conditions. See Securities Exchange Act Release No. 54766 (November 16, 2006), 71 FR 67657 (November 22, 2006) (File No. S7-06-05) ("NYSE Exemption")

10 15 U.S.C. 78f(h)(3)(D).

11 7 U.S.C. 2(a)(1)(D)(i)(III).

12 See Securities Exchange Act Release No. 44725 (August 20, 2001).

13 See Securities Exchange Act Release No. 46090 (June 19, 2002), 67 FR 42760 (June 25, 2002).

the "Prior Joint Orders"). There are, however, other types of securities that underlie listed options that are neither common stock nor covered by the Prior Joint Orders.

Section 6(h)(4)(A) of the Exchange Act[14] and Section 2(a)(1)(D)(v)(I) of the CEA[15] provide that the Commissions, by rule, regulation, or order, may jointly modify the listing standard requirements specified in Sections 6(h)(3)(A) and (D) of the Exchange Act[16] and the criteria specified in Sections 2(a)(1)(D)(i)(I) and (III) of the CEA[17] to the extent that such modification fosters the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors. For the reasons and subject to the conditions discussed below, the Commissions believe that jointly modifying these requirements to permit any security that is eligible to underlie options traded on a national securities exchange to also underlie security futures, and to permit debt securities that are not registered under Section 12 of the Exchange Act ("unregistered debt securities") to underlie security futures, will foster the development of fair and orderly markets, is necessary or appropriate in the public interest, and is consistent with the protection of investors.

I. Discussion

A. Security Futures Based on Securities Eligible to Underlie Options Traded on a National Securities Exchange

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14 15 U.S.C. 78f(h)(4)(A).

15 7 U.S.C. 2(a)(1)(D)(v)(I).

16 15 U.S.C. 78f(h)(3)(A) and (D).

17 7 U.S.C. 2(a)(1)(D)(i)(I) and (III)..

Section 6(h)(3)(D) of the Exchange Act[18] and Section 2(a)(1)(D)(i)(III) of the CEA[19] require that security futures be based upon common stock and such other equity securities as the Commissions jointly determine appropriate. Section 6(h)(4)(A) of the Exchange Act[20] and Section 2(a)(1)(D)(v)(I) of the CEA[21] provide that the Commissions, by rule, regulation, or order, may jointly modify this requirement to the extent that such modification fosters the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors.

The Commissions now believe that modifying the requirement in Section 6(h)(3)(D) of the Exchange Act and Section 2(a)(1)(D)(i)(III) of the CEA to permit any security that is eligible to underlie options traded on a national securities exchange to also underlie security futures will foster the development of fair and orderly markets in security futures products, is appropriate in the public interest, and is consistent with the protection of investors.

To be eligible to underlie options traded on a national securities exchange, and, pursuant to this order, eligible to underlie security futures, a security must meet securities options listing standards of a national securities exchange. Options listing standards of a national securities exchange are rules of an exchange, and, as such, must be filed with the SEC pursuant to Section 19(b) of the Exchange Act,[22] and comply with Section 6(b) of the Exchange Act.[23] Section 6(b)(5) of the Exchange Act,[24] in particular, requires, among other things, that the rules of a

18 15 U.S.C. 78f(h)(3)(D).

19 7 U.S.C. 2(a)(1)(D)(i)(III).

20 15 U.S.C. 78f(h)(4)(A).

21 7 U.S.C. 2(a)(1)(D)(v)(I).

22 15 U.S.C. 78s(b).

23 15 U.S.C. 78f(b).

24 15 U.S.C. 78f(b)(5).

national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest. The SEC may not approve an options exchange's proposed rule, including a proposed options listing standard, unless the SEC finds that it is consistent with the requirements of the Exchange Act, including Section 6(b),[25] and the rules and regulations under the Exchange Act. Accordingly, the Commissions believe that it is appropriate in the public interest and consistent with the protection of investors to modify the listing standard requirements in Section 6(h)(3)(D) of the Exchange Act and Section 2(a)(1)(D)(i)(III) of the CEA to permit any security that is eligible to underlie options traded on a national securities exchange to also underlie security futures. In addition, the Commissions believe that this modification of the listing standard requirements in the Exchange Act and the CEA will reduce impediments to the listing of security futures by allowing the creation of potentially useful new financial instruments, thereby fostering the development of fair and orderly markets in security futures. The Commissions believe, further, that it is appropriate, in the public interest, and consistent with the protection of investors to permit the listing and trading of security futures based on any security that is eligible to underlie an exchange-listed option because such security futures may facilitate price discovery in, and be a useful hedge for, the underlying securities, including certain unregistered debt securities.[26] Finally, the Commissions note that all security

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25 15 U.S.C. 78s(b).

26 The listing standards applicable to options generally require, among other things, that the underlying security be registered under Section 12 of the Exchange Act, be an NMS Stock, as defined in Regulation NMS under the Exchange Act, 17 CFR 242.600(b)(47), and have a substantial number of outstanding shares that are widely held and actively traded. See, e. g., CBOE Rule 5.3 (Criteria for Underlying Securities). To date, the only securities not registered under Section 12 of the Exchange Act (other than U.S.

futures will continue to be required to meet the requirements of Sections 6(h)(3)(B), (C), and (E) – (L) of the Exchange Act[27] and Sections 2(a)(1)(D)(i)(II) and (IV) – (XI) of the CEA.[28]

Unless the Commissions jointly determine otherwise, some securities eligible to underlie options traded on a national securities exchange currently may not be eligible to underlie security futures because such securities may not be common stock or covered by the Prior Joint Orders. By permitting any security eligible to underlie options to also underlie security futures, the Commissions are modifying the listing standard requirements in the Exchange Act and the criteria in the CEA to eliminate the requirement that any security underlying security futures, including each component security of a narrow-based security index, be common stock or such other equity securities as the Commissions may jointly determine. Instead, as long as a security may underlie options traded on a national securities exchange and the listing standards and the criteria for futures on such security meet the requirements of Sections 6(h)(3)(B), (C), and (E) – (L) of the Exchange Act and Sections 2(a)(1)(D)(i)(II) and (IV) – (XI) of the CEA, such security may underlie security futures.[29]

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government securities) that the SEC has approved to underlie exchange-listed options are certain corporate debt securities. See Securities Exchange Act Release No. 55976 (June 28, 2007), 72 FR 37551 (July 10, 2007) (order approving a proposal by the CBOE to list options on certain unregistered corporate debt securities). Among other things, these corporate debt securities must have substantial trading volume, initial principal amount, and outstanding float; the issuer of the corporate debt security must have at least one class of equity security registered under Section 12(b) of the Exchange Act; and the issuer's equity securities must satisfy the exchange's criteria to underlie options. See CBOE Rule 5.3.12.

27 15 U.S.C. 78f(h)(3)(B), (C) and (E) – (L).

28 7 U.S.C. 2(a)(1)(D)(i)(II) and (IV) – (XI).

29 The Commissions note that Section 6(h)(3)(C) of the Exchange Act, 15 U.S.C 78f(h)(3)(C), which will continue to apply, requires that listing standards for security futures be no less restrictive than comparable listing standards for options traded on a national securities exchange or national securities association.

Further, Section 6(h)(2) of the Exchange Act[30] provides that a national securities exchange or a national securities association is permitted to trade only security futures that (A) conform with listing standards that the exchange or association files with the SEC under Section 19(b) of the Exchange Act, and (B) meet the criteria specified in Section 2(a)(1)(D)(i) of the CEA.[31] Such security futures listing standards must also meet the requirements specified in Section 6(h)(3) of the Exchange Act,[32] including the requirement that the listing standards for security futures be no less restrictive than comparable listing standards for options traded on a national securities exchange or a national securities association.[33] Before listing and trading security futures on any security eligible to underlie options traded on a national securities exchange, a national securities exchange or a national securities association must file with the SEC, pursuant to Section 19(b)(7) of the Exchange Act[34] and Rule 19b-7 thereunder,[35] a proposed rule change relating to its listing standards. An exchange or an association also must concurrently file its proposed listing standards with the CFTC pursuant to Section 19(b)(7)(B) of the Exchange Act.[36]

B. Security Futures Based on Unregistered Debt Securities

Section 6(h)(3)(A) of the Exchange Act[37] and Section 2(a)(1)(D)(i)(I) of the CEA[38] require that any security underlying security futures, including each component security of a

30 15 U.S.C. 78f(h)(2).

31 7 U.S.C. 2(a)(1)(D)(i).

32 15 U.S.C. 78f(h)(3).

33 See Section 6(h)(3)(C) of the Exchange Act, 15 U.S.C. 78f(h)(3)(C).

34 15 U.S.C. 78s(b)(7).

35 17 CFR 240.19b-7.

36 15 U.S.C. 78s(b)(7)(B).

37 15 U.S.C. 78f(h)(3)(A).

38 7 U.S.C. 2(a)(1)(D)(i)(I).

narrow-based security index, be registered pursuant to Section 12 of the Exchange Act. Thus, although options are permitted to be listed on unregistered debt securities under exchange listing standards,[39] such securities would not be permitted to underlie security futures without modifying this requirement. As stated above, Section 6(h)(4)(A) of the Exchange Act and Section 2(a)(1)(D)(v)(I) of the CEA provide that the Commissions by rule, regulation, or order, may jointly modify this requirement to the extent that the modification fosters the development of fair and orderly markets in security futures products, is necessary or appropriate in the public interest, and is consistent with the protection of investors.

Pursuant to this authority, the Commissions previously adopted SEC Rule 6h-2[40] and amended CEA Rule 41.21[41] to modify the statutory listing standards for security futures to permit the trading of security futures based on debt securities and indexes composed of certain debt securities.[42] These rules permit the listing and trading of new and potentially useful financial products. The Commissions similarly believe that modifying the statutory listing standards for security futures to permit, under certain conditions, the trading of security futures based on certain unregistered debt securities, and narrow-based indexes composed of such securities, will reduce impediments to the listing of security futures based on debt securities and serve the public interest by allowing the creation of potentially useful new financial instruments, thereby fostering the development of fair and orderly markets in security futures. The Commissions also believe it is appropriate, in the public interest, and consistent with the protection of investors to permit, subject to the conditions discussed below, the listing of such

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39 See supra note 26.

40 17 CFR 240.6h-2.

41 17 CFR 41.21.

42 See 2006 Rulemaking, supra note 8

security futures because they may facilitate price discovery in, and be a useful hedge for, debt securities.

An issuer of debt securities that are registered under Section 12 of the Exchange Act must provide comprehensive public information. This joint order may permit the listing and trading of security futures on debt securities that are not registered under Section 12 of the Exchange Act. However, because the Commissions believe that the public interest and the protection of investors is served by having information about the underlying debt securities and their issuers available, the Commissions are placing certain conditions on this order. In particular, as discussed below, this order is conditioned on an issuer of unregistered debt securities that underlie security futures being subject to the periodic reporting requirements of the Exchange Act. This condition is designed to ensure that information about the issuers and their securities is available to investors and futures traders.

More specifically, the listing and trading of security futures on unregistered debt would be permissible so long as the following four conditions are satisfied.[43] First, the offer and sale of the underlying debt securities must have been registered under the Securities Act of 1933 ("Securities Act").[44] This condition is designed so that participants in the security futures market have access to the detailed disclosure in the Securities Act registration statement for the debt securities underlying these security futures.

Second, the issuer of such securities must have at least one class of equity securities registered under Section 12(b) of the Exchange Act.[45] The debt securities of a wholly-owned

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43 These four conditions are consistent with the conditions in the NYSE Exemption, supra note 9.

44 15 U.S.C. 77a et. seq.

45 15 U.S.C. 78l(b).

subsidiary of a parent company with at least one class of equity securities registered under Section 12(b) of the Exchange Act may also underlie a security future.[46] This condition is designed so that there is public availability of information about the issuer and the securities, even though the particular debt securities underlying the security future are not registered under Section 12 of the Exchange Act. Because any security registered under Section 12(b) is listed on a national securities exchange, this condition assures that a national securities exchange is responsible for monitoring the listed securities of the issuer of the debt securities underlying a security future and enforcing compliance by that issuer with comprehensive listing standards of the applicable national securities exchange.

Third, the transfer agent for the debt securities underlying the security future must be registered under Section 17A of the Exchange Act.[47] This condition is designed so that the transfer agents providing services to issuers of debt securities underlying security futures are subject to SEC oversight and the requirements of the Exchange Act, including Section 17A, and the rules thereunder. Fourth, the indenture for the unregistered debt securities underlying the security future must be qualified under the Trust Indenture Act of 1939 ("Trust Indenture Act").[48] This condition is designed so that the specific protections afforded to debt holders under the Trust Indenture Act apply to debt securities that underlie security futures. The trust indenture for underlying debt securities registered under the Securities Act is qualified under the Trust Indenture Act at the time of registration of those underlying debt securities.

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46 The terms "parent" and "wholly-owned" have the same meanings as in Rule 1-02 of SEC Regulation S-X, 17 CFR 210.1-02.

47 15 U.S.C. 78q-1.

48 15 U.S.C. 77aaa-77bbbb.

As a result, by modifying the listing standard requirements such that the debt securities need not be registered under Section 12 of the Exchange Act, provided that the conditions set forth above are satisfied, the Commissions are increasing the types of debt securities on which security futures may be based while preserving the requirement that information important in making investment and trading decisions is available.

II. Conclusion

For the reasons discussed above, the Commissions by order are jointly modifying the requirement in Section 6(h)(3)(D) of the Exchange Act[49] and the criteria specified in Section 2(a)(1)(D)(i)(III) of the CEA[50] to permit any security to underlie a security future, provided such security is eligible to underlie options traded on a national securities exchange.

In addition, for the reasons discussed above, the Commissions by order are jointly modifying the requirement specified in Section 6(h)(3)(A) of the Exchange Act[51] and the criterion specified in Section 2(a)(1)(D)(i)(I) of the CEA[52] to permit an unregistered debt security, or a narrow-based index composed of unregistered debt securities, to underlie a security future if the following conditions are met:

(1) Each such security is a note, bond, debenture, or evidence of indebtedness that is not an equity security as defined in Section 3(a)(11) of the Exchange Act;[53]

(2) The issuer of each such security has registered the offer and sale of the security under the Securities Act;

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49 15 U.S.C. 78f(h)(3)(D).

50 7 U.S.C. 2(a)(1)(D)(i)(III).

51 15 U.S.C. 78f(h)(3)(A).

52 7 U.S.C. 2(a)(1)(D)(i)(I).

53 15 U.S.C. 78c(a)(11).

(3) The issuer of each such security, or the issuer's parent if the issuer is a wholly-owned subsidiary (as such terms are defined in Rule 1-02 of SEC Regulation S-X),[54] has at least one class of common or preferred equity security registered under Section 12(b) of the Exchange Act[55] and listed on a national securities exchange;

(4) The transfer agent of each such security is registered under Section 17A of the Exchange Act;[56] and

(5) The trust indenture for each such security has been qualified under the Trust Indenture Act of 1939.[57]

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54 17 CFR 210.1-02.

55 15 U.S.C. 78l(b).

56 15 U.S.C. 78q-1.

57 15 U.S.C. 77aaa-77bbbb.

Accordingly,

IT IS ORDERED, pursuant to Section 6(h)(4) of the Exchange Act and Section 2(a)(1)(D)(v)(I) of the CEA, that the requirements in Sections 6(h)(3)(A) and 6(h)(3)(D) of the Exchange Act and the criteria in Sections 2(a)(1)(D)(i)(I) and 2(a)(1)(D)(i)(III) of the CEA are modified, subject to the conditions set forth above, provided however, this order does not affect the CFTC's exclusive jurisdiction under Section 2(a)(1)(C) of the CEA over any futures contract based on an index that is not a "narrow-based security index," as defined in section 3(a)(55) of the Exchange Act and Section 1a(25) of the CEA. Accordingly, nothing in this order shall affect or limit the exclusive authority and jurisdiction of the CFTC with respect to any futures contract, now or in the future, including the CFTC's authority to approve any futures contract that is based upon an index that is not a "narrow-based security index."

By the Commodity Futures Trading Commission.[58]

David A. Stawick
Secretary

November 19, 2009

By the Securities and Exchange Commission.

Elizabeth M. Murphy
Elizabeth M. Murphy
Secretary

November 19, 2009

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58 Because the Commissions are jointly modifying the listing requirements to permit security futures on any security that is eligible to underlie options contracts traded on a national securities exchange, this order supersedes and replaces the Prior Joint Orders. See supra notes 12 and 13.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-61032; File No. PCAOB-2009-01)

November 19, 2009

Public Company Accounting Oversight Board; Notice of Filing of Proposed Amendment to Board Rules Relating to Inspections

Pursuant to Section 107(b) of the Sarbanes-Oxley Act of 2002 (the "Act"), notice is hereby given that on July 2, 2009, the Public Company Accounting Oversight Board (the "Board" or "PCAOB") filed with the Securities and Exchange Commission (the "SEC" or "Commission") the proposed rule changes described in Items I, II, and III below, which items have been prepared by the Board. The Commission is publishing this notice to solicit comments on the proposed rule from interested persons.

I. Board's Statement of the Terms of Substance of the Proposed Rule

On June 25, 2009, the Board adopted an amendment to its rule relating to the frequency of inspections. The proposed amendment adds a new paragraph (g) to existing Rule 4003. The text of the proposed amendment is set out below. Language added by the amendment is in italics.

Rule 4003. Frequency of Inspections

* * *

(g) With respect to any foreign registered public accounting firm concerning which the preceding provisions of this Rule, other than paragraphs (a) and (f), would set a 2009 deadline for the first Board inspection and that is headquartered in a country in which no foreign registered public accounting firm that the Board inspected before 2009 is headquartered, such deadline is extended to 2012, provided, however, that from among the group of all such firms, the Board shall conduct some first inspections in each of the years from 2009 to 2012, scheduled according to such criteria as the Board shall publicly announce.

II. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule

In its filing with the Commission, the Board included statements concerning the purpose of, and basis for, the proposed rule. The text of these statements may be examined at the places specified in Item IV below. The Board has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Board's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule

(a) Purpose

The Sarbanes-Oxley Act of 2002 directs the Board to conduct a continuing program of inspections to assess registered public accounting firms' compliance with certain requirements.[1/] The Act prescribes inspection frequency requirements but also authorizes the Board to adjust the frequency requirements by rule if the Board finds that an adjustment is consistent with the purposes of the Act, the public interest, and the protection of investors.[2/] Inspection frequency requirements adopted by the Board are set out in PCAOB Rule 4003, "Frequency of Inspections."

The Board began a regular cycle of inspections of U.S. firms in 2004 and has conducted 982 such inspections, including repeat inspections of several firms. Inspections of non-U.S. firms began in 2005, and the Board has inspected 140 non-U.S. firms. Those firms are located in

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1/ See Section 104(a) of the Act.

2/ See Section 104(b) of the Act.

26 jurisdictions.[3] There are, however, currently 68 non-U.S. firms that, by virtue of when they first issued audit reports after registering with the PCAOB, the Board is required to inspect for the first time by the end of 2009.[4] For the reasons described below, the Board has adopted Rule 4003(g), which would affect the timing of a subset of those 68 inspections. Specifically, Rule 4003(g) will give the Board the ability to postpone, for up to three years, first inspections that the Board is currently required to conduct before the end of 2009 in jurisdictions where the Board conducted no inspections before 2009. The amendment does not affect inspection frequency requirements concerning any other first inspections, or concerning any second or later inspections, of firms that issue audit reports for issuers.[5]

The PCAOB has recognized since the outset of its inspection program that inspections of non-U.S. firms pose special issues.[6] In its oversight of non-U.S. firms, the Board seeks, to the extent reasonably possible, to coordinate and cooperate with local authorities. Since 2003, when the PCAOB began operations, a number of jurisdictions have also developed their own auditor

3/ The Board has inspected non-U.S. firms located in Argentina, Australia, Bermuda, Brazil, Canada, Chile, Colombia, Greece, Hong Kong, India, Indonesia, Ireland, Israel, Japan, Kazakhstan, Mexico, New Zealand, Norway, Panama, Peru, the Russian Federation, Singapore, South Africa, South Korea, Chinese-Taipei, and the United Kingdom.

4/ This discussion does not include, or apply to, 21 non-U.S. firms whose first inspection deadline has been moved from 2008 to 2009 under Rule 4003(f).

5/ Existing Rule 4003 effectively sets deadlines for the Board's inspections not only of firms that issue audit reports, but also of firms that play a substantial role in the preparation or furnishing of an audit report (as defined in PCAOB Rule 1001(p)(ii)). The Board has previously submitted for Commission approval amendments to Rules 4003(b) and 4003(d) that would eliminate from the Rule any frequency requirement or deadline for the Board to inspect a firm that plays a substantial role but does not issue an audit report. Unless and until the Commission approves such a rule change, however, the extension in proposed rule 4003(g) would (if approved by the Commission) apply to required 2009 PCAOB inspections of non-U.S. firms (in jurisdictions encompassed by the rule's terms) that have played a substantial role as well as to required 2009 inspections of non-U.S. firms that have issued audit reports.

6/ See Briefing Paper, Oversight of Non-U.S. Public Accounting Firms (October 28, 2003) (hereinafter "Oversight of Non-U.S. Firms"); Final Rules Relating to the Oversight of Non-U.S. Public Accounting Firms, PCAOB Release No. 2004-005 (June 9, 2004).

oversight authorities with inspection responsibilities or enhanced existing oversight systems.[7/] The Board believes that it is in the interests of the public and investors for the Board to develop efficient and effective cooperative arrangements with its non-U.S. counterparts.[8/] In jurisdictions that have their own inspection programs, this may include conducting joint inspections of firms that are subject to both regulators' authority.

Indeed, the Board has a specific framework for working cooperatively with its non-U.S. counterparts to conduct joint inspections and, to the extent deemed appropriate by the Board in any particular case, relying on inspection work performed by that counterpart.[9/] PCAOB Rule 4011 permits non-U.S. firms that are subject to Board inspection to formally request that the Board, in conducting its inspection, rely on a non-U.S. inspection to the extent deemed appropriate by the Board. If a Rule 4011 request is made, Rule 4012 provides that the Board will, at an appropriate time before each inspection of the firm, determine the degree, if any, to which the Board may rely on the non-U.S. inspection. Rule 4012 describes aspects of the non-U.S. system that the Board will evaluate in making that determination. Even where the Board does not work with a local regulator to conduct joint inspections, the Board communicates with its counterpart or other local authorities (such as securities regulators or other government agencies and ministries) regarding its inspections to be conducted in the jurisdiction.

7/ In 2006, for instance, the European Union enacted a directive requiring the creation of an effective system of public oversight for statutory auditors and audit firms within each Member State. See The Directive 2006/43/EC of the European Parliament and the Council (May 17, 2006) (the "Eighth Directive"). In addition, among others, Canada created the Canadian Public Accountability Board, and in Australia, the responsibilities of the Australian Securities and Investments Commission were expanded to include auditor oversight. In Asia, Japan established the Certified Public Accountants and Auditing Oversight Board, South Korea delegated responsibility for auditor oversight to its Financial Supervisory Service, and Singapore established the Accounting and Corporate Regulatory Authority.

8/ See Oversight of Non-U.S. Firms at 2-3.

9/ See PCAOB Rules 4011 and 4012; see also Oversight of Non-U.S. Firms at 2-3.

In some jurisdictions, the PCAOB's ability to conduct inspections, either by itself or jointly with a local regulator, is complicated by the concerns of local authorities about potential legal obstacles and sovereignty issues. The Board seeks to work with the home-country authorities to try to resolve these and any other concerns.[10/]

The effort involved in attempting to resolve potential conflicts of law, or to evaluate a non-U.S. system in response to a Rule 4011 request, can be substantial. The effort typically involves negotiating the principles of an arrangement for cooperation consistent with the inspection obligations that the Act imposes on the Board. It also involves the Board gaining a detailed understanding of the other jurisdiction's auditor oversight system in order for the Board to determine the degree of reliance it is willing to place on inspection work performed under that system in a particular inspection year.

Additional effort is involved in coordinating the scheduling of specific inspections. Where possible, the Board seeks to conduct inspections jointly with local authorities both to take advantage of potential efficiencies and to avoid imposing unnecessary regulatory burdens on firms. Like the PCAOB, several of these other authorities proceed according to inspection frequency requirements. While some of the Board's counterparts are established and have inspection programs, many have only recently begun inspections or are still building up their inspections resources. As a result, synchronizing the inspections schedules of these authorities and the PCAOB's requirements is sometimes difficult.

Notwithstanding these challenges, the Board has so far conducted 140 non-U.S. inspections. Moreover, 61 of those inspections, in six jurisdictions, have been conducted jointly

10/ See Oversight of Non-U.S. Firms at 3.

with other auditor oversight authorities, while inspections in 20 jurisdictions have been conducted solely by the PCAOB.[11/]

As noted above, under existing Rule 4003, there are 68 non-U.S. firms that, by virtue of when they first issued audit reports after registering with the PCAOB, the Board is required to inspect for the first time by the end of 2009. Those firms are located in 36 jurisdictions, including several jurisdictions in which the Board has already conducted first inspections of other firms. Of those firms, 49 are located in 24 jurisdictions where the Board has not conducted any inspections to date. Most of those 24 jurisdictions have or soon will have a local auditor oversight authority with which the Board would seek to work toward cooperative arrangements before conducting inspections. Because of the steps involved in concluding such arrangements and to evaluate the local system, the Board has concerns about proceeding as if that work can be completed for all of the jurisdictions in which the PCAOB has not previously conducted inspections in time to conduct the required inspections by the end of 2009.

Accordingly, the Board is adopting a new paragraph (g) to Rule 4003 to allow the Board to postpone, for up to three years, the first inspection of any non-U.S. firm that the Board is currently required to conduct by the end of 2009 and that is in a jurisdiction where the Board has not conducted an inspection before 2009.

In determining the schedule for completion of the inspections subject to new paragraph (g), the Board will implement its proposal to sequence these 49 inspections such that certain minimum thresholds will be satisfied in each of the years from 2009 to 2012. The minimum thresholds relate to U.S. market capitalization of firms' issuer audit clients. The Board will begin

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11/ Joint inspections have been conducted in Australia, Canada, South Korea Norway, Singapore and the United Kingdom.

by ranking the 49 firms according to the total U.S. market capitalization of a firm's foreign private issuer audit clients.[12/] Working from the top of the list (highest U.S. market capitalization total) down, the 49 firms will be distributed over 2009 to 2012 such that, at a minimum, the following criteria are satisfied:

- by the end of 2009, the Board will inspect firms whose combined issuer audit clients' U.S. market capitalization constitutes at least 35 percent of the aggregate U.S. market capitalization of the audit clients of all 49 firms;
- by the end of 2010, the Board will inspect firms whose combined issuer audit clients' U.S. market capitalization constitutes at least 90 percent of that aggregate;
- by the end of 2011, the Board will inspect firms whose combined issuer audit clients' U.S. market capitalization constitutes at least 99.9 percent of that aggregate; and
- the Board will inspect the remaining firms in 2012.[13/]

In addition to meeting those market capitalization thresholds, the Board also will satisfy certain criteria concerning the number of those 49 firms that will be inspected in each year. Specifically, the Board will conduct at least four of the 49 inspections in 2009, at least 11 more in 2010, and at least 14 more in 2011.[14/]

12/ For purposes of the ranking described here, the Board will use the average monthly market capitalization on which each issuer's share of the Board's 2008 accounting support fee was based. Thus, the market capitalization figure used for the ranking does not include the value of any referred work performed by the firm.

13/ Under existing provisions of Rule 4003 that are not affected by this amendment, 2012 would also be the deadline for the Board to conduct the second inspection of those of the 49 firms whose first inspection occurs in 2009.

14/ The issuer audit client U.S. market capitalization currently associated with a significant number of the 49 firms is relatively low, and even zero in a number of cases where firms appear to have stopped issuing audit

It is important to note that the distribution described above will not operate to prevent an inspection from occurring earlier than called for by the schedule. Any inspection may be moved to an earlier year for a variety of reasons, such as the presence of risk factors (including risk factors relating to referred work[15/] that the firm performs on audits for which it is not the principal auditor), synchronization of schedules with a local regulator for purposes of a joint inspection, or simply the opportunity and the availability of resources to do an inspection earlier (including availability of inspectors with specialized industry knowledge and relevant language skills). In addition, the Board will at least annually review updated market capitalization data and consider whether there have been any changes that warrant moving a particular inspection forward to an earlier year.

Conversely, the Board does not intend to make changes that would move an inspection of one of these 49 firms to a later year than in the initial distribution except as the result of a development relating to the market capitalization of the firm's issuer clients. Specifically, if a firm's issuer audit client market capitalization drops significantly and the firm performs no significant amount of referred work on audits, its inspection might be delayed to a later year. In any event, the Board will not, for any reason, move one of these 49 inspections to a later year than in the initial distribution without publicly describing the change and the reason for it.

In the Board's view, this adjustment to the inspection frequency requirement is consistent with the purposes of the Act, the public interest, and the protection of investors. The Board believes that its approach to implementing Rules 4011 and 4012, developing cooperative

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reports for issuers. As a result, approximately 92% of the relevant issuer market capitalization is associated with 15 of the 49 firms.

15/ Because the PCAOB is still in the process of gathering information about each firm's referred work, the 2009 inspections will not use referred work as a risk factor for purposes of scheduling.

arrangements, and conducting joint inspections with foreign regulators is enhancing the Board's efforts to carry out its inspection responsibilities. There is long-term value in accepting a limited delay in inspections to continue working toward cooperative arrangements where it appears reasonably possible to reach them. The Board also believes that the additional time to conduct certain inspections will have the added benefit of giving the Board more time to continue to enhance its inspection program, particularly in the areas of risk assessment and pre-inspection planning, and the Board intends to do so.

The Board recognizes that some non-U.S. firms may be reluctant to comply with PCAOB inspection demands because of a concern that doing so might violate local law or the sovereignty of their home country. The Board believes that the purposes of the Act, the public interest, and the protection of investors are better served, up to a point, by delaying some of the first inspections to work toward a cooperative resolution than by precipitating legal disputes involving conflicts between U.S. and non-U.S. law that could arise if the Board sought to enforce compliance with its preferred schedule without regard for the concerns of non-U.S. authorities.

The Board does not intend, however, to make any further adjustments to the inspection frequency requirements applicable to firms whose first inspection was due no later than 2009. While the Board will continue to work toward cooperation and coordination with authorities in the relevant jurisdictions, the Board will make inspection demands on the firms early enough in the year in which they are scheduled for inspection according to the above described sequencing to allow the Board to conduct the inspections during that year.[16/]

16/ Apart from the proposed rule amendment, the Board has implemented certain practices to provide additional transparency with regard to the Board's international inspections program. These practices include (1) making a public announcement, near the beginning of each year until 2012, identifying all non-U.S. jurisdictions in which there are firms that the Board will inspect that year, (2) maintaining a public list of all registered firms that have not yet had their first Board inspection even though more than four years have passed since the end of the

(b) Statutory Basis

The statutory basis for the proposed rule is Title I of the Act.

B. Board's Statement on Burden on Competition

The Board does not believe that the proposed rule will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule imposes no burden beyond the burdens clearly imposed and contemplated by the Act.

C. Board's Statement on Comments on the Proposed Rule Received from Members, Participants or Others

The Board released the proposed rule amendment for public comment in Release No. 2008-007 (December 4, 2008). A copy of Release No. 2008-007 and the comment letters received in response to the PCAOB's request for comment are available on the PCAOB's Web site at www.pcaobus.org/Rules/Docket_027. The Board received twenty-four written comment letters. The Board has carefully considered the comment letters, as discussed below.

Several commenters suggested that the Board exercise its authority under Section 106 of the Act to exempt firms that cannot cooperate with PCAOB inspections due to legal conflicts or sovereignty-based opposition from their local governments. The Board believes that it is not in the interests of investors or the public to exempt non-U.S. firms from the Act's inspection requirement given that the Board has previously determined not to exempt non-U.S. firms from

calendar year in which they first issued an audit report while registered with the Board, and (3) making biannual public announcements of the Board's progress toward meeting the thresholds described above with respect to the number of firms to be inspected and the aggregate market capitalization of firm clients. The Board also maintains on its Web site a list of all jurisdictions in which there are registered firms that the Board has inspected. Additional details concerning these practices are provided in PCAOB Release No. 2009-003, available on the Board's Web site at www.pcaobus.org/Rules/Docket_027.

the Act's registration requirements and given that an inspection is the Board's primary tool of oversight.[17]

The Board also received several comment letters addressing the length of the proposed extension for certain firms with 2009 deadlines. Some comment letters expressed concern about the inspection delay of up to three years but ultimately expressed qualified support for the Board's decision. These comments urged the Board to permit no further delays and to proceed as described above by sequencing the inspection of firms subject to the extension based on certain thresholds relating to the U.S. market capitalization of firms' issuer audit clients. Some comments also suggested that the Board should utilize the additional time provided by the proposed extension to enhance its international inspections program, particularly in the areas of risk assessment and pre-inspection planning.

Other comment letters supported the Board's decision to extend the inspection deadlines, but some qualified their support by noting that three years may not be enough time to overcome the legal conflicts and sovereignty concerns in all relevant jurisdictions. Several comments expressed support for the Board's plan to sequence the deferred inspections in time based on the U.S. market capitalization of the firms' clients, but some also noted that this plan did not adequately take into account the varying degree of legal conflicts present in the different jurisdictions and might have the effect of requiring early on during the three year period the inspection of firms in jurisdictions with legal obstacles that cannot be overcome quickly.

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[17] When it first became operational, the Board considered whether to exempt non-U.S. firms from registration with the Board. The Board determined that exempting non-U.S. firms would not protect the interests of investors or further the public interest given that registration is the predicate to all of the Board's other oversight programs. See Registration System for Public Accounting Firms, PCAOB Release No. 2003-007 (May 6, 2003) at 13.

As explained above, the Board believes that an extension of up to three years for the relevant firms is the appropriate course. Distributing the affected firms across three years strikes the proper balance between avoiding unnecessary delays in the inspection of registered firms and allowing reasonable time for the Board to continue its efforts to reach cooperative arrangements with the relevant home-country regulators. The Board believes that any longer or further extension would not be in the interests of investors or the public.

III. Date of Effectiveness of the Proposed Rule and Timing for Commission Action

Within 60 days of the date of publication of this notice in the Federal Register or within such longer period as (i) the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Board consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule changes are consistent with the requirements of Title I of the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/pcaob.shtml); or

- Send an e-mail to rule-comments@sec.gov. Please include File Number PCAOB-2009-01 on the subject line.

Paper comments:

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

All submissions should refer to File Number PCAOB-2009-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (http://www.sec.gov/rules/pcaob/shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule changes that are filed with the Commission, and all written communications relating to the proposed rule changes between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at the principal office of the PCAOB. 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. All submissions should refer to File Number PCAOB-2009-01 and should be submitted on or before [**insert date 21 days from publication in the Federal Register**].

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61038 / November 20, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13691

In the Matter of **MOSAIC NUTRACEUTICALS CORP. (f/k/a MOSAIC NUTRICEUTICALS CORP.) and CHARLES T. TOWNSEND,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 21C AND 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, IMPOSING A CEASE-AND-DESIST ORDER, AND REVOKING REGISTRATION OF SECURITIES**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 21C and 12(j) of the Securities Exchange Act of 1934 (the "Exchange Act") against Mosaic Nutraceuticals Corp. (f/k/a Mosaic Nutriceuticals Corp.) ("Mosaic") and pursuant to Section 21C of the Exchange Act against Charles T. Townsend ("Townsend") (collectively the "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents Mosaic and Townsend have each submitted an Offer of Settlement (collectively, the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 21C and 12(j) of the Securities Exchange Act of 1934, Making Findings, Imposing a Cease-and-Desist Order, and Revoking Registration of Securities ("Order"), as set forth below.

III.

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

SUMMARY

1. This proceeding arises as a result of the issuance of three false and misleading press releases by Mosaic Nutraceuticals Corp. (f/k/a Mosaic Nutriceuticals Corp.) ("Mosaic") and its President, Charles Townsend ("Townsend"). In each of the three press releases, Mosaic claimed that it planned to support the launch of various nutraceutical products[2] with a multi-million dollar advertising and public relations campaign. In fact, when Mosaic issued each of the three press releases, Mosaic had no money, no bank accounts, no business plan, no plan to borrow funds from a bank or other financial institution, and no funds to finance such a campaign or even pay to manufacture its products.

RESPONDENTS

2. Mosaic is a Nevada corporation based in Dallas, Texas that owns the marketing and distribution rights for various nutraceutical products. Mosaic is a public company whose stock is quoted on the Pink Sheets under the ticker symbol "MCNJ." Mosaic became a reporting company on July 13, 2005 when it filed a Form 10-SB with the Commission.

3. Charles T. Townsend, age 63, resides in Lewisville, Texas and is the president and a director of Mosaic. Townsend has an accounting degree from the University of Texas and a Master's Degree in Business Administration from the University of North Texas.

FACTS

4. Mosaic was formed on May 24, 2004 as a result of a reverse merger between a private company named Westchester Group, Inc. ("Westchester") and a public shell company named ePublishedBooks.com, Inc. ("ePub").

5. Immediately after the merger, Townsend was hired as Mosaic's President, Secretary, and Treasurer.

6. Between May and December 2004, Mosaic issued seven press releases, three of which announced the pending launch of the company's new nutraceutical products and claimed that Mosaic intended to support the launch of each product with multi-million dollar advertising and public relations campaigns.

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

[2] A nutraceutical product is a food or naturally occurring food supplement that is thought to have a beneficial effect on human health.

7. On July 13, 2004, Mosaic issued a press release announcing the upcoming launch of a proprietary cholesterol-reducing candy chew named Lipotrene. In the press release, Mosaic represented that it planned to "back the launch of Lipotrene with a multi-million dollar advertising and PR campaign."

8. Mosaic's stock began trading on the Pink Sheets on July 20, 2004.

9. On August 3, 2004, after the markets had closed, Mosaic issued a press release announcing the upcoming launch of an osteoarthritis and pain-relieving topical rub named Celaprix. Again, Mosaic claimed that it would support the launch of Celaprix "with a multi-million dollar advertising campaign."

10. On August 4, 2004, the first full business day after the press release was issued, the price of Mosaic stock rose 73 percent to close at $0.26 per share on trading volume of 299,566 shares, an increase from 21,861 shares traded the prior day.

11. On November 17, 2004, Mosaic issued a press release announcing the pending launch of a proprietary osteoarthritis formula called Joint-2-Life. Once again, Mosaic represented that it planned to support the launch of Joint-2-Life "with a multi-million dollar PR and advertising campaign."

12. On November 17, the price of Mosaic stock increased 94 percent to close at $0.35 per share on trading volume of 597,638 shares, an increase from 33,000 shares traded the prior day.

13. Townsend reviewed and approved the language contained in the July 13, 2004, August 3, 2004, and November 17, 2004 press releases, and he authorized the issuance of each press release.

VIOLATIONS

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

IV.

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

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

In view of the foregoing, the Commission deems it necessary and appropriate for the protection of investors to impose the sanctions agreed to in the Offers submitted by Mosaic and Townsend.

Accordingly, it is hereby ORDERED that:

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

B. Respondent Townsend cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

C. Registration of each class of Respondent Mosaic's securities shall be, and hereby is, revoked pursuant to Section 12(j) of the Exchange Act.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Aguilar
Not Participating

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 61039A / November 20, 2009

Admin. Proc. File No. 3-12753

In the Matter of

JOSEPH JOHN VANCOOK

c/o Lewis D. Lowenfels, Esq.
Law Offices of Tolins & Lowenfels
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New York, NY 10017

and

Michael J. Sullivan, Esq.
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350 Mount Kemble Avenue
Morristown, NJ 07962

OPINION OF THE COMMISSION

BROKER-DEALER PROCEEDING

CEASE-AND-DESIST PROCEEDING

Grounds for Remedial Action

Fraud

Aiding and Abetting and Causing Recordkeeping Violations

Salesperson associated with registered broker-dealer willfully violated Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5 by committing deceptive acts as part of a scheme to defraud and misrepresenting material facts in order to facilitate his clients' illegal trading activity in shares of certain registered investment companies; salesperson also aided and abetted and caused broker-dealer's failure to keep accurate books and records in violation of Section 17(a)(1) of the Exchange Act and Rule 17a-3(a)(6) thereunder. *Held*, it is in the public interest to bar Respondent from associating with any broker or dealer, to impose a cease-and-desist order, to order disgorgement of $533,234.01, plus prejudgment interest, and to assess a $100,000 civil penalty.

APPEARANCES:

Lewis D. Lowenfels, Esq., of Law Offices of Tolins & Lowenfels, and *Michael J. Sullivan*, of Coughlin Duffy LLP, for Joseph John VanCook.

William P. Hicks, *Robert K. Gordon*, and *Yolanda L. Ross*, for the Division of Enforcement.

Appeal filed: July 21, 2008
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Oral argument: July 20, 2009

I.

Joseph John VanCook, a former salesperson and partial owner of Pritchard Capital Partners, LLC ("Pritchard Capital" or the "Firm"), a registered broker-dealer, appeals an administrative law judge's decision.[1] The law judge found that VanCook willfully violated Section 10(b) of the Securities Exchange Act of 1934[2] and Exchange Act Rule 10b-5[3] by orchestrating a fraudulent scheme involving material misrepresentations to permit his clients to late trade[4] shares of certain registered investment companies. The law judge also found that VanCook aided and abetted and willfully caused the Firm's clearing broker to violate Rule 22c-1

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1 In connection with the conduct at issue in this proceeding, Pritchard Capital consented, without admitting or denying any findings, to the entry of our order finding that it willfully violated Section 17(a)(1) of the Securities Exchange Act of 1934 and Exchange Act Rule 17a-3(a)(6) for failing to make and keep current certain books and records, that it willfully aided and abetted and caused its clearing broker to violate Rule 22c-1 of the Investment Company Act of 1940, and that it failed reasonably to supervise VanCook with a view to preventing his willful violation of the federal securities laws. *Pritchard Capital Partners, LLC*, Securities Exchange Act Rel. No. 57704 (Apr. 23, 2008), 93 SEC Docket 5304, 5309-10.

2 15 U.S.C. § 78j(b).

3 17 C.F.R. § 240.10b-5.

4 *See infra* Section II.A for a discussion of late trading.

of the Investment Company Act of 1940.[5] The law judge further found that VanCook aided and abetted and willfully caused the Firm to violate Exchange Act Section 17(a)(1) and Exchange Act Rule 17a-3(a)(6) by failing to make and keep current certain books and records.[6] The law judge barred VanCook from association with any broker or dealer or investment company, imposed a cease-and-desist order against him, ordered disgorgement of $538,565.70, plus prejudgment interest, and assessed a $100,000 third-tier civil money penalty. We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.

II.

A. Late Trading of Mutual Funds

Orders to buy and sell mutual fund shares can be submitted all day. The price of a mutual fund share is based on its net asset value ("NAV"). The NAV is the current market value of a mutual fund's total assets, minus its total liabilities, divided by the total number of shares outstanding. Mutual funds generally calculate the NAV once a day,[7] usually at or as of when the major United States stock exchanges close at 4:00 p.m. Eastern time.[8] Mutual funds typically disclose in their prospectuses the time when the NAV is computed. The prospectuses of mutual funds traded by Pritchard Capital's clients at issue disclosed that the funds calculated the NAV "at" or "as of" the close of regular trading on the New York Stock Exchange ("NYSE"), normally 4:00 p.m. Consistent with Investment Company Act Rule 22c-1, which requires a mutual fund

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[5] 17 C.F.R. § 270.22c-1.

[6] 15 U.S.C. § 78q(a)(1); 17 C.F.R. § 240.17a-3(a)(6).

[7] *See* 17 C.F.R. § 270.22c-1(b)(1) (generally requiring mutual funds to calculate their NAVs at least once daily, Monday through Friday, but providing for certain exceptions).

[8] *See, e.g., DH2, Inc. v. SEC*, 422 F.3d 591, 592 (7th Cir. 2005) (stating that a mutual fund's NAV is "generally fixed by a fund when the major U.S. stock markets close at 4:00 p.m. eastern time"); *SEC v. Simpson Capital Mgmt., Inc.*, 586 F. Supp. 2d 196, 199 (S.D.N.Y. 2008) (stating that "[t]he prices of mutual fund shares are not continually reset over the course of the day, but are typically fixed for an entire day at a single price. Mutual funds . . . generally determine the NAV of mutual fund shares at the close of the major United States securities exchanges and markets – 4:00 p.m. [Eastern time]."); *Disclosure Regarding Market Timing and Selective Disclosure of Portfolio Holdings*, Securities Act Rel. No. 8343 (Dec. 11, 2003), 81 SEC Docket 2971, 2976 (stating that, "[t]ypically, mutual funds calculate their NAVs once each day at or near the close of the major U.S. securities exchanges and markets (usually 4:00 p.m., Eastern time)"). All times referenced in this opinion are Eastern time.

trading order to be priced at the "next computed" NAV,[9] the prospectuses stated that orders had to be received by 4:00 p.m. in order to be executed at that day's NAV. The prospectuses further stated that the time of receipt of an order by a mutual fund intermediary, rather than by the mutual fund itself, was the time for determining the price that the order would receive.[10]

"Late trading" refers to the unlawful practice of permitting mutual fund orders received after the 4:00 p.m. pricing time to receive the NAV calculated at or as of 4:00 p.m. that day, instead of 4:00 p.m. the following trading day.[11] Late trading enables the trader to profit from

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9 *See* 17 C.F.R. § 270.22c-1(a) (providing that "[n]o registered investment company issuing any redeemable security, no person designated in such issuer's prospectus as authorized to consummate transactions in any such security, and no principal underwriter of, or dealer in, any such security shall sell, redeem, or repurchase any such security except at a price based on the current net asset value of such security which is next computed after receipt of a tender of such security for redemption or of an order to purchase or sell such security").

10 *See Amendments to Rules Governing Pricing of Mutual Fund Shares*, Investment Company Act Rel. No. 26288 (Dec. 11, 2003), 81 SEC Docket 3177, 3179 (stating that under Investment Company Act Rule 22c-1 mutual fund orders must be submitted to dealers and other intermediaries by 4:00 p.m. in order to receive the current day's share price); *Staff Interpretive Positions Relating to Rule 22c-1*, Investment Co. Act Rel. No. 5569 (Jan. 9, 1969), 1969 WL 96373, at *1 (stating that Investment Company Act Rule 22c-1 "contemplates that the time of receipt of the order by the retail dealer is controlling" for determining the price that it receives).

The evidence as to when the mutual funds at issue calculated the NAV is based on a Division exhibit prepared by the Division's expert witness. The expert witness explained at the hearing that the exhibit is a summary of the relevant prospectus language for eighty percent of the funds at issue (the threshold for inclusion appears to have been prospectuses of non-money market funds with at least twenty-five transactions executed on behalf of the clients at issue) gathered from registration statements filed with the Commission. VanCook has not objected to the use of or reliance on this exhibit as representing the pricing practices of all the funds at issue in this proceeding.

11 *See, e.g.*, *SEC v. Pentagon Capital Mgmt. PLC*, 612 F. Supp. 2d 241, 248 (S.D.N.Y. 2009) (stating that late trading "refers to the practice of placing orders to buy, redeem or exchange U.S. mutual fund shares after the time as of which the funds calculate their NAV, but receiving the price based on the prior day's NAV"); *In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d 845, 852 n.1 (D. Md. 2005) (stating that late trading is the "practice of placing orders to buy or sell mutual fund shares after 4:00 p.m. ET [Eastern Time], but receiving the price based on the prior NAV already determined as of 4:00 p.m. that same day") & *id.* at 856 (holding that "[l]ate trading is itself illegal, and therefore, as alleged by plaintiffs, a scheme, practice, or course of business effectuating late trading is inherently fraudulent"); *Scott G. Monson*, Investment Co. Act

(continued...)

market events, such as earnings announcements and futures trading, that occur after 4:00 p.m. but are not reflected in the current day's NAV.[12] The late trader obtains an advantage, at the expense of other shareholders of the mutual fund, when he learns of market-moving information and is able to buy, exchange, or sell mutual fund shares at NAVs set before the market-moving information is released.[13] Late trading violates the "forward pricing rule" set forth in Investment Company Act Rule 22c-1,[14] which requires the price of mutual fund shares to be set at the NAV

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[11] (...continued)
Rel. No. 28323 (June 30, 2008), 93 SEC Docket 7517, 7518 n.2 (stating that "[t]he illegal practice of permitting a purchase or redemption order received after the fund calculates its NAV (typically 4:00 p.m. Eastern Time) to receive the same day's NAV is referred to as 'late trading'"); *Charles C. Fawcett*, Exchange Act Rel. No. 56770 (Nov. 8, 2007), 91 SEC Docket 3147, 3148-49 n.4 ("Late trading is the illegal practice of permitting a purchase or redemption order received after the 4:00 p.m. pricing time to receive the share price calculated as of 4:00 p.m. that day." (internal quotations and citation omitted)).

[12] *See Amendments to Rules Governing Pricing of Mutual Fund Shares*, 81 SEC Docket at 3177.

[13] *Id.*

[14] 17 C.F.R. § 270.22c-1(a). Rule 22c-1's primary purpose is to prevent dilution-based abuses related to "backward pricing," the practice of basing the price of a mutual fund share on the NAV determined as of the close of the markets on the previous day. *See, e.g., Adoption of Rule 22c-1 under the Investment Company Act of 1940 Prescribing the Time of Pricing Redeemable Securities for Distribution, Redemption, and Repurchase and Amendment of Rule 17a-3(a)(7) under the Securities Exchange Act of 1934 Requiring Dealers to Time-Stamp Orders*, Investment Co. Act Rel. No. 5519 (Oct. 16, 1968), 1968 WL 87057; *see also, e.g., United States v. NASD*, 422 U.S. 694, 707 (1975) (explaining that the "interim period" between the calculation of a mutual fund's closing price on the previous day and the next-day opening price based on the NAV at the current day's closing provides opportunities to engage in "riskless trading" by exploiting the price difference).

"next computed" by the fund after the receipt of an order to buy or sell shares.[15] Late trading can harm innocent mutual fund shareholders by diluting the value of their investment.[16]

B. VanCook Joins Pritchard Capital

Joseph VanCook has been working in the securities industry since 1995. In 1996, he obtained his Series 7 and 63 licenses and became a registered representative. In early 2000, VanCook began to develop relationships with hedge funds that market timed mutual funds.[17]

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[15] Decisions interpreting Rule 22c-1 have read it to prohibit mutual fund investors from trading a fund's shares after the 4:00 p.m. pricing time while still receiving that day's NAV. *See Simpson Capital Mgmt.*, 586 F. Supp. 2d at 202 (holding that Rule 22c-1's requirement that the price of mutual fund shares be set at the NAV "next computed" by a mutual fund after the receipt of an order to buy or sell shares established that the time for setting NAV is the time "as of" which the NAV is calculated, generally 4:00 p.m., and not, as defendants argued, the time when the calculation is actually made) & *id.* at 203 (stating that defendants' interpretation of the Rule "would allow dealers to provide their customers with the same day's NAV on mutual fund trades submitted until the actual point of NAV calculation and would allow an end run around Congress's and the Commission's intent to prevent dilution of share value, speculative trading, and unfair treatment of investors"); *SEC v. JB Oxford Holdings, Inc.*, No. CV-04-7084 PA (C.D. Cal. Aug. 24, 2005) (unpublished minute order) (giving deference to Commission's interpretation of Rule 22c-1 setting the relevant "as of" time as the time that a mutual fund values its holdings for purposes of pricing mutual fund trades, rather than the time a fund actually performs its NAV calculation); *Paul A. Flynn*, Initial Decision No. 316 (Aug. 2, 2006), 88 SEC Docket 2146, 2173-74 (ALJ decision) (holding that the phrase "NAV that is next computed" means the NAV as of the time the mutual fund sets for its calculation, which is typically 4:00 p.m.), *declared final*, Exchange Act Rel. No. 54390 (Aug. 31, 2006), 88 SEC Docket 2649; *see also, e.g., Prusky v. Reliastar Life Ins. Co.*, 445 F.3d 695, 698 n.5 (3d Cir. 2006) (stating that "[t]he term 'late trading' is somewhat misleading because trading after the close of the market is entirely permissible so long as the trades are priced using the NAV set the next day. The Rule [Rule 22c-1]'s requirement that prices be based on the next computed NAV is referred to as 'forward pricing.' Thus, late trading may be more aptly described as violating the forward pricing rule.") (citations omitted); *Amendments to Rules Governing Pricing of Mutual Fund Shares*, 81 SEC Docket at 3178 (stating that "[l]ate trading not only violates [R]ule 22c-1, but managers who permit late trading also breach their fiduciary duties to the funds and fund shareholders").

[16] *See Amendments to Rules Governing Pricing of Mutual Fund Shares*, 81 SEC Docket at 3181; *see also In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d at 852 n.1 (discussing plaintiffs' allegations of effects of late trading and market timing).

[17] "Market timing" includes the frequent buying and selling of shares of the same mutual fund in order to exploit inefficiencies in mutual fund pricing. *Pentagon Capital Mgmt.*,

(continued...)

Pritchard Capital, a Louisiana-based broker-dealer, hired VanCook in March 2001 to open its New York branch office. Based on an understanding with Thomas Ward Pritchard,[18] the Firm's majority owner, VanCook spent most of his time using his market-timing hedge fund relationships to open a new line of business for the Firm.[19] Elizabeth McMahon, who was hired when the New York branch office opened in March 2001, assisted VanCook in servicing these clients and reported to him.[20]

C. Van Cook Establishes an Order System for Late-Trading Clients

1. VanCook Changes the Firm's Clearing Broker, Enabling Him to Late Trade on Behalf of Clients

When VanCook joined Pritchard Capital, Bear Stearns was the Firm's clearing broker that transmitted orders placed by the Firm's clients to the mutual funds.[21] Bear Stearns required that Pritchard Capital fax orders to its offices by 4:00 p.m. each day in order for the Firm's clients to

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17 (...continued)
612 F. Supp. 2d at 253; *see also*, *SEC v. Ficken*, 546 F.3d 45, 48 (1st Cir. 2008) (stating that "[m]arket timing is a mutual fund share trading strategy that exploits brief discrepancies between the stock prices used to calculate the shares' value once a day, and the prices at which those stocks are actually trading" (internal quotations and citation omitted)).

18 In connection with the conduct at issue in this proceeding, Pritchard consented, without admitting or denying any findings, to the entry of our order finding that he failed reasonably to supervise VanCook with a view to preventing his willful violation of the federal securities laws. *Pritchard Capital Partners*, 93 SEC Docket at 5310.

19 VanCook eventually acquired a minority interest in the Firm. His association with Pritchard Capital ended in February 2004. Since leaving Pritchard Capital, VanCook was associated with registered broker-dealer Punk, Ziegel & Company, L.P. until May 2008, at which time he became associated with his current employer, registered broker-dealer Ladenburg Thalmann & Co., Inc.

20 In connection with the conduct at issue in this proceeding, McMahon consented, without admitting or denying any findings, to the entry of our order finding that she willfully aided and abetted and caused Pritchard Capital's violation of Exchange Act Section 17(a)(1) and Exchange Act Rule 17a-3(a)(6) for failing to make and keep current certain books and records, and that she willfully aided and abetted and caused the Firm's clearing broker to violate Investment Company Act Rule 22c-1. *Pritchard Capital Partners*, 93 SEC Docket at 5310.

21 Pritchard Capital was an introducing broker; the Firm did not have dealer agreements with mutual funds and therefore could not directly submit its orders to the funds. Instead, the Firm contracted with a clearing broker, which had dealer agreements with mutual funds and submitted orders to the funds on the Firm's behalf.

receive that day's NAV. In late 2001, VanCook recommended that Pritchard Capital change its clearing broker from Bear Stearns to Banc of America Securities ("Banc of America"). Pritchard Capital placed client orders with Banc of America by entering them directly into a computer system called the Mutual Fund Routing System ("MFRS"). Unlike Bear Stearns' procedure that required orders to be faxed by 4:00 p.m., the Firm could enter mutual fund orders in MFRS until 5:30 p.m. and receive that day's NAV.[22] VanCook acknowledged at the hearing that when he entered orders in MFRS, he expected to get the same day's NAV.

Page two of a May 2001 instructional manual on MFRS (the "Processing Guide") provided by Banc of America to the Firm stated:

> All orders should be received and time stamped by the close of the NYSE 4 P.M. EST. The MFRS system allows orders that have been entered prior to 4 P.M. EST to be review [sic] until 5:15 P.M. EST.[23]

Nothing in the Processing Guide stated that the review period provided additional time after the NYSE's regular trading session had closed for broker-dealers to submit new orders, or to confirm, modify, or cancel orders already submitted.

Van Cook testified that he "probably looked at the pictures and the pages that worked on order entry, but . . . never read [the Processing Guide] cover to cover." He also testified that "we never thought about [how the Processing Guide related to the time for receiving and placing orders]. This book to us was an instruction book of how to work MFRS and the system." VanCook further testified that he understood the statements in the Processing Guide to mean that he could enter orders until 5:30 p.m. regardless of whether he received an order before or after 4 p.m. Pritchard testified that he understood the statements in the Processing Guide to mean that entering orders into the MFRS until 5:30 p.m. served as the Firm's verification that it had received the order before 4:00 p.m.

VanCook did not create paper order tickets for his clients, but, upon receiving final instructions from a client, VanCook would enter the order information in MFRS and print out a snapshot of the computer screen that reflected that information. VanCook knew that MFRS provided no means for communicating to Banc of America or the relevant mutual fund the time at which a client order was actually received.

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22 VanCook testified that he could not recall the "exact Bear Stearns rules," but, when asked if he would have been aware of the difference in the times by which he had to submit trades to his clearing brokers, VanCook responded, "Yeah, I guess so."

23 Although the Processing Guide states that 5:15 p.m. was the cut-off time, the parties stipulated that it was 5:30 p.m.

2. VanCook Modifies Order System for Three Clients, Enabling Them to Late Trade

VanCook established an order system to accommodate and keep track of his market-timing clients' voluminous trading. VanCook's market-timing clients typically would e-mail or fax to VanCook a list of proposed orders, which VanCook referred to as a "trade sheet." VanCook instructed his clients to submit the proposed trade sheets, which he would time stamp upon receipt, to the Firm by 4:00 p.m. VanCook submitted an order to the relevant mutual fund company through the Firm's clearing broker only upon receiving final instructions via e-mail, fax, or telephone from a client about which trades to execute on the latest proposed trade sheet. VanCook required most of his clients to submit final instructions by 4:00 p.m.

However, VanCook does not dispute that he modified the proposed trade sheet order system for three clients by allowing them to finalize their proposed trade sheet instructions after 4:00 p.m. From November 2001 through July 2003, on behalf of these late-trading clients, VanCook, or others acting according to VanCook's instructions, executed 4,936 late trades[24] with approximately twenty-five mutual fund families.[25] As noted above, the funds' prospectuses stated that the NAV was determined at or as of 4:00 p.m. when regular trading on the NYSE closed, and that an order had to be received by the intermediary by the 4:00 p.m. close in order to obtain that day's NAV. McMahon testified that VanCook told her which clients were permitted to finalize their trading instructions after 4:00 p.m. It is undisputed that no one at the Firm time-stamped, or otherwise recorded, the time at which the Firm received these post-4:00 p.m. final trade instructions.

Goodwin Accounts. Andrew Goodwin ran numerous market-timing hedge funds over several years and learned about late-trading practices during 2000 while he was employed with Canary Capital, LLC as a vice president and senior portfolio manager. Goodwin understood the advantage of placing mutual fund orders after 4:00 p.m. and sought a trading platform that would allow him to engage in the practice.

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[24] The number of late trades placed (4,936) does not include any proposed orders that the three hedge fund clients ultimately instructed Pritchard Capital to cancel. These canceled orders, the number of which has not been identified by the Division, was likely significant. One of VanCook's hedge fund clients testified, for example, that he cancelled seventy percent of the proposed trades he submitted to Pritchard Capital based on post-closing information.

[25] The record indicates that, at VanCook's direction, McMahon entered the majority (approximately one-half to two-thirds) of orders into the system, with VanCook entering approximately fifteen percent of the hedge fund clients' trades. Another Pritchard Capital employee named Keith Robinson entered the remainder, with the exception of a small number of corrections or other entries made by the staff of Banc of America for administrative ease.

VanCook met Goodwin sometime in 2001. After joining Pritchard Capital, VanCook asked Goodwin, who at the time was independently operating market-timing hedge funds, if he would be interested in opening an account at Pritchard Capital. Goodwin testified that he and VanCook discussed the details of Goodwin submitting proposed trade sheets before 4:00 p.m. and confirming which of those trades to execute after 4:00 p.m. Goodwin also testified that, during this discussion, he learned that Banc of America, with whom he had worked before, was the Firm's clearing broker and he "knew that they could handle orders . . . after 4:00 p.m." Goodwin testified that the ability to late trade was one of the services that attracted him to Pritchard Capital. According to Goodwin, VanCook stated that he was "dumbfounded" by why another client, who declined an opportunity to late trade in a fund, "couldn't perceive a way to make money with the advantage."

Beginning in February 2002, Goodwin opened several late-trading accounts with VanCook ("Goodwin accounts"). VanCook's counsel stipulated at the hearing that Goodwin regularly finalized orders after 4:00 p.m. and that either VanCook or McMahon entered those orders in MFRS to effect the trade. Goodwin testified that he finalized "probably over ninety percent" of his proposed trade sheets after 4:00 p.m., and McMahon testified that the number was closer to ninety-eight percent, occurring "usually between 4:00 p.m. and 4:45 p.m."[26] The Firm placed 1,828 late-trading orders on behalf of the Goodwin accounts between February 2002 and July 2003. The prospectuses of those funds stated that the NAV was determined at or as of 4:00 p.m. when regular trading on the NYSE closed, and that an order had to be received by the 4:00 p.m. close in order to obtain that day's NAV. Goodwin closed the accounts in July 2003.

Millennium Accounts. Kovan Pillai was a portfolio manager at Millennium Capital Partners, L.P. ("Millennium"), a market-timing hedge fund, from April 2001 through December 2005.[27] Scott Murray, an assistant portfolio manager at Millennium from June 2001 until April 2006, helped Pillai place orders. Pillai met VanCook in the summer of 2002 and told him that he market timed international mutual funds. Pillai began to open international mutual fund market-timing accounts with VanCook in October 2002.

At first, Pillai and Murray regularly submitted and finalized proposed trade sheets with VanCook by 3:30 p.m. Pillai quickly concluded that the performance in his international mutual fund market-timing accounts with VanCook was inferior to market-timing accounts he held with other firms. Pillai testified that, when he informed VanCook that he intended to close the

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[26] Goodwin testified that the Firm processed proposed trade sheets that he sometimes submitted to the Firm after 4:00 p.m.

[27] In connection with their market-timing activities conducted during the period at issue, Millennium and Pillai consented, without admitting or denying any findings, to the entry of our order finding that they willfully violated Securities Act Section 17(a), Exchange Act Section 10(b), and Exchange Act Rule 10b-5. *Millennium Capital Partners, L.P.*, Securities Act Rel. No. 8639 (Dec. 1, 2005), 86 SEC Docket 2412, 2420-21.

accounts, VanCook told him "about this other business that he was doing with some other clients that was extremely profitable." Pillai testified that VanCook:

> told me that you submit the orders as you always do but before 5:00 or 5:05 at the latest, if you have a change of heart, if you see something happening in the business world that would change your opinion, then you were able to bust that trade.

Murray recalled at the hearing that VanCook told him that there was a way to:

> allow trades to be canceled if they were no longer desirable based on information that came out between 4:00 and however late the trades could be canceled.

Pillai testified that VanCook suggested that using this order system for domestic mutual funds would be advantageous and "told us we would get the price that we normally would get from placing the order before 4:00." Pillai viewed VanCook's comments to be an attempt to retain his business. VanCook testified, "I don't deny it happened, I don't remember the conversation. . . . My main concern was trying to keep the account and continue to do business with Millennium."

In December 2002, Pillai and Murray began to use the late-trading system outlined by VanCook with two domestic mutual fund accounts ("Millennium accounts"). According to Pillai, "we would submit scenarios in the middle of the day as we had always done and then sometime around 5:00 we would make a decision whether we wanted to take the trade or not." Pillai or Murray finalized all proposed trade sheets with VanCook or McMahon after 4:00 p.m. and cancelled approximately seventy percent of the proposed trades.

In January 2003, Pillai became concerned about the legality of his late trading and consulted Millennium's attorney, Fred Stone. Stone advised Pillai to discontinue late trading, and Pillai immediately informed VanCook about his conversation with Stone. Pillai testified that VanCook stated in response:

> Kovan, I promise you I never would have dropped you in something if it was legally questionable. I'm sure your in-house counsel is being overly cautious, I'm sure he's wrong about this . . . .

Pillai testified that, at a subsequent lunch meeting, VanCook "repeated more or less what he had said earlier" and reiterated his opinion that he believed that Stone was "wrong." VanCook testified that he did not recall that Pillai told him about the conversation with Stone or that he responded as Pillai stated.

From December 2002 through January 2003, the Firm placed twenty-three late-trading orders for the Millennium accounts. The prospectuses of those mutual funds stated that the NAV was determined at or as of 4:00 p.m., when regular trading on the NYSE closed, and that an order had to be received by the 4:00 p.m. close in order to obtain that day's NAV. Pillai stopped late trading in the Millennium accounts with Pritchard Capital in January 2003.

Simpson Accounts. Robert Simpson was the director and/or managing member of a number of market-timing hedge funds on whose behalf he opened accounts with VanCook in October 2001 ("Simpson accounts").[28] VanCook testified that he had told Simpson that Simpson could finalize his mutual fund orders with the Firm after 4:00 p.m. VanCook's counsel stipulated at the hearing that, "calls came in from Simpson regularly after 4:00 p.m. with final directives as to what to do and that either Mr. VanCook or Ms. McMahon put those orders through to the MFRS to effect the trade." McMahon testified that final instructions regarding the Simpson accounts were received "always" after 4:00 p.m. and "almost always after 5:00 p.m."

When asked at the hearing why Simpson account orders were finalized after 4:00 p.m., McMahon explained, "they just seemed to always know that you could put trades in at Banc of America up until 5:30, and Joe said it was acceptable." The Firm placed 3,085 late-trading orders on behalf of the Simpson accounts between November 2001 and July 2003 with mutual funds whose prospectuses stated that the NAV was determined at or as of 4:00 p.m., when regular trading on the NYSE closed, and that an order had to be received by the 4:00 p.m. close in order to obtain that day's NAV.[29] Simpson closed the accounts in September 2003.[30]

D. VanCook Receives Legal Advice from Pritchard Capital's Attorney to Place Orders by 4:00 p.m.

In May 2003, VanCook told Pritchard that one of VanCook's customers wanted legal advice regarding Investment Company Act Rule 22c-1, a rule with which Pritchard was

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28 No one testified on behalf of the Simpson accounts at the hearing.

29 The Firm placed orders on behalf of the Simpson accounts through September 2003. However, because the Order Instituting Proceedings charged VanCook with violations of the securities laws only through July 2003, we do not base findings of liability on the orders placed after that date.

30 In connection with the conduct at issue in this proceeding, among other things, the Division filed a complaint in the United States District Court for the Southern District of New York alleging that Simpson, his hedge fund, and another respondent engaged in an illegal late-trading scheme in violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5. That matter is currently pending. *See Simpson Capital Mgmt.*, 586 F. Supp. 2d at 208 (denying Simpson's motion to dismiss complaint). Our findings here with respect to Simpson are made solely for the purpose of the proceeding before us.

unfamiliar. According to Pritchard, VanCook generally described the rule, and Pritchard agreed to participate in a conference call with Pritchard Capital's attorney, Jay Seale, VanCook, VanCook's client, and the client's business acquaintance, who ran a hedge fund. Pritchard testified that, during the call, he and VanCook mainly listened to the others, who discussed Rule 22c-1 in general, opined that the rule applied to mutual fund companies but not salespersons, and expressed concern that a salesperson could nonetheless be liable for "aiding and abetting a dealer" if orders were placed after 4:00 p.m.

Pritchard testified that Seale told him and VanCook to "stick to 4:00 p.m.," *i.e.*, do not permit orders received after 4:00 p.m. to be entered for execution at that day's NAV, a point that Pritchard re-emphasized to VanCook. At the hearing, the Division introduced Pritchard's handwritten notes taken during the call, which state, among other things, "tentative orders during day, take verbal confirm at end of day" and "not making trade after pricing." Pritchard also testified that, at the time, he thought that "Joe being a partner, and us paying for legal advice, and the legal advice saying stick to 4:00, that both partners, Joe VanCook and Tommy Pritchard, would know that 4:00 is what you stick to."

VanCook testified that he did not recall that Rule 22c-1 was discussed during the call. Instead, VanCook testified that a 4:00 p.m. order deadline "wasn't one of the important things to me in that conversation. This piece of particular business you're talking about was $2 million a year commission to our Firm. That's the part that I really remember, and the fact that we weren't going to do it is another part that I really remember." VanCook also testified that, at the time, Rule 22c-1 was not his "issue," "job," or "concern." Following the call, VanCook continued to allow the Goodwin and Simpson accounts to late trade.

E. VanCook Assures Pritchard that He Is Placing Orders by 4:00 p.m.

In July 2003, Pritchard became aware of the New York Attorney General's investigation into mutual fund trading practices. Pritchard testified that, at that time, he explicitly asked VanCook numerous times whether VanCook had been "letting people put trades in after 4:00 p.m." Pritchard testified that VanCook replied that he had not been and had never done so.[31] VanCook testified that he does not remember discussing late trading with Pritchard.

F. VanCook's Perspective About the Timing of Placing Client Orders

According to VanCook, he believed that receiving and time stamping proposed trade sheets by 4:00 p.m., despite the fact that clients confirmed which trades to execute on the proposed trade sheets after 4:00 p.m., "would have satisfied any '4:00 p.m. rule.'" He testified that "it was made very clear" to him only in August or September 2003 that Rule 22c-1 prescribed the time when orders had to be placed for purposes of calculating a fund's NAV. He

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[31] It is unclear whether VanCook had stopped late trading when he responded to Pritchard's inquiries.

also testified that he did not read any of the prospectuses of the mutual funds in which his clients traded, including the language regarding when NAVs were calculated, because he "thought the most important thing was to build relationships and talk to the people that work at those fund families." In response to being asked at the hearing whether he thought it was important for him to know when mutual funds set their prices, VanCook stated, "No, we never thought about it."

The law judge found that VanCook's testimony about his lack of knowledge of late trading and Investment Company Act Rule 22c-1 was "deliberately vague" and "evasive."[32] The law judge noted that testimony from Goodwin, Pillai, Murray, and Pritchard was quite specific regarding discussions with VanCook about the mechanics of late trading and the fact that it violated Rule 22c-1 and was illegal. The law judge noted further that the testimony of these witnesses was consistent, either with each other or with documentary evidence.[33] Based on the law judge's observation that VanCook's testimony was deliberately vague and evasive, and on VanCook's general experience in the securities industry, his expertise with mutual funds, his spearheading the switch to a clearing broker that accommodated post-4:00 p.m. trading decisions, and the availability of prospectuses that contained pricing deadlines, the law judge determined that it was "simply incredible that [VanCook] did not know when the mutual funds' NAVs were calculated or that he did not fully understand the application of . . . Rule 22c-1 pricing requirements to mutual fund trades."[34]

III.

The Order Instituting Proceedings ("OIP") alleged that VanCook willfully violated Exchange Act Section 10(b) and Exchange Act Rule 10b-5 by permitting certain of the Firm's clients to late trade mutual fund shares from November 2001 through July 2003. Exchange Act Section 10(b) and Exchange Act Rule 10b-5 "prohibit the employing of fraudulent schemes or the making of material misrepresentations and omissions in . . . purchases or sales of securities."[35] To establish liability under Exchange Act Section 10(b) and Exchange Act

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32 *See Joseph John VanCook*, Initial Decision Rel. No. 350 (July 10, 2008), 93 SEC Docket 7686, 7699.

33 The law judge explicitly credited the testimony of Goodwin, Pillai, and Murray. Although the law judge did not explicitly credit Pritchard's testimony, he relied upon such testimony over that of VanCook's.

34 *See Joseph John VanCook*, 93 SEC Docket at 7700.

35 *SEC v. Brooks*, No. Civ. A. 3:99-CV-1326-D, 1999 WL 493052, at *2 (N.D. Tex. July 12, 1999); *see also* 15 U.S.C. § 78j(b), 17 C.F.R. § 240.10b-5; *SEC v. Dain Rauscher, Inc.*, 254 F.3d 852, 855-56 (9th Cir. 2001) (noting that the antifraud provisions "prohibit fraudulent conduct or practices" and "forbid making a material misstatement or omission" in connection with the offer or sale of securities).

Rule 10b-5, the Division must show by a preponderance of the evidence that VanCook (1) committed a deceptive or manipulative act as part of a scheme to defraud, made an untrue statement of material fact,[36] or omitted to state a fact that made a prior statement misleading; (2) engaged in such conduct in connection with the purchase or sale of a security;[37] and (3) acted with scienter.[38]

A. VanCook's Conduct

Deceptive Acts as Part of a Scheme to Defraud. Courts have recognized that, as a general matter, late trading of mutual fund shares can constitute a scheme to defraud.[39] Here, VanCook engaged in numerous deceptive acts in furtherance of the deceptive late-trading scheme. VanCook made misrepresentations in furtherance of the late-trading scheme when he, or McMahon at his direction, submitted mutual fund orders after 4:00 p.m. on behalf of the Goodwin, Millennium, and Simpson accounts for execution at that day's NAV. The submission of orders to mutual funds after the 4:00 p.m. close for execution at the current day's NAV constitutes a misrepresentation that final orders were received before the funds' 4:00 p.m. pricing time, as reflected in the applicable prospectus language.[40] The submissions created the false impression that the orders were received before 4:00 p.m. when, in fact, the trading decisions

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[36] A fact is material if there is a substantial likelihood that a reasonable investor would have considered the misstated or omitted fact important in making an investment decision, and if disclosure of the misstated or omitted fact would have significantly altered the total mix of information available to the investor. *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976); *see also Wheat v. Hall*, 535 F.2d 874, 876 (5th Cir. 1976) ("[T]he test of materiality is whether a reasonable man would attach importance to the fact misrepresented [or omitted] in determining his course of action.").

[37] The United States Supreme Court has embraced an expansive interpretation of Exchange Act Section 10(b)'s "in connection with" language. *See, e.g., Merrill Lynch, Pierce, Fenner & Smith Inc. v. Dabit*, 547 U.S. 71, 85 (2006); *SEC v. Zandford*, 535 U.S. 813, 819 (2002); *United States v. Naftalin*, 441 U.S. 768, 773 (1979). VanCook does not dispute that those requirements have been met.

[38] *See SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 111 (2d Cir. 1998); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996); *Simpson Capital Mgmt.*, 586 F. Supp. 2d at 201.

[39] *See Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 261; *Simpson Capital Mgmt.*, 586 F. Supp. 2d at 204-05; *In re Mut. Funds Inv. Litig.*, 384 F. Supp. 2d at 856 & n.10.

[40] *See Paul A. Flynn*, Initial Decision No. 316 (Aug. 2, 2006) (ALJ opinion) (stating that "[s]ubmitting orders to mutual funds for execution at that day's NAV is a representation that the orders were received by the intermediary prior to the fund's NAV calculation"), 88 SEC Docket 2146, 2174, *declared final*, Exchange Act Rel. No. 54390 (Aug. 31, 2006), 88 SEC Docket 2649.

were made after 4:00 p.m.[41] The mutual funds therefore were deceived into thinking that the trades were made before 4:00 p.m. and into giving the trades that day's NAV.[42]

To effectuate his clients' late trades, VanCook secured a new clearing broker for the Firm knowing that its order entry system, MFRS, provided an opportunity to place orders after 4:00 p.m. and still receive that day's NAV, unlike the Firm's previous clearing broker. VanCook also knew that MFRS provided no means for communicating to the clearing broker or the relevant mutual fund the time at which a client order was received, thereby allowing late trades to sidestep detection.

VanCook's order submissions were contrary to provisions in mutual fund prospectuses that required broker-dealers to receive trade orders "at" or "as of" 4:00 p.m. and stated that orders had to be received by 4:00 p.m. in order to be executed at that day's NAV. Although the Processing Guide provided a review period until 5:30 p.m., this was not intended to provide additional time to submit new orders, or to confirm, modify, or cancel orders already submitted, after the NYSE's regular trading session had closed. Nonetheless, VanCook permitted the Goodwin, Millennium, and Simpson accounts to finalize their proposed trade sheets after 4:00 p.m. There is no dispute that VanCook and McMahon, at his direction, placed almost 5,000 orders on behalf of these clients, who consistently finalized their proposed trade sheets after 4:00 p.m.

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41 *See Simpson Capital Mgmt.*, 586 F. Supp. 2d at 204-05 (denying motion to dismiss complaint alleging illegal late trading scheme in violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5; complaint sufficiently alleged that defendants engaged in "deceptive conduct" where their acts communicated the "false impression" to mutual funds that trades were submitted before 4:00 p.m., when in fact they were submitted with the benefit of market news after 4:00 p.m.).

42 *Id.* At oral argument, VanCook's counsel asserted that there was no basis to conclude that mutual funds were deceived given the lack of testimony from any mutual fund. As discussed above, we find the record amply supports a conclusion that the mutual funds were deceived based on the false impression VanCook created that the orders were received before 4:00 p.m. when in fact they were received after 4:00 p.m. As the Second Circuit Court of Appeals stated recently, "[i]n its ordinary meaning, 'deceptive' covers a wide spectrum of conduct involving cheating or trading in falsehoods." *SEC v. Dorozhko*, 574 F.3d 42, 50 (2d Cir. 2009) (citing Webster's International Dictionary, 679 (2d ed. 1934), as "defining 'deceptive' as 'tending to deceive,' and defining 'deceive' as '[t]o cause to believe the false, or to disbelieve the true' or '[t]o impose upon; to deal treacherously with; cheat'"). Noting the holding of the Fifth Circuit in *Regents of the Univ. of Cal. v. Credit Suisse First Boston (USA), Inc.*, 482 F.3d 372, 389 (5th Cir. 2007), the Court concluded that "[i]n light of this ordinary meaning, it is not at all surprising that Rule 10b-5 equates 'deceit' with 'fraud.'" *Id.*

VanCook's use of proposed trade sheets was another deceptive act in furtherance of the fraudulent late-trading scheme. VanCook instructed his clients to submit the proposed trade sheets to the Firm by 4:00 p.m. so that the sheets could be time stamped before the close of trading. However, VanCook allowed these clients to finalize their proposed trades after 4:00 p.m. without creating new order tickets or otherwise documenting the confirmations and cancellations. Thus, VanCook used the time-stamped trade sheets to disguise the fact that VanCook's customers made trading decisions after the close of trading. VanCook also falsely reassured Pritchard that VanCook had not been allowing customers to place orders after 4:00 p.m. and had never done so.

Through these numerous deceptive acts, VanCook created the false impression that final orders associated with the Goodwin, Millennium, and Simpson accounts were placed before 4:00 p.m. and were therefore entitled to that day's NAV when in fact they were not.[43] As a result, Van Cook's late-trading clients obtained an undisclosed advantage, at the expense of other shareholders of the relevant mutual funds, when they learned of market-moving information and were able to buy, exchange, or sell mutual fund shares at NAVs set before the market-moving information was released. The mutual funds at issue were deceived into providing improper prices for those orders contrary to their prospectus language and transmitting and effecting orders contrary to their published policies and procedures, as well as applicable rules and regulations, thereby harming or causing the risk of harm to shareholders who made investment decisions premised upon improper prices and suffered dilution to the value of their shares.

Materiality. The late-trading scheme in which VanCook participated was material because mutual funds and their shareholders would have wanted to know that some investors were able to benefit from trading on post-4:00 p.m. information, thereby potentially diluting the value of shareholder investments. VanCook's submission of late trades also was material because the mutual funds at issue would have wanted to know that they were transmitting and effecting orders contrary to their published policies and procedures, as well as applicable rules and regulations, such as Investment Company Act Rule 22c-1.

VanCook's Arguments. VanCook argues that he cannot be held liable under Exchange Act Rule 10b-5(a) because "the Supreme Court ended so-called 'scheme liability' as a viable Rule 10b-5 theory" with its decision in *Stoneridge Investment Partners LLC v. Scientific-Atlantic, Inc.*[44] VanCook contends that the "*Stoneridge* case makes clear that a putative violator of Rule 10b-5 must himself or herself actually trigger each element of the rule. Merely being associated with a scheme is not enough."

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[43] *See Pentagon Capital Mgmt.*, 612 F. Supp. 2d at 261 (observing that "deceptive conduct" within the meaning of Exchange Act Section 10(b) and Exchange Act Rule 10b-5 "irreducibly entails some act that gives the victim a false impression") (citation omitted).

[44] 552 U.S. 148 (2008).

VanCook's reliance on *Stoneridge* is misplaced. VanCook's liability is based not on "merely being associated with the scheme," but on engaging in acts that were directly linked to the deception practiced upon the mutual funds at issue. VanCook was intimately involved with the creation, marketing, and implementation of the system that enabled the three clients to late trade. VanCook communicated his deceptive acts to the mutual funds at issue by submitting late-trading orders to them through the Firm's clearing broker. Moreover, in *Stoneridge*, the Supreme Court held that the defendants were not liable under Exchange Act Section 10(b) and Exchange Act Rule 10b-5 because the investor plaintiffs had not relied on the defendants' acts or statements.[45] Unlike litigants in private causes of action, however, the Division is not required to prove reliance as an element of its claim against VanCook.[46] Accordingly, we reject VanCook's contention that his conduct does not fall within the scope of the antifraud provisions.

VanCook "challenges the finding that the mere submission of the trades can be a legally cognizable materially false representation sufficient to trigger Section 10(b) and Rule 10b-5 liability." He asserts that, "[a]s the Second Circuit recognized in [*United States v.*] *Finnerty*,[47] the mere execution of a trade (even if performed with an improper purpose and even if leading to an unfair windfall) cannot be converted into a materially false representation. A mere trade not accompanied by other communications, is not a representation."

In *Finnerty*, the Court of Appeals was presented with the question of whether interpositioning, the practice of a specialist declining to match public buy and sell orders and interposing itself between the matching orders in order to generate profits for the specialist's firm, constitutes deceptive conduct. The court determined that interpositioning did not amount to deceptive conduct under Exchange Act Section 10(b) or Exchange Act Rule 10b-5 because there was "no evidence that Finnerty conveyed an impression that was misleading."[48] Here, in contrast, VanCook communicated the false impression to mutual funds that the orders were

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45 *Id.* at 769-770.

46 *SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1363-64 (9th Cir. 1993); *SEC v. Blavin*, 760 F.2d 706, 711 (6th Cir. 1985); *SEC v. North Am. Research & Dev. Corp.*, 424 F.2d 63, 84 (2d Cir. 1970); *Simpson Capital Mgmt.*, 586 F. Supp. 2d at 201.

47 533 F.3d 143 (2d Cir. 2008).

48 *Finnerty*, 533 F.3d at 149-50.

received before 4:00 p.m., when they were, in fact, received after 4:00 p.m.[49] We find that this constitutes deceptive conduct under Exchange Act Section 10(b) and Exchange Act Rule 10b-5.

B. VanCook's Scienter

Scienter is a mental state embracing an intent to deceive, manipulate, or defraud.[50] It includes recklessness, defined as conduct which is "'highly unreasonable' and . . . represents 'an extreme departure from the standards of ordinary care . . . to the extent that the danger [of misleading the individual or entity at issue] was either known to the defendants or so obvious that the defendant must have been aware of it.'"[51]

VanCook had substantial experience in the securities industry, held two securities licenses, was a partial owner of the Firm, and was responsible for opening the Firm's new branch office whose sole line of business initially involved the market-timing hedge fund customers that VanCook acquired and maintained based on his previous experience. VanCook knew that his success at developing and maintaining relationships with market-timing hedge funds was critical, given that it generated his primary source of income and was the basis for Pritchard's decision to hire him. The law judge found it "simply incredible that [VanCook] did not know when the

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[49] *See Simpson Capital Mgmt.*, 586 F. Supp. 2d at 204-05 (denying motion to dismiss complaint alleging illegal late-trading scheme in violation of Exchange Act Section 10(b) and Exchange Act Rule 10b-5).

Courts also have found that submitting an order containing misleading or inaccurate information to a mutual fund can constitute a misrepresentation. *See SEC v. Druffner*, 517 F. Supp. 2d 502, 508-09 (D. Mass. 2007) (finding that salesperson's submission of orders that included modified identifying client information constituted material misrepresentations), *aff'd sub nom. SEC v. Ficken*, 546 F.3d 45 (1st Cir. 2008); *SEC v. Gann*, 2008 WL 857633, at *10 (N.D. Tex. Mar. 31, 2008) (same), *aff'd*, 565 F.3d 932 (5th Cir. 2009). VanCook also asserts that he did not make misrepresentations because neither he nor the Firm "ever sent trade sheets to Banc of America." The Division has not alleged, and we have not found, that VanCook made misrepresentations on this basis.

[50] *Hochfelder*, 425 U.S. at 193 n.12.

[51] *Rolf v. Blyth, Eastman, Dillion & Co.*, 570 F.2d 38, 47 (2d Cir. 1978) (quoting *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977)), *cert. denied*, 439 U.S. 1039 (1978); *see also, e.g.*, *SEC v. Steadman*, 967 F.2d 636, 641-42 (D.C. Cir. 1992) (quoting *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977), *cert. denied*, 434 U.S. 875). Proof of scienter may be demonstrated by circumstantial evidence. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390-91 n.30 (1983); *Valicenti Advisory Servs., Inc. v. SEC*, 198 F.3d 62, 65 (2d Cir. 1999).

mutual funds' NAVs were calculated or that he did not fully understand the application of . . . Rule 22c-1 pricing requirements to mutual fund trades."[52]

Against that backdrop, VanCook knowingly manipulated the Firm's order system to facilitate late trading, a deceptive practice whose advantage he appreciated and that enabled him to acquire and/or maintain three clients. VanCook was responsible for Pritchard Capital's switch from a clearing broker who required trades to be submitted by 4:00 p.m. to one that allowed trades to be entered until 5:30 p.m. This enabled the late trading to occur. His "trade sheet" protocol required that all his clients submit their proposed trades by 4:00 p.m., but he allowed customers to make trading decisions after 4:00 p.m. The trade sheets permitted VanCook to create the false appearance that trades were placed prior to 4:00 p.m. That the trade sheets were used for this deceptive purpose is supported by the fact that the record contains no evidence that VanCook ever implemented procedures to record the times that orders on the trade sheets were modified or cancelled.

Testimony from clients who finalized trades after 4:00 p.m. consistently showed that VanCook knew of the advantage his scheme provided his clients and used the ability to late trade to attract and retain business. Goodwin testified that, before opening accounts with Pritchard, he discussed with VanCook the ability to finalize trades after 4:00 p.m. and recalled that VanCook appreciated the advantage that late trading offered. Pillai testified that VanCook offered him the ability trade after 4:00 p.m. to retain his business. Murray's testimony corroborates Pillai's testimony on this point. The law judge explicitly credited the testimony of Goodwin, Pillai, and Murray over that of VanCook, and we find no basis in the record to overturn the law judge's finding.[53]

Moreover, VanCook persisted in encouraging his clients to late trade even after one expressed concern over the legality of post-4:00 p.m. trading in January 2003. The law judge found that Pillai credibly testified that VanCook argued that Pillai's attorney, who advised Pillai to stop late trading, was "wrong" and "overly cautious." A few months later, VanCook participated in a conference call with a different client about the same issue, *i.e.*, whether late trading was unlawful. Pritchard Capital's attorney told VanCook not to late trade. VanCook's claimed ignorance about the conference call is contradicted by Pritchard, whose testimony is supported by his handwritten notes. Unlike VanCook, Pritchard concluded, based on the statements of the Firm's attorney, that he and VanCook, as partners receiving clear legal advice, must abide by the 4:00 p.m. order deadline. However, VanCook continued late trading. When the New York Attorney General's investigations caused Pritchard concern over his Firm's compliance with securities laws and prompted him to ask VanCook whether he permitted clients

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[52] A law judge's credibility findings are entitled to considerable weight and deference. *See, e.g.*, *Warwick Capital Mgmt., Inc.*, Investment Advisers Act Rel. No. 2694 (Jan. 16, 2008), 92 SEC Docket 1410, 1413-14 n.9.

[53] *Id.*

to trade after 4:00 p.m., VanCook lied to him, telling Pritchard that he had never accepted trades after 4:00 p.m.

The evidence is consistent in demonstrating that VanCook, despite his failure to recall many of the events and conversations that others remember with clarity and despite his assertions that he was unaware that his conduct was improper, knew or must have known that his scheme would deceive mutual funds into believing that his clients' late orders were received before 4:00 p.m. and that they were therefore entitled to receive that day's NAV. We find that VanCook acted with scienter.

VanCook's Arguments. VanCook argues that he lacked the requisite scienter. VanCook claims to have no awareness that 4:00 p.m. was a critical cut-off point for submitting mutual fund trades in order for his mutual fund clients to receive that day's NAV. For the reasons discussed above, the law judge did not credit VanCook's claim.[54] Moreover, VanCook would have been aware had he read the prospectuses of the dozens of mutual funds that his clients traded and the Processing Guide of the clearing broker that he helped to secure. The prospectuses consistently disclosed that shares were priced at or as of 4:00 p.m., and the Processing Guide contained explicit instructions to enter all trades by 4:00 p.m., excepting corrections and similar administrative tasks that could be entered until 5:30 p.m. VanCook nonetheless claims that he believed that he could enter orders until 5:30 p.m., a belief that his colleague, Pritchard, did not share. During this period he was warned that attorneys thought the practice was unlawful. VanCook's failure to comply with the requirements of the Processing Guide and mutual fund prospectuses was highly unreasonable and represented an extreme departure from the standards of ordinary care expected of a registered representative in his position to the extent that the danger of misleading the mutual funds and their shareholders was either known to VanCook or so obvious that he must have been aware of it.

VanCook contends that he did not engage in deceptive market timing or the use of deceptive devices typically used by market timers, such as altered account numbers, representative numbers, or tax identifications numbers. Assuming VanCook's assertions to be true, the fact that he did not use these deceptive devices as part of his market-timing trading is not evidence of lack of scienter with respect to the deceptive late-trading scheme.

VanCook also asserts that the fact that the "trade sheet protocol" was not invented by him and was used "throughout the market timing industry generally" refutes a finding that it was "somehow developed by [him] to facilitate late trading." Whether the trade sheet protocol VanCook used had innocuous origins is beside the point, given that VanCook ultimately used it on behalf of a subset of his clients to create the false appearance that trading decisions were made before 4:00 p.m., a feature that was central to the fraudulent scheme that he operated for almost two years.

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[54] *See supra* Section II. F. discussing the law judge's credibility findings.

VanCook questions how it is "fair to say that [he] must have been aware that [his] practice was improper" when, he claims, no "red flags" existed. Specifically, VanCook claims that just about everyone else in the securities industry was unaware that late trading was improper, that his colleagues did not object to his order system, and that his clients were persons of "stature" whose account performance was relatively modest. VanCook repeatedly ignored numerous "red flags"—including the information contained in prospectuses and Banc of America's Processing Guide, the warnings issued by his client's attorney and his own Firm's attorney, and conversations with Pritchard regarding the importance of the 4:00 p.m. deadline—that indicated his conduct was not only improper but also deceptive.[55] Also, while the three clients at issue may have been sophisticated analysts who participated in the late-trading activity, VanCook was critical to its implementation and capitalized on its advantage to attract and retain customers and to generate significant commissions for himself. In the face of this evidence, we reject VanCook's claim that he acted without the requisite scienter.[56]

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[55] In this regard, we reject VanCook's claim that our finding that he must have been aware of the impropriety of his conduct "tramples on the fundamental notion of fair notice." "Due process requires . . . only that 'laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited.'" *Valicenti Advisory Servs.*, 198 F.3d at 66 (quoting *Upton v. SEC*, 75 F.3d 92, 98 (2d Cir. 1996)). VanCook, an experienced securities professional, cannot "credibly claim lack of fair notice of the proscription against defrauding investors." *Id.* As the First Circuit Court of Appeals stated in *SEC v. Tambone*, 550 F.3d 106, 148 (1st Cir. 2008), "[t]he Commission seeks with its action to enforce provisions of the securities laws that have been in existence for over half a century. Since their inception, it has been unlawful to offer or sell [ ] securities using a false or misleading statement. The Due Process Clause of the Constitution requires nothing more by way of notice."

[56] *See Joseph Abbondante*, Exchange Act Rel. No. 53066 (Jan. 6, 2006), 87 SEC Docket 203, 226 & n.76 (rejecting blame-shifting arguments); *Michael G. Keselica*, 52 S.E.C. 33, 37 (1994) (same); *B.R. Stickle & Co.*, 51 S.E.C. 1022, 1025 (1994) (same).

The purported failure of others to detect or object to the impropriety of VanCook's conduct does not relieve him of "responsibility for what he knew or was reckless in not knowing and for what he did." *See Jett*, 57 S.E.C. 350, 390 (2004) (finding that, even if management knew of respondent's fraudulent conduct, "indeed even if they ordered him to commit it – that would not relieve Jett of responsibility for what he knew or was reckless in not knowing and for what he did").

We conclude that VanCook willfully[57] violated Exchange Act Section 10(b) and Exchange Act Rule 10b-5.[58]

IV.

VanCook was also charged with aiding and abetting and causing Pritchard Capital's violations of certain provisions of the securities laws requiring firms to keep accurate books and records. Exchange Act Section 17(a)(1) and Rule 17a-3(a)(6) thereunder require that broker-dealers registered with the Commission make and keep current, for prescribed periods, certain books and records. Rule 17a-3(a)(6) requires that registered broker-dealers make and keep a

> memorandum of each brokerage order, and of any other instruction, given or received for the purchase or sale of securities, whether executed or unexecuted. The memorandum shall show the terms and conditions of the order or instructions and of any modification or cancellation thereof; the account for which entered; the time the order was received; the time of entry; the price at which executed; the identity of each associated person, if any, responsible for the account; the identity of any other person who entered or accepted the order on behalf of the customer or, if a customer entered the order on an electronic system, a notation of that entry; and, to the extent feasible, the time of execution or cancellation.[59]

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[57] A willful violation of the securities laws means the intentional commission of an act that constitutes the violation; there is no requirement that the actor must be aware that he is violating any statutes or regulations. *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks and citation omitted).

[58] In light of our conclusion that VanCook is liable as a primary violator of the antifraud provisions of Exchange Act Section 10(b) and Exchange Act Rule 10b-5, we do not address his secondary liability for aiding and abetting and causing Banc of America's violations of Investment Company Act Rule 22c-1, which, by its terms, does not apply to VanCook directly. 17 C.F.R. § 270.22c-1(a). As discussed, VanCook's liability here is premised on his commission of deceptive acts as part of a scheme to defraud that involved material misrepresentations. *See generally* 6 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation*, § 20.5 (6th ed. 2009) (stating that "[e]ven in the absence of an express rule prohibiting late trading, the SEC has made clear that late trading is improper and violates the [antifraud provisions of the] securities laws").

[59] Rule 17a-3(a)(6) was amended, effective May 2, 2003, to add the requirement to record the time an order was received from a customer. *See* Books and Records Requirements for Brokers and Dealers Under the Securities Exchange Act of 1934, 66 Fed. Reg. 55,817 (Nov. 2, 2001).

To establish aiding and abetting liability, we must find that (1) Pritchard Capital violated those provisions, (2) VanCook substantially assisted the violations, and (3) VanCook provided that assistance with the requisite scienter.[60] The scienter requirement for aiding and abetting liability may be satisfied by showing that VanCook knew of, or recklessly disregarded, the wrongdoing and his role in furthering it.[61]

From May 2, 2003 through July 2003, Pritchard Capital time-stamped upon receipt proposed trade sheets from the three hedge fund clients.[62] These trade sheets often did not represent the clients' final trading instructions. Instead, Pritchard Capital permitted these clients to confirm, cancel, or modify those trade instructions later in the day. It is undisputed that Pritchard did not record the time at which these confirmations or modifications were made. The Firm's failure to record the time at which customers submitted their final trading instructions constituted a primary violation of Exchange Act Section 17(a)(1) and Rule 17a-3(a)(6) thereunder. VanCook, who accepted order modifications from his hedge fund customers without noting the time he received these modifications, and who established the system by which McMahon also accepted "proposed trade sheets" and subsequent order modifications without documenting the time of receipt of these modifications, substantially assisted the violation.

We also find that VanCook provided that assistance with scienter. As explained above, VanCook engaged in a scheme to deceive mutual funds into believing that his late-trading clients were entitled to that day's NAV because their orders were received by 4:00 p.m. VanCook knew or must have known that time-stamping the clients' proposed trade sheets upon receipt but failing to record the time that his clients made their actual final trading decisions would help to conceal their late trading.[63] We conclude, therefore, that VanCook aided and abetted Pritchard Capital's violations of Exchange Act Section 17(a)(1) and Exchange Act Rule 17a-3(a)(6). Further,

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60 *See Robert J. Prager*, Exchange Act Rel. No. 51974 (July 6, 2005), 85 SEC Docket 3413, 3421 & n.17 (citing additional cases).

61 *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).

62 May 2, 2003 is the beginning of the violative conduct because that is the date Rule 17a-3(a)(6) was amended to add the requirement to show the time that an order was received from a customer. *See supra* note 59.

63 *See Simpson Capital Mgmt.*, 586 F. Supp. 2d at 208 (finding that plaintiff's allegations, which included, among other things, that defendants "submitted proposed trades to the broker-dealers on 'scenario sheets' before 4:00 p.m. that allowed the defendants the opportunity to authorize those trades late in the day and incorporate after-market information into their decisions," were sufficient to defeat motion to dismiss complaint).

because one who aids and abets a primary violation is necessarily a cause of that violation,[64] we also find that VanCook was a cause of Pritchard Capital's violations of these provisions.[65]

V.

A. Bar from Association

Exchange Act Section 15(b)(6) authorizes us to censure, place limitations on, suspend, or bar a person associated with a broker or dealer if we determine that the person has, among other things, willfully violated the federal securities laws and it is in the public interest to do so.[66] In determining what sanction is in the public interest, we consider the factors articulated in *Steadman v. SEC.*[67] Those factors include the egregiousness of a respondent's actions, the degree of scienter involved, the isolated or recurrent nature of the infraction, the recognition of the wrongful nature of the conduct, the sincerity of any assurances against future violations, and the likelihood that the respondent's occupation will present opportunities for future violations.[68] We have also stated that conduct that violates the antifraud provisions "is especially serious and subject to the severest sanctions."[69]

We conclude that VanCook's conduct was egregious. He participated in a scheme that involved the placement of nearly 5,000 late mutual fund orders effecting the purchase and sale of

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[64] *Sharon M. Graham*, 53 S.E.C. 1072, 1085 n.35 (1998), *aff'd*, 222 F.3d 994 (D.C. Cir. 2000).

[65] We have previously explained that "negligence is sufficient to establish 'causing' liability . . . , at least in cases in which a person is alleged to 'cause' a primary violation that does not require scienter." *KPMG Peat Marwick LLP*, 54 S.E.C. 1135, 1175 (2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002). VanCook argues that, "b[y] placing no evidence into the record to establish the appropriate standard of care, the Division failed to prove negligence for its 'causing' charges." Here, we have found that VanCook was at least reckless in failing to record the time his clients submitted their final trade instructions, which "exceeds the statutory language of [Exchange Act] Section 21C." *Robert M. Fuller*, 56 S.E.C. 976, 989 n.29 (2003), *petition denied*, 95 Fed. Appx. 361 (D.C. Cir. 2004). The Division therefore need not have separately proven how VanCook's conduct was negligent.

[66] 15 U.S.C. § 78*o*(b)(6).

[67] 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

[68] *Id.*

[69] *Justin F. Ficken*, Advisers Act Rel. No. 2803 (Oct. 17, 2008), 94 SEC Docket 10887, 10891 & n.20 (citing cases).

billions of dollars' worth of mutual fund shares.[70] This volume of trading had the potential to cause substantial dilution in value of the mutual fund shares affected by the scheme.[71] The scheme defrauded dozens of mutual funds and, ultimately, their shareholders, who—unlike VanCook's clients—did not have access to post-closing market information to inform their trading decisions and who were unaware of the effects VanCook's late trades were having on the value of their investments. VanCook's fraudulent scheme generated over $500,000 in compensation for himself and another $500,000 in account fees for Pritchard Capital.

As we explained above, VanCook's conduct demonstrated a high degree of scienter.[72] The late-trading scheme was not an isolated incident, but a recurrent pattern that extended over a substantial period of time and stopped only after it was detected by regulators. VanCook has not offered assurances against future violations, nor has he recognized that he committed serious antifraud violations, instead characterizing himself as merely a "low level introducing broker who stumbled into late trading practices" conceived of by others. Further, VanCook fails to appreciate the duties and responsibilities attendant to being a securities professional, focusing on "trying to keep the account[s]" and the substantial commissions they represented while considering compliance with the securities laws to be outside the purview of his position—*i.e.*, not his "issue," "job," or "concern." We also consider that VanCook has remained in the securities industry and has been associated with two other registered broker-dealers since leaving Pritchard Capital, indicating a potential to commit future violations. These factors lead us to

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[70] The Division did not calculate the precise monetary value represented by the late trade orders entered by VanCook; however, the vast majority of trades exceeded $200,000 in value, and many trades were valued in the tens of millions of dollars.

[71] The Division did not offer a calculation of the amount by which VanCook's trades diluted the value of the mutual fund shares affected; however, the substantial number and dollar volume of trades suggests the dilution was likely significant. *See In re Mut. Funds Litig.*, 437 F. Supp. 2d 439, 442 (D. Md. 2006) (discussing the potential dilutive effects of late trading on the net asset value of mutual fund shares); *Gen. Am. Life Ins. Co.*, Proposed Plan of Distribution, Admin. Proc. File No. 3-12720 (May 22, 2008), 2008 SEC LEXIS 1216, *7-8 (describing method of calculation of dilution of mutual fund shares caused by late trading as the product, per day, of the number of shares sold or purchased and the difference between the NAV on the transaction date and the NAV on the day after the transaction).

[72] VanCook argues that "[e]ven if one were to accept, for the sake of argument, that Mr. VanCook's post-4:00 p.m. trading practices were illegal, the fact that he engaged in no deceptive market timing should have weighed heavily in determining appropriate sanctions," and therefore a bar is too strict a sanction. We have found that VanCook's post-4:00 p.m. trading practices were fraudulent; the fact that he did not also engage in other misconduct is not a mitigating circumstance. *Dane S. Faber*, 57 S.E.C. 297, 313 n.33 (2004) (finding that failure to engage in other violative conduct did not mitigate violations at issue).

conclude that a bar from association with any broker or dealer is necessary to protect the public interest and will serve a remedial purpose.

B. Cease-and-Desist Order

Securities Act Section 8A(a) and Exchange Act Section 21C authorize the Commission to impose a cease-and-desist order if it finds that any person has violated the federal securities laws or rules thereunder.[73] In determining whether a cease-and-desist order is appropriate, we look to whether there is some risk of future violations.[74] The risk of future violations required to support a cease-and-desist order is significantly less than that required for an injunction.[75] A single violation can be sufficient to indicate some risk of future violations.[76] Our finding that a violation is egregious "raises an inference that it will be repeated."[77] We also consider whether other factors demonstrate a risk of future violations, including the seriousness of the violation, 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 recognition of the wrongfulness of the conduct, the opportunity to commit future violations, and the remedial function to be served by a cease-and-desist order in the context of any other sanctions sought in the proceeding.[78] This inquiry is flexible, and no single factor is dispositive.[79]

We find that the risk of future violations is high. VanCook's conduct was serious and recurrent. He engaged in deceptive conduct that spanned at least twenty-one months. His violations were relatively recent and involved a high degree of scienter.[80] VanCook profited substantially from his deceptive conduct at the expense of mutual fund investors who did not

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73 15 U.S.C. §§ 77A(a), 78u-3.

74 *KPMG Peat Marwick, LLP*, 54 S.E.C. 1135, 1185 (2001), *reconsideration denied*, 55 S.E.C. 1 (2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002).

75 *KPMG Peat Marwick*, 54 S.E.C. at 1191.

76 *See Geiger v. SEC*, 363 F.3d 481, 489 (D.C. Cir. 2004).

77 *Id.*

78 *KPMG Peat Marwick*, 54 S.E.C. at 1192.

79 *Id.*

80 *See Rita J. McConville*, Exchange Act Rel. No. 51950 (June 30, 2005) (imposing cease-and-desist order based on "relatively recent" conduct that occurred more than five years prior to issuance of Commission's opinion), 85 SEC Docket 3127, 3152, *petition denied*, 465 F.3d 780 (7th Cir. 2006), *cert. denied*, 552 U.S. 811 (2007).

have access to post-4:00 p.m. market information when they made their trading decisions. Although we have ordered that VanCook be barred from associating with any broker or dealer, the issuance of a cease-and-desist order will serve the remedial purpose of encouraging him to take his responsibilities more seriously in the future should he be allowed to re-enter the securities industry or should he act in a capacity that does not require registration. A cease-and-desist order will also serve to protect the investing public from possible future violations by VanCook should he become associated with an investment adviser or investment company. Therefore, we conclude that, in addition to a bar against associating with broker-dealers, it is in the public interest to impose a cease-and-desist order against VanCook.

C. Disgorgement

Securities Act Section 8A(e), Exchange Act Section 21B(e), and Exchange Act Section 21C(e) authorize disgorgement, including reasonable prejudgment interest, in a cease-and-desist proceeding and a proceeding in which a civil money penalty may be imposed.[81] Disgorgement is an equitable remedy designed to deprive wrongdoers of their unjust enrichment and to deter others from similar misconduct.[82] "[T]he amount of disgorgement should include all gains flowing from the illegal activities."[83]

When calculating disgorgement, "separating legal from illegal profits exactly may at times be a near-impossible task."[84] As a result, disgorgement "need only be a reasonable approximation of profits causally connected to the violation."[85] Once the Division shows that its disgorgement figure is a reasonable approximation of the amount of unjust enrichment, the burden shifts to the respondent to demonstrate that the Division's estimate is not a reasonable approximation.[86]

The Division requests that we order VanCook to disgorge $538,565.70. The Division's expert arrived at this figure by adding the wrap fees (*i.e.*, fees based on the value of assets under management in the clients' accounts, not based on the number of trades the clients submitted)

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81 15 U.S.C. §§ 77h-1(a), 78u-2(e), 78u-3(e).

82 *SEC v. First City Fin. Corp., Ltd.*, 890 F.2d 1215, 1230 (D.C. Cir. 1989).

83 *David Henry Disraeli*, Exchange Act Rel. No. 57027 (Dec. 21, 2007), 92 SEC Docket 852, 879, *aff'd*, 2009 WL 1791547 (D.C. Cir. 2009) (slip copy).

84 *First City Fin. Corp.*, 890 F.2d at 1231.

85 *Id.*

86 *SEC v. Lorin*, 76 F.3d 458, 462 (2d Cir. 2006); *First City Fin. Corp.*, 890 F.2d at 1232.

paid monthly to Pritchard Capital by Simpson, Millennium, and Goodwin during certain time periods, and then dividing that figure in half.[87] As explained below, we conclude that this calculation reasonably approximates VanCook's ill-gotten gains from Simpson and Millennium but that the figure representing his improper gains from Goodwin is overstated.

Simpson. The Division's expert calculated that VanCook earned $388,007.59 in fee-based commissions from the five accounts opened by Simpson. This figure includes commissions earned from these accounts only during the period charged in the OIP (*i.e.*, November 2001 through July 2003).[88] Simpson placed orders on behalf of all five of his accounts at Pritchard. The record establishes that essentially all of the trading decisions in these accounts were made after 4:00 p.m. but still received that day's NAV: VanCook's attorney stipulated at the hearing that Simpson "regularly" confirmed his orders after 4:00 p.m., and McMahon testified that final trade instructions from Simpson "always" came in after 4:00 p.m. We find that the record supports the conclusion that the figure of $388,007.59, which represents the commissions VanCook earned from fees paid by Simpson for the maintenance of his late-trading accounts during the period charged, reasonably approximates the amount VanCook should disgorge for the fraud he perpetrated on mutual funds related to the Simpson accounts.

Millennium. The Division's expert calculated that VanCook earned $97,241.23 in commissions from the seven accounts maintained by Millennium. Although Millennium had opened accounts with Pritchard as early as October 2002, the expert included in his disgorgement figure only those commissions earned from the Millennium accounts by VanCook beginning in December 2002—when Pillai first accepted VanCook's offer to submit trade confirmations after 4:00 p.m.—and continuing through July 2003. The record indicates that Millennium used only two of its seven accounts to late trade, and that the late trading in those two accounts occurred over only a two-month period; however, we find it is reasonable to characterize the commissions VanCook earned after November 2002 on all seven accounts as ill-gotten proceeds. As Pillai testified, Millennium intended to close its accounts with Pritchard—accounts that were underperforming compared to accounts Millennium maintained with other brokers—but decided to keep the accounts open when VanCook made an effort to keep Millennium's business by offering Pillai the ability to cancel or confirm trades after 4:00 p.m. VanCook himself testified that his "main concern was trying to keep the account and continue to do business with Millennium." Because the record evidence shows that VanCook retained all of the Millennium

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87 VanCook testified that he was paid as compensation half of the wrap fees paid to Pritchard Capital by his clients. The Division's expert included only those wrap fees paid by Simpson from November 2001 through July 2003, to conform to the period charged in the OIP. He also limited the fees paid by Millennium to include only those paid after December 2002, at which time Millennium began engaging in its late trading activity.

88 The wrap fees were billed and collected monthly in arrears; for example, Pritchard collected the wrap fee for October 2001 by withdrawing funds from the client's account in November 2001. Not all of the Simpson accounts were open throughout this entire period.

accounts after November 2002 by virtue of his late-trading scheme and his offer to Pillai to take advantage of the benefits of that scheme, we conclude that $97,241.23 reasonably approximates the ill-gotten proceeds VanCook earned from Millennium.

Goodwin. The Division's expert calculated that VanCook received $53,316.89 in fee-based commissions from the fourteen Goodwin accounts that Pritchard serviced. This figure includes all of the commissions VanCook earned from all Goodwin accounts from their opening dates (which range from early 2002 through mid-2003) to their closing dates (as late as July 2003). The evidence suggests, however, that this figure is over-inclusive because not all of the trades that Goodwin submitted to Pritchard were confirmed after the close. Goodwin testified that he confirmed "probably over ninety percent" of his orders after 4:00 p.m., while McMahon estimated it to be "98 percent of the time." Moreover, in contrast to the Millennium accounts, it is not clear from the record that the ability to late trade was Goodwin's primary incentive for maintaining his accounts with Pritchard. Goodwin testified that the ability to trade after the close "was one of the reasons but not the only reason" he chose to do business with Pritchard. Therefore, we have determined to reduce the amount of disgorgement attributable to the Goodwin accounts by ten percent, to more closely align the figure with the approximate frequency of late trading in which Goodwin admittedly engaged. Accordingly, we find that $47,985.20 reasonably approximates the ill-gotten proceeds VanCook earned from Goodwin.

Disgorgement total. VanCook has not demonstrated that the Division's estimate of the disgorgement amount is unreasonable. VanCook argues that, because the Division emphasizes the May 2003 telephone call with Pritchard and Seale as the time at which "VanCook should have known late trading was illegal," VanCook should have to disgorge only those fees he collected from his three hedge fund clients from May 2003 through July 2003. However, the Division has argued, and we have found, that VanCook acted with scienter throughout the entire period charged. Although the May 2003 telephone call represents particularly persuasive evidence of VanCook's deceptive state of mind, his role in Pritchard Capital's change of clearing brokers from Bear Stearns (which did not permit submission of orders after 4:00 p.m.) to Banc of America (which did permit it) as well as his use of this new capability to attract and retain hedge fund customers demonstrates that, from the origin of the scheme, VanCook acted with scienter. We therefore find that the estimate of disgorgement submitted by the Division ($538,565.70), reduced by ten percent of the value of the fees received by VanCook from Goodwin ($5,331.69), reasonably approximates his unjust enrichment.[89] We order VanCook to disgorge $533,234.01, plus prejudgment interest.[90]

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[89] *First City Fin. Corp.*, 890 F.2d at 1231 (finding that disgorgement "need only be a reasonable approximation of profits causally connected to the violation").

[90] *See Terence Michael Coxon*, 56 S.E.C. 934, 971 (2003) ("[e]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the equivalent of an interest free loan from the

(continued...)

D. Civil Penalty

Exchange Act Section 21B authorizes the Commission to impose a civil money penalty where a respondent has willfully violated any provision of the federal securities laws and a penalty is in the public interest.[91] Exchange Act Section 21B establishes a three-tiered system of civil penalties, each with a larger maximum penalty amount applicable to increasingly serious misconduct.[92] For each act or omission involving fraud that "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed the act or omission," third-tier civil penalties may be warranted.[93] In determining whether a penalty is in the public interest, we may consider whether there was fraudulent misconduct, harm to others or unjust enrichment, whether the respondent had prior violations, and the need for deterrence, as well as such other matters as justice may require.[94]

We find that a third-tier penalty is warranted here. As noted, VanCook engaged in fraud. He earned over half a million dollars in compensation from his late-trading hedge fund clients during the course of the scheme. Further, although the Division has not established the precise amount of losses suffered by the mutual fund shareholders who did not trade on post-closing information in this case, the risk of substantial loss through dilution of fund share values was significant given the number of trades (nearly 5,000 exclusive of cancelled orders) and the dollar amounts involved (most in excess of $200,000 per trade). The Exchange Act permits a third-tier penalty of up to $120,000 for each violation by a natural person committed during the relevant period.[95] However, in light of the other sanctions already imposed upon VanCook, we find that a penalty of $100,000 for the entirety of VanCook's late-trading scheme is an amount necessary to

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[90] (...continued)
wrongdoer's victims."); Commission Rule of Practice 600(a), 17 C.F.R. § 201.600(a) (noting that "[p]rejudgment interest shall be due on any sum required to be paid pursuant to an order of disgorgement" and describing method of calculation of prejudgment interest due on sums ordered to be disgorged).

[91] 15 U.S.C. § 78u-2(a).

[92] 15 U.S.C. § 78u-2(b).

[93] 15 U.S.C. § 78u-2(b)(3).

[94] 15 U.S.C. § 78u-2(c).

[95] Violations committed by a natural person after February 2, 2001, but before February 14, 2005, have a maximum penalty per occurrence of $6,500 in the first tier; $60,000 in the second tier; and $120,000 in the third tier. *See* Debt Collection Improvement Act of 1996, Pub. L. No. 104-134, ch. 10, sec. 31001, § 3701(a)(1); 28 U.S.C. § 2461 (effective Mar. 9, 2006); 17 C.F.R. §§ 201.1001, 201.1002.

deter VanCook from future misconduct given his failure to appreciate his responsibilities as a securities professional, and will also have a remedial effect of deterring others from engaging in the same misconduct.[96]

E. VanCook's Arguments Against Sanctions

VanCook claims that he cannot pay the disgorgement and prejudgment interest "together with the $100,000 penalty." For the first time in these proceedings, he offers sworn financial statements purporting to document his financial situation. Under Rule of Practice 630(a), we may, in our discretion, consider evidence of ability to pay in determining whether a respondent should be required to pay disgorgement, interest, or civil penalties.[97] Ability to pay, however, is only one factor that informs our determination and is not dispositive.[98] In particular, "[e]ven when a respondent demonstrates an inability to pay, we have discretion not to waive the penalty, [disgorgement, or interest,] particularly when the misconduct is sufficiently egregious."[99]

We have reviewed the financial statements submitted by VanCook. Those statements show that VanCook has a positive net worth of nearly $400,000 and that he earned over $200,000 working for broker-dealers in the twelve months prior to filing his financial statements. We are not persuaded, therefore, that VanCook is unable to pay the sanctions imposed. Moreover, VanCook's conduct was sufficiently egregious to outweigh any consideration of his inability to pay disgorgement, prejudgment interest, or penalties.[100] Ordering VanCook to pay disgorgement plus prejudgment interest and a third-tier penalty of $100,000 is necessary to

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[96] We note that the Division of Enforcement requested that the law judge impose a civil penalty equal to the amount of disgorgement ($538,565.70). The law judge instead ordered a $100,000 penalty, as do we. In its brief before us, the Division stated that it believed the penalty imposed by the law judge "is reasonable and in the public interest."

[97] 17 C.F.R. § 201.630(a).

[98] *See, e.g.*, *Brian A. Schmidt*, 55 S.E.C. 576, 597-98 (2002) (noting that, under Exchange Act Section 21B, ability to pay a penalty is but one factor to consider in determining whether a penalty is in the public interest); *see also, e.g.*, *SEC v. Warren*, 534 F.3d 1368, 1370 (11th Cir. 2008) (per curiam) (stating that "[a]t most" a defendant's ability to pay is one factor to be considered in imposing a civil money penalty or disgorgement for violations of the federal securities laws).

[99] *Philip A. Lehman*, Exchange Act Rel. No. 54660 (Oct. 27, 2006), 89 SEC Docket 536, 543.

[100] *See, e.g.*, *Disraeli*, 92 SEC Docket at 883 (finding that respondent's misconduct was sufficiently egregious and outweighed any financial information submitted in support of his asserted inability to pay the disgorgement and penalty amounts) & n.125 (collecting cases).

prevent him from profiting from his misconduct and to deter him and others from defrauding mutual funds and their shareholders through illegal and deceptive trading practices.

VanCook also argues that the sanctions imposed against him are excessive compared to the sanctions imposed on other respondents involved in these proceedings. VanCook cites specifically to the sanctions to which Pillai, Pritchard, and McMahon consented in settling Commission proceedings against them.[101] It is well-established that the determination of appropriate remedial action depends on the facts and circumstances of each case and cannot be determined by comparison with the actions taken in other proceedings.[102] "Moreover, parties that settle disciplinary proceedings often receive less severe sanctions than those who do not."[103] VanCook argues that "a respondent who takes his case to a hearing should not be subject to a disproportionate and massive penalty for having the temerity to defend himself." However, the sanctions that are imposed in settled cases are the result of a myriad "pragmatic considerations such as the avoidance of time- and manpower-consuming adversarial litigation" that enter into decisions to accept offers of settlement from respondents.[104] For this reason they

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101 *See supra* notes 18, 20 & 27. Pillai consented to a cease-and-desist order, twelve-month suspension from association with an investment adviser, $1 disgorgement order, and $150,000 civil penalty. *Millennium Capital Partners, L.P.*, 86 SEC Docket at 2421. Pritchard consented to a nine-month suspension from serving in a supervisory capacity and agreed to pay a $50,000 civil penalty. *Pritchard Capital Partners*, 93 SEC Docket at 5310. McMahon consented to a censure and a cease-and-desist order. *Id.*

102 *See Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) (stating that "[t]he employment of a sanction within the authority of an administrative agency is thus not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases"); *Geiger*, 363 F.3d at 488 (stating that "[t]he Commission is not obligated to make its sanctions uniform, so we will not compare this sanction to those imposed in previous cases").

103 *Ficken*, 94 SEC Docket at 10893 & n.31 (citing cases).

104 *Lehman*, 89 SEC Docket at 550.

cannot be meaningfully compared to the sanctions imposed in litigated cases, which are the result of fact-specific considerations of various factors designed to best protect the public interest. Accordingly, we reject VanCook's argument that we should reduce his sanctions based on those imposed in settlements with other individuals.

An appropriate order will issue.[105]

By the Commission (Chairman SCHAPIRO and Commissioners CASEY, WALTER, and PAREDES; Commissioner AGUILAR not participating).

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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[105] 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. 61039A / November 20, 2009

Admin. Proc. File No. 3-12753

In the Matter of

JOSEPH JOHN VANCOOK

c/o Lewis D. Lowenfels, Esq.
Law Offices of Tolins & Lowenfels
747 Third Avenue
New York, NY 10017

and

Michael J. Sullivan, Esq.
Coughlin Duffy LLP
350 Mount Kemble Avenue
Morristown, NJ 07962

CORRECTED

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that Joseph VanCook be, and he hereby is, barred from association with any broker or dealer; and it is further

ORDERED that VanCook cease and desist from committing or causing any violations or future violations of Sections 10(b) and 17(a)(1) of the Exchange Act of 1934, and Exchange Act Rules 10b-5 and 17a-3(a)(6); and it is further

ORDERED that VanCook disgorge $533,234.01, plus prejudgment interest of $228,901.89, such prejudgment interested calculated beginning from August 1, 2003, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that VanCook pay a civil money penalty in the amount of $100,000.

Payment of the amount to be disgorged and the civil money penalty 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 William P. Hicks, Division of Enforcement, Securities and Exchange Commission, Atlanta Regional Office, 3475 Lenox Road, Suite 1000, Atlanta, Georgia 30326.

By the Commission.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 2953 / November 20, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13693

In the Matter of **DAVID L. HERSH,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against David L. Hersh ("Hersh" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Section III.2 below, which are admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

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

1. Respondent, 40 years old, is a resident of Wendell, North Carolina. During 2007 and 2008, Respondent acted as an unregistered investment adviser.

2. On November 2, 2009, a final judgment was entered by consent against Respondent, permanently enjoining him from future violations of Sections 5(a), 5(c), and 17(a) of the Securities Act of 1933 ("Securities Act"), Section 10(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled Securities and Exchange Commission v. David L. Hersh, Civil Action Number 5:09-cv-417, in the United States District Court for the Eastern District of North Carolina.

3. The Commission's complaint alleged that Respondent offered and sold securities to unsophisticated investors on the basis of misrepresentations and omissions of material fact to fund an options trading scheme. Respondent pooled investor funds and diverted some of the funds for his personal use. Respondent knowingly misrepresented the expected returns from the options trading scheme to existing and potential investors and did not disclose the related trading risks. Respondent routinely created and used fraudulent documents to mislead existing and potential investors. The complaint also alleged that Respondent sold unregistered securities. The complaint alleged that Respondent thereby violated Sections 5(a), 5(c), and 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 thereunder. Respondent consented to the entry of the final judgment of permanent injunction without admitting or denying the allegations contained in the Commission's complaint, except as to jurisdiction and venue.

IV.

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

Accordingly, it is hereby ORDERED:

Pursuant to Section 203(f) of the Advisers Act, that Respondent Hersh be, and hereby is barred from association with any investment adviser.

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.

Elizabeth M. Murphy
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 243

[Release No. 34-61050; File No. S7-04-09]

RIN 3235-AK14

Amendments to Rules for Nationally Recognized Statistical Rating Organizations

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

ACTION: Final rules.

SUMMARY: The Commission is adopting rule amendments that impose additional disclosure and conflict of interest requirements on nationally recognized statistical rating organizations ("NRSROs") in order to address concerns about the integrity of the credit rating procedures and methodologies at NRSROs.

DATES: Effective Date: [**insert date 60 days after publication in the Federal Register**].

Compliance Date: [**insert date 180 days after publication in the Federal Register**]

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SUPPLEMENTARY INFORMATION:

I. BACKGROUND

A. Prior Commission Actions

On June 16, 2008, the Commission, in the first of three related actions, proposed a series of amendments to its existing rules governing the conduct of NRSROs under the Securities Exchange Act of 1934 ("Exchange Act") as well as a new rule mandating additional requirements for NRSROs.[1] The proposed amendments in the June 2008 Proposing Release were designed to further the purposes of the Credit Rating Agency Reform Act of 2006 ("Rating Agency Act") to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.[2] More particularly, they were designed to enhance the transparency and objectivity of the NRSRO credit rating process generally

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1 See Proposed Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 57967 (June 16, 2008), 73 FR 36212 (June 25, 2008) ("June 2008 Proposing Release"). The Commission adopted the initial set of NRSRO rules in June 2007. See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564 (June 18, 2007) ("June 2007 Adopting Release"). The second action taken by the Commission (also on June 16, 2008) was to propose a new rule that would require NRSROs to distinguish their ratings for structured finance products from other classes of credit ratings by publishing a report with the rating or using a different rating symbol. See June 2008 Proposing Release. The third action taken by the Commission was to propose a series of amendments to rules under the Exchange Act, the Securities Act of 1933 ("Securities Act"), the Investment Company Act of 1940 ("Investment Company Act"), and the Investment Advisers Act of 1940 that would eliminate references to NRSRO credit ratings in certain rules. See References to Ratings of Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 58070 (July 1, 2008), 73 FR 40088 (July 11, 2008); Securities Ratings, Securities Act Release No. 8940 (July 1, 2008), 73 FR40106 (July 11, 2008); References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28327 (July 1, 2008), 73 FR 40124 (July 11, 2008).

2 See Credit Rating Agency Reform Act of 2006, Pub. L. No. 109-291; Report of the Senate Committee on Banking, Housing, and Urban Affairs to Accompany S. 3850, Credit Rating Agency Reform Act of 2006, S. Report No. 109-326, 109th Cong., 2d Sess. (Sept. 6, 2006) ("Senate Report"), p. 2.

and in particular with respect to rating structured finance products,[3] to increase competition among NRSROs, and to make it easier for market participants to assess the credit ratings performance of NRSROs. For example, the amendments, as proposed, would have required NRSROs to make additional public disclosures about their methodologies for determining structured finance ratings, publicly disclose the histories of their ratings, and make additional internal records and furnish additional information to the Commission in order to assist staff examinations of NRSROs. The proposals also would have prohibited NRSROs and their analysts from engaging in certain activities that could impair their objectivity, such as recommending how to obtain a desired rating and then rating the resulting security.

On February 2, 2009, the Commission adopted, with revisions, a majority of the rule amendments proposed in the June 2008 Proposing Release.[4] Concurrently with the adoption of those final rule amendments, the Commission proposed additional amendments to paragraph (d) of Rule 17g-2 with respect to the disclosure of ratings histories. The Commission also re-proposed with substantial modifications amendments to paragraphs (a) and (b) of Rule 17g-5, a new paragraph (e) to Rule 17g-5, and a conforming amendment to Regulation FD.[5]

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3 The term "structured finance product" as used throughout this release refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. This broad category of financial instrument includes, but is not limited to, asset-backed securities such as residential mortgage-backed securities ("RMBS") and to other types of structured debt instruments such as collateralized debt obligations ("CDOs"), including synthetic and hybrid CDOs, or collateralized loan obligations ("CLOs").

4 See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342 (February 2, 2009), 74 FR 6456 (February 9, 2009) ("February 2009 Adopting Release").

5 See Re-proposed Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59343 (February 2, 2009), 74 FR 6485 (February 9, 2009) ("February 2009 Proposing Release").

Today, the Commission is adopting, with revisions, the rule amendments proposed in the February 2009 Proposing Release.

B. Summary of the Comments and Final Rules

In enacting the Rating Agency Act, which provides the Commission with the authority to establish a registration and oversight program for NRSROs, Congress cited as its purpose "to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."[6] The Commission seeks to further the purposes of Congress in enacting the Rating Agency Act. The rule amendments being adopted today are designed to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry. In the June 2008 Proposing Release, the Commission cited concerns about the integrity of NRSROs' credit rating procedures and methodologies in light of the role they played in the credit market turmoil.[7] As discussed throughout this release, the amendments being adopted today continue the Commission's process of addressing concerns about the integrity of the credit rating procedures and methodologies at NRSROs. The amendments incorporate most aspects of the proposed and re-proposed amendments but include several revisions based on the comments received.

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6 See Senate Report p. 2; Rating Agency Act §2 (Finding 5).

7 See June 2008 Proposing Release, 73 FR at 36213-36218.

The Commission received letters from 31 commenters[8] on the proposed and re-proposed amendments set forth in the February 2009 Proposing Release.[9] Several

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8 On April 15, 2009, the Commission held a Roundtable to Examine Oversight of Credit Rating Agencies ("Roundtable"). A number of the letters and statements submitted in connection with the Roundtable commented on the proposed rule amendments contained in the February 2009 Proposing Release and are discussed herein. All comments submitted in connection with the Roundtable are available on the Commission's Internet Web site, located at http://www.sec.gov/comments/s7-04-09/s70409.shtml and in the Commission's Public Reference Room in its Washington, DC headquarters.

9 Letter dated February 26, 2009 from Mike Marchywka ("Marchywka Letter"); letter dated March 5, 2009 from Shawn S. Fahrer, Student, CUNY ("Fahrer Letter"); letter dated March 8, 2009 from Russell D. Sears ("Sears Letter"); letter dated March 18, 2009 from Takefumi Emori, Managing Director, Japan Credit Rating Agency, Ltd. ("JCR Letter"); letter dated March 25, 2009 from Laurel N. Leitner, Analyst, Council of Institutional Investors ("Council Letter"); letter dated March 25, 2009 from Mary Keogh, Managing Director, Regulatory Affairs and Daniel Curry, President, DBRS, Inc. ("DBRS Letter"); letter dates March 25, 2009 from Richard Whiting, Executive Director and General Counsel, Financial Services Roundtable ("FSR Letter"); letter dated March 25, 2009 from Charles D. Brown, General Counsel, Fitch Ratings ("Fitch Letter"); letter dated March 26, 2009 from Gregory W. Smith, General Counsel, Colorado Public Employees' Retirement Association ("Colorado PERA Letter"); letter dated March 26, 2009 from Douglas Adamson, Executive Vice President, American Bankers Association ("ABA Letter"); letter dated March 26, 2009 from George Miller, Executive Director and Sean C. Davy, Managing Director, American Securitization Forum and Securities Industry and Financial Markets Association ("ASF/SIFMA Letter"); letter dated March 26, 2009 from Karrie McMillan, General Counsel, Investment Company Institute ("ICI Letter"); Letter dated March 26, 2009 from John P. Hunt, Acting Professor of Law, University of California, Davis ("Hunt Letter"); letter dated March 26, 2009 from Cate Long, Multiple-Markets ("Multiple-Markets Letter"); letter dated March 26, 2009 from Hidetaka Tanaka, Senior Executive Managing Director, Rating and Investment Information, Inc. ("R&I Letter"); letter dated March 27, 2009 from Vickie A. Tillman, Executive Vice President, Standard and Poor's Investment Ratings Services ("S&P Letter"); letter dated March 28, 2009 from Michel Madelain, Chief Operating Officer, Moody's Investor Service, Moody's ("Moody's Letter"); letter dated March 31, 2009 from Robert G. Dobilas, CEO and President, Realpoint, LLC. ("Realpoint Letter"); letter dated April 2, 2009 from Keith F. Higgins, Chair, Committee on Federal Regulation of Securities, American Bar Association Section of Business Law ("ABA Committee Letter") (representing views of the Committee, not the American Bar Association); letter dated April 3, 2009 from Dottie Cunningham, CEO, Commercial Mortgage Securities Association ("CMSA Letter"); letter dated May 19, 2009 from Lawrence A. Pingree, SiliconValleyForex.com ("Pingree Letter"); statement by Gregory W. Smith, General Counsel, Colorado Public Employees' Corporation, submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("Colorado PERA Statement"); statement by Deborah A. Cunningham, Executive Vice President, Chief Investment Officer, Federated Investors, Inc., submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("Federated Statement"); statement by Glenn Reynolds, CEO, CreditSights, Inc., submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("CreditSights Statement"); statement by Alex J. Pollock, Resident Fellow, American Enterprise Institute, submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("AEI Statement"); statement by Raymond W. McDaniel, CEO and President, Moody's Investor Service submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("Moody's Statement"); statement by Robert G. Dobilas, President and CEO, Realpoint, Inc., submitted for U.S. Securities and Exchange Commission Roundtable to

commenters expressed general support for the proposed measures and the goals they were designed to achieve.[10] Commenters expressed support, for example, for the Commission's efforts to increase transparency[11] and foster competition within the credit ratings industry.[12] Other commenters, however, expressed concerns about the potential negative effects of the proposed and re-proposed rule amendments.[13] Those comments included concerns that action more vigorous than that proposed by the Commission was needed to improve the quality of credit ratings[14] and to facilitate investors' independent

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Examine Oversight of Credit Rating Agencies (April 15, 2009) ("Realpoint Statement"); statement by Ethan Berman, RiskMetrics Group, submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("RiskMetrics Statement"); statement by Daniel Curry, President, DBRS Inc., submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("DBRS Inc. Statement"); Statement by Paul Schott Stevens, President and CEO, Investment Company Institute, submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("ICI Statement"); statement by Sean Egan, Co-Founder and Managing Director, Egan-Jones Rating Co., submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("Egan-Jones Statement"); statement by James A. Kaitz, President and CEO, Association for Financial Professionals, submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("AFP Statement"); statement by George P. Miller, Executive Director, American Securitization Forum, submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("ASF Statement"); statement by James H. Gellert, President and CEO, and Dr. Patrick James Caragata, Founder and Executive Vice Chairman, Rapid Ratings International, Inc., submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("Rapid Ratings Statement"); statement by Richard H. Baker, Managed Funds Associates, submitted for U.S. Securities and Exchange Commission Roundtable to Examine Oversight of Credit Rating Agencies (April 15, 2009) ("MFA Statement"); letter dated June 1, 2009 from Christine DiFabio, Vice President, Advocacy and Accounting Policy, Financial Executives International ("FEI Letter"); letter dated June 12, 2009 from Curtis C. Verschoor, L Q Research Professor, School of Accountancy, DePaul University ("Verschoor Letter"). These comments are available on the Commission's Internet Web site, located at http://www.sec.gov/comments/s7-04-09/s70409.shtml and in the Commission's Public Reference Room in its Washington, DC headquarters.

10 See, e.g., Marchywka Letter; Council Letter; Colorado PERA Letter; R&I Letter; ABA Committee Letter; Pingree Letter; Realpoint Statement; FEI Letter.

11 See ABA Committee Letter; Pingree Letter; Realpoint Statement.

12 See Colorado PERA Letter.

13 See, e.g., Fahrer Letter; DBRS Letter; ICI Letter; Hunt Letter; Moody's Letter; DBRS Statement; Verschoor Letter

14 See Hunt Letter.

analysis of the products underlying such ratings,[15] as well as the concern that increased competition would not necessarily increase the quality of credit ratings.[16]

The Commission notes that in addition to citing fostering competition in the credit rating industry as one of the purposes of the Rating Agency Act, Congress stated its finding in the Rating Agency Act that "additional competition [among credit rating agencies] is in the public interest."[17] In seeking to increase competition, the Commission seeks to further the purposes of Congress in enacting the Rating Agency Act.

In summary, the Commission is adopting amendments to paragraph (d) of Rule 17g-2 and paragraphs (a) and (b) of Rule 17g-5 as well as a new paragraph (e) of Rule 17g-5 and a conforming amendment to Regulation FD.[18] The amendments to paragraph (d) of Rule 17g-2 require a broader disclosure of credit ratings history information. Specifically, as adopted in the February 2009 Adopting Release, paragraph (d) of Rule 17g-2 requires the disclosure of ratings actions histories, in eXtensible Business Reporting Language ("XBRL") format, for 10% of the ratings in each class for which the NRSRO has registered and for which it has issued 500 or more credit ratings paid for by the issuer, underwriter, or sponsor of the security being rated ("issuer-paid" credit ratings), with each required disclosure of a new ratings action to be made no later than six months after the ratings action is taken (hereinafter sometimes referred to as the "10% requirement").[19] The amendments being adopted today add the requirement that an

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15 See ICI Letter.

16 See Fahrer Letter; Hunt Letter.

17 See Rating Agency Act §2.

18 17 CFR 243.100, 243.101, 243.102 and 243.103.

19 See February 2009 Adopting Release, 74 FR at 6460-6462. As discussed in greater detail below, due to the fact that the Commission has not yet published the List of XBRL Tags for NRSROs on its Internet Web site, on August 5, 2009, the Commission provided notice that an NRSRO subject to those disclosure provisions can satisfy the requirement to make publicly available ratings history information in an XBRL format by using an XBRL format or any other machine-readable

NRSRO disclose ratings action histories for all credit ratings initially determined on or after June 26, 2007 in an interactive data file that uses a machine-readable format (hereinafter sometimes referred to as the "100% requirement"). In the case of issuer-paid credit ratings, each new ratings action will be required to be reflected in such publicly disclosed histories no later than twelve months after it is taken, while in the case of ratings actions that are not issuer-paid, each new ratings action will be required to be reflected no later than twenty-four months after it is taken.[20] An NRSRO will be allowed to use any machine-readable format to make this data publicly available until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in the XBRL format using the Commission's List of XBRL Tags for NRSROs. This new disclosure requirement applies to all NRSRO credit ratings regardless of the business model under which they are determined. Consequently, the new requirement applies to all types of credit ratings regardless of whether they are issuer-paid credit ratings, credit ratings made available only to subscribers ("subscriber-paid" credit ratings), or credit ratings generated on an unsolicited basis and made publicly available ("unsolicited" credit ratings).

The amendments to paragraphs (a) and (b) of Rule 17g-5 being adopted today, substantially as proposed in the February 2009 Proposing Release, require an NRSRO that is hired by issuers, sponsors, or underwriters (hereinafter collectively "arrangers") to determine an initial credit rating for a structured finance product to (1) disclose to non-hired NRSROs that have furnished the Commission with the certification described

format, until such time as the Commission provides further notice. See infra, note 99 and accompanying text.

20 See 17 CFR 240.17g-2(d).

below that the arranger is in the process of determining such a credit rating and (2) to obtain representations from the arranger that the arranger will provide information given to the hired NRSRO to the non-hired NRSROs that have furnished the Commission with the certification described below.[21] In addition, the new paragraph (e) of Rule 17g-5 being adopted today, as proposed in the February 2009 Proposing Release, requires an NRSRO seeking to access information provided by an arranger to a hired NRSRO and made available to other NRSROs pursuant to the amended rule to furnish the Commission with an annual certification that the NRSRO is accessing the information solely to determine credit ratings and will determine a minimum number of credit ratings using that information.[22] Finally, the amendment to Rule 100(b)(2)(iii) of Regulation FD being adopted today, substantially as proposed in the February 2009 Proposing Release, accommodates the new disclosure requirements under Rule 17g-5 by permitting the disclosure of material non-public information to an NRSRO regardless of whether the NRSRO makes its ratings publicly available.[23]

In order to allow NRSROs sufficient time to implement the new disclosure requirements, the compliance date of the amendments is delayed until 180 days after publication in the Federal Register. The Commission notes that it used the same time period for compliance with the 10% disclosure requirement pursuant to Rule 17g-2.[24] While certain NRSROs already are complying with the 10% disclosure requirement, the Commission notes that the 100% disclosure requirements being adopted are an expansion of the current 10% disclosure requirements for issuer-paid credit ratings and for the first

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21 See 17 CFR 240.17g-5(a)(3) and (b)(9).

22 See 17 CFR 240.17g-5(e).

23 See 17 CFR 243.100(b)(2)(iii).

24 See February 2009 Adopting Release, 74 FR at 6461.

time will require all NRSROs to disclose ratings history. Therefore, with respect to the requirements under Rule 17g-5, the Commission believes the compliance date is appropriate in order to allow the NRSROs and arrangers sufficient time to implement the new disclosure requirements.

II. FINAL AMENDMENTS TO RULE 17g-2

A. Summary and Background

Rule 17g-2 requires an NRSRO to make and retain certain records relating to its business and to retain certain other records made in the normal course of business operations. The rule also prescribes the time periods and manner in which these records are required to be retained and, as described below, requires certain of those records regarding ratings histories to be publicly disclosed.[25] The Commission is adopting today additional amendments to paragraph (d) of Rule 17g-2 to enhance the requirements in the rule to publicly disclose these records of credit rating histories for the purpose of providing users of credit ratings, investors, and other market participants and observers the raw data with which to compare the credit ratings performance of NRSROs by showing how different NRSROs initially rated an obligor or security and, subsequently, adjusted those ratings, including the timing of the adjustments.

Paragraph (a)(8) to Rule 17g-2 requires an NRSRO to make and retain, as part of its internal records that are available to Commission staff, a record of the ratings history of each outstanding credit rating it maintains showing all rating actions (initial rating, upgrades, downgrades, placements on watch for upgrade or downgrade, and withdrawals) and the date of such actions identified by the name of the security or obligor rated and, if applicable, the CUSIP for the rated security or the Central Index Key (CIK) number for

[25] See 17 CFR 240.17g-2.

the rated obligor.[26] Paragraph (d) of Rule 17g-2 requires an NRSRO to make publicly available in an XBRL format ratings action histories for 10% of the outstanding issuer-paid credit ratings required to be retained pursuant to paragraph (a)(8), selected on a random basis, for each class of credit rating for which it is registered and for which it has issued 500 or more issuer-paid credit ratings, with each required disclosure of a new ratings action to be made no later than six months after the ratings action is taken.[27] Exhibit 1 of Form NRSRO requires an NRSRO subject to the public disclosure requirements of Rule 17g-2(d) to indicate in the exhibit the Web address where the XBRL Interactive Data File with the required information can be accessed.[28]

While paragraph (a)(8) of Rule 17g-2 and the amendments to Exhibit 1 were adopted in the February 2009 Adopting Release substantially as proposed, paragraph (d) of Rule 17g-2, as adopted, reflected modifications from the originally proposed amendment. Specifically, as proposed, the rule would have required an NRSRO to make ratings actions histories publicly available on its corporate Web site in XBRL format for 100% of outstanding credit ratings six months after the date of the rating action, regardless of whether the credit ratings were issuer-paid, subscriber-paid, or unsolicited.[29] The rule as adopted, however, limited this required ratings history disclosure to 10% of the outstanding issuer-paid credit ratings required to be retained pursuant to paragraph (a)(8) of Rule 17g-2 for each class of credit rating for which the NRSRO is registered and for which it has issued 500 or more issuer-paid credit ratings, with each required

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26 See February 2009 Adopting Release; 17 CFR 240.17g-2(a)(8).

27 See February 2009 Adopting Release; 17 CFR 240.17g-2(d).

28 See February 2009 Adopting Release; Instructions to Form NRSRO.

29 See June 2008 Proposing Release, 73 FR at 36228-36230.

disclosure of a new ratings action to be disclosed no later than six months after the ratings action is taken.[30]

In the February 2009 Proposing Release, the Commission stated that the amendments to paragraph (d) of Rule 17g-2 adopted in the February 2009 Adopting Release would provide users of credit ratings with information to begin assessing the performance of NRSROs subject to the rule.[31] The Commission also stated in the February 2009 Proposing Release that it continued to believe that the proposed amendments to paragraph (d) of Rule 17g-2 set forth in the June 2008 Proposing Release, which would have required public disclosure of ratings action histories for all outstanding credit ratings, could provide substantial benefits to users of credit ratings.[32] However, the Commission wanted to solicit further comment on the proposed amendments to the rule in order to gain a better understanding of how they would impact NRSROs operating under the issuer-paid and subscriber-paid business models.[33]

Consequently, the Commission re-proposed amendments to paragraph (d) that would require disclosure of ratings histories for 100% of the issuer-paid credit ratings outstanding. In addition, the Commission asked a series of detailed questions to elicit information about how the rule proposal would impact issuer-paid NRSROs and whether the rule should be expanded to apply to all credit ratings: issuer-paid, subscriber-paid, and unsolicited.[34]

The amendments proposed in the February 2009 Proposing Release would have created three new subparagraphs to paragraph (d) of Rule 17g-2: (d)(1), (d)(2), and

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30 17 CFR 240.17g-2(d).

31 See February 2009 Proposing Release, 74 FR at 6487-6488.

32 See February 2009 Proposing Release, 74 FR at 6487-6488.

33 See February 2009 Proposing Release, 74 FR at 6487-6490.

34 See February 2009 Proposing Release, 74 FR at 6488-6490.

(d)(3). Paragraphs (d)(1) and (d)(2) would have contained the text of paragraph (d) as adopted in the February 2009 Adopting Release. Specifically, paragraph (d)(1) would have contained the record retention requirements of paragraph (d) as originally adopted by the Commission in the June 2007 Adopting Release.[35] Paragraph (d)(2) would have contained the 10% ratings history disclosure requirements adopted by the Commission in the February 2009 Adopting Release.[36] Finally, paragraph (d)(3) would have contained the new requirement that NRSROs disclose, in XBRL format, ratings history information for 100% of their outstanding issuer-paid credit ratings initially determined on or after June 26, 2007 (the effective date of the Rating Agency Act). Under the proposed amendment, a credit rating action would not have needed to be disclosed until twelve months after the action was taken.[37]

The Commission received responses from twenty-three commenters addressing various aspects of the proposed amendments to paragraph (d) of Rule 17g-2 and responding to some of the questions posed by the Commission.[38] A substantial number of commenters expressed general support for expanding the public disclosure requirements for ratings history information.[39] One NRSRO, for example, stated that the proposed amendment "balances the need for adequate disclosure of historical information

35 See June 2007 Adopting Release, 72 FR at 33622; see also 17 CFR 240.17g-2(d).

36 See February 2009 Adopting Release, 74 FR at 6460-6463

37 See February 2009 Proposing Release, 74 FR at 6487-6488.

38 See JCR Letter; Council Letter; DBRS Letter; Fitch Letter; Colorado PERA Letter; ABA Letter; ASF/SIFMA Letter; ICI Letter; Hunt Letter; Multiple-Markets Letter; R&I Letter; S&P Letter; Moody's Letter; Realpoint Letter; ABA Committee Letter; CMSA Letter; Colorado PERA Statement; Federated Statement; AEI Statement; Risk Metrics Statement; DBRS Statement; ICI Statement; AFP Statement; ASF Statement; Rapid Ratings Statement; MFA Statement.

39 See, e.g., Council Letter; Fitch Letter; ASF/SIFMA Letter; ICI Letter; Hunt Letter; Multiple-Markets Letter; Colorado PERA Statement; Federated Statement; Risk Metrics Statement; AFP Statement; ASF Statement.

with the legitimate commercial concerns of the NRSROs."[40] Some commenters, however, expressed general opposition to the proposed amendments.[41] Two NRSROs, for example, questioned the Commission's authority to adopt the proposed disclosure requirements, contending that the amendments were not "narrowly tailored" and expressing concern over the potential impact the proposed requirements would have on their intellectual property interests and rights in their ratings data.[42] As discussed below, the Commission is adopting the amendments to paragraph (d) of Rule 17g-2 under its authority to require NRSROs to make and keep for specified periods such records as the Commission prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.[43] In addition, the amendments as adopted are intended to further the goals of the Rating Agency Act, fostering competition, transparency, and accountability in the credit rating industry, by striking an appropriate balance between providing users of credit ratings, investors, and other market participants and observers with a sufficient volume of raw data with which to gauge the accuracy of different NRSROs' ratings over time while at the same time addressing concerns raised by NRSROs regarding their ability to derive revenue from granting market participants access to their credit ratings and downloads of their credit ratings.

As discussed in detail below, the Commission is adopting paragraphs (d)(1) and (d)(2) substantially as proposed. However, in response to the comments received and to facilitate the ability of users of credit ratings to directly compare the ratings performance

40 See Fitch Letter.
41 See, e.g., DBRS Letter; R&I Letter; S&P Letter; Moody's Letter.
42 See S&P Letter; Moody's Letter.
43 See Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

of all NRSROs, the Commission is expanding the ratings history disclosure requirement in new paragraph (d)(3) to include ratings history information for all NRSRO credit ratings initially determined on or after June 26, 2007 (the effective date of the Rating Agency Act), whether issuer-paid, subscriber-paid, or unsolicited. The amendment as adopted requires a ratings action on an issuer-paid credit rating to be publicly disclosed no later than twelve months after it is taken, as proposed in the February 2009 Proposing Release. For ratings actions taken on ratings that are not issuer-paid, however, the amendment as adopted allows a delay of twenty-four months between the time a credit rating action is taken and the time it must be disclosed. The Commission is structuring the amendment as adopted in this manner in order to address commenters' concerns regarding the potentially disproportionate negative effects such a disclosure requirement could have on NRSROs operating under the subscriber-paid business model in the absence of a sufficiently long delay between the time a ratings action is taken - and made available to paid subscribers - and the time that ratings action must be made public.

In addition, as discussed in detail below, the Commission has not yet published the List of XBRL Tags for NRSROs on its Internet Web site. Consequently, the Commission is clarifying in the rule text of new paragraph (d)(3) of Rule 17g-2 that an NRSRO can make the required ratings history data publicly available in any machine-readable format, including XBRL, until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in XBRL format using the List of XBRL Tags for NRSROs.

B. Paragraph (d)(1) of Rule 17g-2

As adopted, paragraph (d)(1) of Rule 17g-2 consists of the record retention requirements of paragraph (d) as originally adopted by the Commission in the June 2007 Adopting Release. These requirements mandate that an NRSRO maintain an original, or a true and complete copy of the original, of each record required to be retained pursuant to paragraphs (a) and (b) of Rule 17g-2 in a manner that, for the applicable retention period specified in paragraph (c) of Rule 17g-2, makes the original record or copy easily accessible to the principal office of the NRSRO and to any other office that conducted activities causing the record to be made or received.[44] The purpose of these requirements is to facilitate Commission examination of the NRSRO and to avoid delays in obtaining the records during an on-site examination.

The Commission did not receive any comments on this proposal to codify the existing requirements of paragraph (d) as new paragraph (d)(1) and is adopting it as proposed.

C. Paragraph (d)(2) of Rule 17g-2

Paragraph (d)(2) of Rule 17g-2, as adopted, consists of the ratings history disclosure requirements adopted by the Commission in the February 2009 Adopting Release (i.e., the 10% requirement). As noted above, this provision requires an NRSRO to make publicly available, in an XBRL format, ratings action histories for 10% of the outstanding issuer-paid credit ratings required to be retained pursuant to paragraph (a)(8) of Rule 17g-2, selected on a random basis, for each class of credit rating for which it is registered and for which it has issued 500 or more issuer-paid credit ratings, with each required disclosure of a new ratings action to be made no later than six months after the ratings action is taken. Several commenters raised questions about whether it was

44 See June 2007 Adopting Release, 72 FR at 33622.

appropriate or necessary to have both a 10% requirement and a 100% requirement. In particular, two commenters stated that the proposed 100% disclosure requirement of paragraph (d)(3) to Rule 17g-2 would be duplicative of the existing 10% disclosure requirement for issuer-paid ratings in new paragraph (d)(2).[45] In addition, both of those commenters as well as a third suggested that the Commission consider the results of the 10% disclosure requirement before adopting the proposed 100% disclosure.[46] These three commenters also argued that in light of the existing 10% disclosure requirement, the amendment as proposed, including the 100% disclosure requirement, was not narrowly tailored.[47] One commenter noted that the Commission has not allowed any time to pass to be able to judge whether the existing 10% disclosure requirement will operate effectively to facilitate comparisons of the aggregate performance of issuer-paid ratings.[48] Another commenter suggested extending the 10% requirement in paragraph (d)(2) of Rule 17g-2 to all NRSROs first before adopting the 100% disclosure requirement.[49] A third commenter stated that the Commission should withdraw the 10% disclosure obligation altogether if it should decide to adopt the 100% requirement.[50]

The Commission notes that the 10% requirement and 100% requirement will provide different types of data sets with which to analyze and compare the performance of NRSROs' credit ratings. For example, the 10% requirement applies to all outstanding and future credit ratings that fall within the rule's scope (i.e., an NRSRO is required to draw its random selection of a 10% sample from its entire pool of issuer-paid credit

45 See DBRS Letter; S&P Letter.
46 See DBRS Letter; Moody's Letter; S&P Letter.
47 See DBRS Letter; Moody's Letter; S&P Letter.
48 See Moody's Letter.
49 See DBRS Letter.
50 See S&P Letter.

ratings, regardless of when the obligor or instrument was initially rated) whereas the 100% requirement is limited to outstanding credit ratings initially determined on or after June 26, 2007. Therefore, initially, the 10% requirement will provide ratings history information that is much more retrospective and will include ratings histories for credit ratings that have been outstanding for much longer periods of time. In addition, ratings actions subject to the 10% disclosure requirement must be disclosed more promptly (within six months) than ratings actions subject to the 100% requirement. The data generated by the 10% requirement will involve a longer time series of information and, therefore, is designed to aid statistical research on credit ratings performance.

The 100% ratings history disclosure requirement will result in a different data set. It will be broader in scope but more limited in time, applying only to credit ratings initially determined on or after June 26, 2007. The 100% disclosure requirement also allows for a longer delay between the time a ratings action is taken and the time it must be disclosed – twelve months for ratings actions on issuer-paid credit ratings and twenty-four months for ratings actions on ratings not issuer-paid – as opposed to the six month delay allowed under the 10% disclosure requirement. The 100% ratings disclosure will provide for a more granular comparison of the performance of an NRSRO's credit ratings. In particular, it will require ratings history disclosure for every outstanding credit rating of each NRSRO. This will permit users of credit ratings and others to take a specific debt instrument and compare the ratings history for the instrument of each NRSRO that rated it. Thus, whereas the 10% requirement will be limited to analyses using a statistical sampling, the 100% requirement will facilitate analyses of how the NRSROs each rated a specific obligor, security, or money market instrument. In addition, as discussed further below, whereas the 10% requirement is limited to issuer-paid credit ratings, the 100% requirement covers all credit ratings regardless of the business model under which they are issued, thereby allowing comparisons across and among a broader set of NRSROs. Thus, the comprehensive disclosure of ratings histories for all outstanding credit ratings will facilitate a more fundamental ratings-by-ratings comparisons across NRSROs, and will also generate data that can be used to develop independent statistical analyses of the overall performance of an NRSRO's credit ratings in total and within classes and subclasses of credit ratings (e.g., within product or industry types). This will provide users of credit ratings with more ways to analyze the performance of the NRSROs' credit ratings. The increased ability to understand how an NRSRO's credit ratings perform will further the goals of the Rating Agency Act to foster accountability, transparency, and competition in the credit rating industry.[51]

Furthermore, the Commission notes that while the 100% requirement will be useful to market participants and observers within a short period of the rule being effective (the vast majority will be available at twelve months) for the purposes of comparing the performance of different NRSROs rating the same obligors or instruments, due to the June 26, 2007 cutoff date and the longer grace periods, it will take time for the new 100% disclosure requirement to generate the comprehensive data pool necessary for thorough independent analysis and comparison of the long-term ratings performance of the NRSROs. In the meantime, the 10% requirement will provide ratings performance information on issuer-paid credit ratings (the vast majority of outstanding NRSRO credit ratings). Thus, in addition to the other benefits of retaining the 10% requirement, the

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51 See Credit Rating Agency Reform Act of 2006, Pub. L. No 109-291; Senate Report, p. 2.

ratings performance and information it provides will help bridge the gap until the 100% requirement has generated a robust set of data.[52]

In light of the different structures of the two ratings history disclosure requirements as well as the different data sets which they will provide, and the corresponding complimentary ways in which they will advance the goals of the Rating Agency Act and the Commission's rules, the Commission believes that it would be beneficial to retain the 10% ratings history disclosure requirement alongside the new 100% disclosure requirement being adopted today.

Accordingly, the Commission is adopting new paragraph (d)(2) to Rule 17g-2 as proposed.

D. Paragraph (d)(3) of Rule 17g-2

As adopted, new paragraph (d)(3) to Rule 17g-2 requires each NRSRO to disclose ratings history information for 100% of its credit ratings initially determined on or after June 26, 2007, with each ratings action to be disclosed no later than twelve months or twenty-four months after it is taken, depending on whether the rating is issuer-paid. Any ratings action information required under the 100% disclosure requirement with respect to issuer-paid credit ratings need not be made public less than twelve months from the date such ratings action is taken. A ratings action on a rating that is not issuer-paid need not be made public less than twenty-four months from the date it is taken. As noted above, this represents a modification of the proposed amendment, which would have applied the 100% disclosure requirement only to issuer-paid ratings with a twelve month grace period. The Commission requested comments on a number of specific questions

[52] According to Form NRSRO submissions by the NRSROs, issuer-paid credit ratings account for over 98% of the current credit ratings issued by NRSROs.

pertaining to this provision of the proposed amendment, and the modifications are designed to address the comments received in response to those questions.

The Commission specifically requested comment on whether the proposed 100% disclosure requirement should apply equally to issuer-paid and subscriber-paid credit ratings.[53] The Commission received letters from seventeen commenters in response to this inquiry,[54] with twelve of those commenters answering in the affirmative.[55] Several commenters argued that excluding subscriber-paid credit ratings from the proposed disclosure requirements would be inconsistent with the Commission's goals in proposing the amendment—enhancing NRSRO accountability, transparency, and competition.[56] In addition, several commenters stated that limiting the disclosure requirement to issuer-paid ratings would deprive users of the ability to assess the accuracy and integrity of subscriber-paid credit ratings.[57] Two commenters argued that limiting the rule to issuer-paid credit ratings would result in a lack of uniformity in regulatory approach and create a lack of transparency for subscriber-paid credit ratings, and therefore would not be in the best interests of investors or the capital markets.[58] One commenter in favor of expanding the disclosure requirement to include subscriber-paid credit ratings suggested allowing a

53 February 2009 Proposing Release, 74 FR at 6489

54 See Council Letter; DBRS Letter; Fitch Letter; Colorado PERA Letter; ASF/SIFMA Letter; ICI Letter; Hunt Letter; Multiple-Markets Letter; S&P Letter; Moody's Letter; Realpoint Letter; ABA Committee Letter; Colorado PERA Statement; AEI Statement; RiskMetrics Statement; DBRS Statement; ICI Statement; AFP Statement; Rapid Ratings Statement; MFA Statement

55 See Council Letter; DBRS Letter; Fitch Letter; Colorado PERA Letter; ASF/SIFMA Letter; Multiple-Markets Letter; S&P Letter; Moody's Letter; Colorado PERA Statement; RiskMetrics Statement; DBRS Statement; ICI Statement; AFP Statement; MFA Statement;.

56 See, e.g., Council Letter; Fitch Letter; Colorado PERA Letter; ASF/SIFMA Letter; S&P Letter; Moody's Letter; ICI Statement.

57 See, e.g., Council Letter; Fitch Letter; Colorado PERA Letter; ASF/SIFMA Letter; Moody's Letter; Colorado PERA Statement; MFA Statement.

58 See DBRS Statement; Moody's Letter.

longer posting delay for subscriber-paid ratings actions than for issuer-paid credit ratings.[59]

Five commenters argued that the rule should not apply to subscriber-paid credit ratings.[60] Concerns expressed by these commenters included a higher likelihood of substantial financial harm to subscriber-paid NRSROs that would arise from the required disclosures[61] and the threat of overly burdensome and costly requirements.[62] One commenter, arguing that "Subscriber-Paid competition introduces credibility back into the ratings business," warned that the Commission should be "careful not to, in the interest of being overly fair...quash the very solutions to the problems so plaguing the industry."[63]

The Commission also asked whether the rule should apply to unsolicited credit ratings.[64] The Commission received letters from nine commenters in response to this inquiry,[65] with seven responding generally in the affirmative.[66] One commenter noted that any distinction between solicited and unsolicited ratings would stigmatize unsolicited ratings and undercut the ability to foster competition,[67] while others noted that the disclosure of unsolicited ratings provides a point of comparison facilitating efforts to identify those NRSROs with conflicts of interests.[68] In contrast, one commenter stated

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59 See Multiple-Markets Letter.

60 See Hunt Letter; Realpoint Letter; ABA Committee Letter; AEI Statement; Rapid Ratings Statement.

61 See e.g., Hunt Letter; Realpoint Letter.

62 See e.g., Realpoint Letter; Rapid Ratings Statement.

63 Rapid Ratings Statement.

64 See February 2009 Proposing Release, 74 FR at 6490.

65 See Council Letter; DBRS Letter; Fitch Letter; Colorado PERA Letter ASF/SIFMA Letter; Hunt Letter; Multiple-Markets Letter; Realpoint Letter; ABA Committee Letter.

66 See Council Letter; DBRS Letter; Fitch Letter; Colorado PERA Letter; ASF/SIFMA Letter; Hunt Letter; ABA Committee Letter.

67 See Fitch Letter.

68 See e.g., Council Letter; Colorado PERA Letter.

that requiring unsolicited NRSROs to publish their ratings would "put them out of business."[69]

The Commission believes the rule should apply to all types of credit ratings, whether issuer-paid, subscriber-paid, or unsolicited. The intent of the rule is to facilitate comparisons of credit rating accuracy across all NRSROs – including direct comparisons of different NRSROs' treatment of the same obligor or instrument – in order to enhance NRSRO accountability, transparency, and competition. Excluding certain types of credit ratings issued by NRSROs from the rule's scope could undermine this goal, particularly where the exclusion effectively would remove an NRSRO entirely from the rule's scope because that NRSRO issues only the types of credit ratings not covered by the rule. Ratings history information for outstanding credit ratings is the most direct means of comparing the performance of two or more NRSROs. It allows an investor or other user of credit ratings to compare how all NRSROs that maintain a credit rating for a particular obligor or instrument initially rated that obligor or instrument and, thereafter, how and when they adjusted their credit rating over time. This will allow the person reviewing the credit rating histories of the NRSROs to reach conclusions about which NRSROs did the best job in determining an initial rating and, thereafter, making appropriate and timely adjustments to the credit rating.

For example, if three hypothetical NRSROs – X Credit Ratings Company, Y Credit Ratings Company, and Z Credit Ratings Company – each rated a hypothetical ABC Security, the 100% requirement would allow an investor to directly compare the ratings performance of those three NRSROs for that security. To illustrate, assume that when ABC Security was issued in August 2007, X Credit Ratings Company and Y Credit

69 See Realpoint Letter.

Ratings Company initially gave it their highest rating of 'AAA,' while Z Credit Ratings Company initially rated it as 'A.' Assume further that in March 2008, X Credit Ratings Company downgraded ABC Security to 'AA,' followed by a June 2008 downgrade to 'A,' while Y Credit Ratings Company maintained its 'AAA' rating for ABC Security until August 2008, at which point it downgraded it to 'A.' Assume also that Z Credit Ratings Company maintained its 'A' rating for ABC Security without change. Under the 100% disclosure requirement adopted today, an investor reviewing the ratings histories in August 2009 would be able to see that X Credit Ratings Company and Y Credit Rating Companies had, by August 2008, arrived at the same 'A' rating for ABC Security – but they will have taken significantly different paths to get to that rating:

	X Credit Ratings Company	**Y Credit Ratings Company**	**Z Credit Ratings Company**
August 2007	AAA	AAA	A
March 2008	AA	AAA	A
June 2008	A	AAA	A
August 2008	A	A	A

By examining the credit rating histories of the three hypothetical NRSROs for ABC Security, an investor will be able to perform an individual analysis of which NRSROs did the best job in determining an initial rating and in making appropriate and timely adjustments to the credit rating.

The Commission believes that the new disclosure requirements will foster greater accountability and transparency for ratings performance for NRSROs as well as competition among NRSROs by making it easier for persons to analyze the actual credit ratings performance of NRSROs in assessing creditworthiness, regardless of the business model under which an NRSRO operates. These disclosures may also enhance competition by making it easier for smaller and less established NRSROs to develop proven track records when determining credit ratings and for potential users of their ratings to evaluate the relative quality and performance of these NRSROs.

In addition to facilitating individual comparisons of NRSRO ratings performance, disclosure of ratings histories will allow market observers to generate statistics about NRSRO performance by compiling and processing the information in the aggregate. Currently, NRSROs are required to publicly disclose internally generated default and transition performance statistics in Exhibit 1 of Form NRSRO. The existing disclosure requirements of Exhibit 1, as amended in the February 2009 Adopting Release,[70] provide investors and other users of credit ratings with useful, standardized performance statistics with which to compare the performance of NRSROs. The raw data to be provided by NRSROs pursuant to the new ratings history disclosure requirements, however, will enable market participants to develop performance measurement statistics that would supplement those required to be published by the NRSROs themselves in Exhibit 1, tapping into the expertise of credit market observers and participants in order to create better and more useful means to compare the credit ratings performance of NRSROs. The ratings history disclosure requirements adopted today will facilitate the ability of individual users of credit ratings to design their own performance metrics to generate the performance statistics most meaningful to them. Users of credit ratings will benefit from the ability to generate performance statistics best suited to their individual needs.

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[70] See February 2009 Adopting Release, 74 FR at 6457-6459.

As discussed above, the arguments raised by commenters for excluding particular types of credit ratings from the rule's scope focused largely on the potential that the disclosure requirement will result in undue costs to, or have a disproportionate negative impact on the revenues of, NRSROs that issue that type of credit rating.[71] For example, NRSROs that primarily determine subscriber-paid credit ratings argued that these ratings should not be subject to the rule because it will cause subscribers to stop paying them for access to current outstanding credit ratings.[72] NRSROs that primarily determine issuer-paid and unsolicited credit ratings argued that these ratings should not be subject to a 100% disclosure requirement because it would cause persons who pay for downloadable access to their current ratings to stop paying for the service.[73] They also argued that they derive separate revenue from selling access to historical information about their outstanding credit ratings.[74]

In the February 2009 Proposing Release, the Commission asked a series of detailed questions to elicit information about whether the rule would have the impacts described above. The intent was to provide interested persons with the chance to provide more detailed comments and supply supporting quantitative data if appropriate. Although, as noted above, commenters expressed concern over the potential costs, they did not provide quantitative data as requested by the Commission.

After careful review of the comments, the Commission believes that expanding the rule to include all types of credit ratings (i.e., the ability to compare the performance of all NRSROs) will maximize its benefits to users of credit ratings. The Commission

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71 See e.g., Hunt Letter; Realpoint Letter.

72 See e.g., Realpoint Letter.

73 See e.g., JCR Letter; R&I Letter.

74 See e.g., Moody's Letter; S&P Letter.

acknowledges commenters' concerns over potential loss of NRSRO revenue, and notes that an overall drop in subscription revenues across the credit rating industry could be a sign that the rule's requirement that NRSROs publicly disclose their credit ratings histories is having the unintended effect of causing users of credit ratings to cease purchasing access to current credit ratings or downloads of current credit ratings due to the availability of ratings histories disclosed on a delayed basis.

As discussed further below, however, it is the Commission's belief that increasing the grace period between the time a ratings action is taken on a rating issued that is not issuer-paid and the time it is required to be disclosed to twenty-four months will address these concerns and mitigate any potential negative impact on such NRSRO revenues. To the extent that users of credit ratings are paying subscription fees in significant part to obtain current ratings information, ratings that are twenty-four months old likely will not constitute a sufficient substitute for current ratings information such that existing subscribers would cease to pay such subscription fees for access to current ratings information. In addition, while several NRSROs whose ratings are issuer-paid also earn revenue from payments for downloads of their ratings, the Commission understands that this revenue is a relatively small percentage of their overall revenue. The Commission believes that the twelve month delay in publication will help mitigate any effect on these revenues for the 100% disclosure requirement. As with the credit ratings that are not issuer-paid, ratings that are twelve months old likely will not constitute a sufficient substitute for current ratings information such that existing customers would cease to pay fees for access to current ratings information. Furthermore, the amended rule, as adopted, does not require the disclosure of the analysis and report that typically accompany the publication of a credit rating. NRSROs will continue to be able to distribute such information as they see fit, including selling such information to subscribers, which should also serve to mitigate any potential loss of subscribers.

Nonetheless, the Commission intends to closely monitor the impact, if any, the new disclosure requirements of the rule, as amended, have on the revenues NRSROs obtain from users purchasing access to current credit ratings or downloads of current credit ratings. Depending on what, if anything, this monitoring reveals, the Commission may re-examine the rule and, if appropriate, consider modifications designed to address the concerns of harm to NRSRO revenue derived from selling current ratings information, balanced against the concerns expressed by other commenters regarding the usefulness of ratings history disclosure to investors when such disclosure does not include more recent (and perhaps more relevant) ratings. For example, the Commission's monitoring may reveal that users of credit ratings are ceasing to purchase access to current credit ratings or downloads of current credit ratings because of the public disclosure of the histories of those ratings. Alternatively, it may reveal that investors and other users of credit ratings are continuing to pay subscription fees for access to current ratings information, thus confirming that they do not view historical ratings as an adequate substitute for such current ratings To complement the Commission's monitoring, the Commission encourages interested persons to notify the Commission of relevant developments under the new rules. For example, NRSROs should notify the Commission if they believe they are losing revenues because users of credit ratings view the twenty-four months delayed ratings action history disclosure as an adequate substitute for purchasing access to up-to-date credit ratings or downloads of up-to-date credit ratings.

The Commission notes, however, that the rule is intended to foster greater accountability and transparency of credit rating performance for NRSROs and to increase competition by allowing users of credit ratings to better assess and compare the performance of NRSROs, and other Commission rules are designed to reduce undue reliance on ratings by investors and other market participants. The increased accountability and transparency provided by the rule could cause users of credit ratings to shift their business from one NRSRO to another based on their views as to which entity provides the most accurate credit ratings. A loss of revenues by some NRSROs resulting in the gain of revenues by other NRSROs occasioned by a shift in business would not be a reason to consider modifying the rule as discussed above; indeed, it could be evidence that the rule is serving its intended purpose. A steep decrease in subscription revenues across the credit rating industry, however, could be the result of a number of factors, and the Commission would carefully examine such a decrease. Although a general decline in subscription revenue likely would reflect that investors and other market participants have less demand for ratings, such a decrease in demand would be expected if regulatory emphasis on credit ratings is reduced, investors are performing their own independent analyses, and investors had less confidence in the quality of ratings. However, a decrease in demand also could be a sign that the rule is having the unintended effect of causing users of credit ratings to cease purchasing access to current credit ratings or downloads of current credit ratings due to the availability of ratings histories disclosed on a twenty-four month delay.

To the extent NRSROs derive revenues from selling access to their ratings histories, the Commission acknowledges that the new rule may well have a negative impact on this revenue stream. As noted earlier, the amended rule, as adopted, does not require NRSROs to disclose the analysis or report that typically accompany a credit rating, which should also serve to mitigate any potential loss of subscribers to NRSROs' credit ratings histories. The Commission asked questions designed to quantify the amount of revenues derived by NRSROs from this activity but did not receive any revenue figures. However, information gathered by Commission staff over the course of discussions with NRSROs indicates that the amount of revenues they derived from selling access to ratings histories is not significant when compared to the revenues derived from other credit rating services. Nonetheless, the Commission encourages an NRSRO to notify the Commission if the rule causes a loss of this revenue source that is significant when compared to its total revenues. If that is the case, the Commission will re-examine the rule and review whether any action is appropriate.

The Commission also proposed, and requested comment on the appropriateness of, limiting the application of the proposed new disclosure requirements of paragraph (d)(3) of Rule 17g-2 to ratings initially determined on or after June 26, 2007, as well as comment on whether the data for ratings determined on or after that date would provide meaningful information to users of credit ratings. The Commission asked, alternatively, whether the final rule should apply to ratings determined on or after a different date, such as the date of enactment of the Rating Agency Act, or to all outstanding credit ratings regardless of when issued.[75] Several commenters argued in favor of expanding the rule

[75] February 2009 Proposing Release, 74 FR at 6488.

to cover all outstanding credit ratings,[76] with two stating that limiting disclosure to products initially rated on or after June 26, 2007 would exclude many of the structured finance products that contributed to the current financial crisis.[77] One commenter suggested that the rule be applied to all outstanding credit ratings starting three to five years ago,[78] while another stated that the disclosure required under the rule should include, at a minimum, the "2005 underwriting cohort."[79] One commenter, stating that there is nothing in the Rating Agency Act that imposes a time-based limit on the Commission's authority to require disclosure, argued that rating history disclosure should be required for as many ratings as possible and suggested a starting date "as early as the early 2000s" as "an absolute minimum."[80] Another commenter stated that the costs for issuer-paid NRSROs to provide ratings histories for all outstanding credit ratings would not be substantial, arguing that the data was already available in digitized form and that the conversion to the XBRL format would require relatively simple technology.[81]

Two commenters expressed their opposition to applying the proposed new disclosure rule to all outstanding credit ratings, arguing that such a requirement would entail undue costs and burdens.[82] One added that the benefit received from applying the disclosure requirements to all outstanding credit ratings would be of limited value.[83]

The Commission believes that using the date of effectiveness of the Rating Agency Act strikes an appropriate balance between the Commission's desire to maximize

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76 See, e.g., Council Letter; Fitch Letter; Colorado PERA Letter; ASF/SIFMA Letter; Hunt Letter; Multiple-Markets Letter.

77 See Colorado PERA Letter; Council Letter.

78 See ASF/SIFMA Letter.

79 See Multiple-Markets Letter.

80 See Hunt Letter.

81 See Multiple-Markets Letter.

82 See DBRS Letter; ABA Committee Letter.

83 See ABA Committee Letter.

the amount of raw data to be disclosed and the potential costs of the disclosure. The amendment as adopted limits the application of the rule's new disclosure requirements to credit ratings issued after credit rating agencies were put on notice of the effectiveness of the Commission's new regulatory authority over NRSROs. The Commission believes that using the date of effectiveness of the Rating Agency Act will permit, on a reasonable timeline, the development of a robust set of data while limiting the burden on NRSROs.

The Commission also requested comments as to whether the proposed twelve-month grace period between the time a ratings action was taken and the time it would be required to be disclosed under proposed paragraph (d)(3) of Rule 17g-2 would be sufficient to address concerns regarding the revenues NRSROs derive from selling downloads of, and data feeds to, their current issuer-paid credit ratings.[84] The Commission received twelve comments in response to these inquiries.[85] Of these, three commenters expressed agreement with the proposed twelve-month grace period,[86] with one noting that a six-month grace period would also be sufficient.[87]

The commenters expressing disagreement with the proposed time lag offered a variety of suggestions as to the appropriate period. Three commenters argued for a longer grace period, citing the negative effects on revenue they expected would arise from a twelve-month period.[88] One commenter, arguing that the required disclosure would negatively impact sales of its historical database, expressed its belief that its database sales business would not be as negatively impacted if the Commission extended

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84 February 2009 Proposing Release, 74 FR at 6488.

85 See JCR Letter; DBRS Letter; Fitch Letter; ASF/SIFMA Letter; ICI Letter; Hunt Letter; Multiple-Markets Letter; R&I Letter; S&P Letter; Realpoint Letter; ABA Committee Letter; Rapid Ratings Statement; ICI Statement.

86 See DBRS Letter; Fitch Letter; ABA Committee Letter.

87 See DBRS Letter.

88 See JCR Letter; R&I Letter; Realpoint Letter.

the time lag to at least 18 months. That commenter further expressed the belief that such a time lag would not impede third-party review of credit ratings performance.[89] One commenter suggested 36 months as the shortest possible delay to protect its subscription fees.[90] A third commenter, while stating that subscriber-paid NRSROs should never be required to disclose their ratings information, suggested a 2 to 3 year period as an alternative.[91] Two commenters argued that no grace period would be sufficient to avoid negatively impacting the revenues they derived from selling access to ratings history data.[92]

Other commenters suggested a shorter grace period,[93] with one suggesting a six month time-lag,[94] another two suggesting a three month time-lag,[95] and one suggesting immediate disclosure.[96] As noted above, one commenter supported either a six-month or twelve-month lag.[97] One commenter that supported the six month time lag expressed the belief that six months represented an appropriate balance between the private commercial interests of the NRSROs impacted and the wider public interests.[98] One commenter that supported the three-month time lag stated that the twelve-month time would not meet the stated goal of the proposal to make it easier for persons to analyze the actual performance and accuracy of NRSROs' credit ratings.[99] The other commenter supporting a three-month lag, noting that "rating information that is even three months old is extremely stale

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89 See R&I Letter.

90 See JCR Letter.

91 See Realpoint Letter.

92 See S&P Letter; Rapid Ratings Statement.

93 See DBRS Letter; ASF/SIFMA Letter; ICI Letter; Hunt Letter; Multiple-Markets Letter.

94 See DBRS Letter; ASF/SIFMA Letter.

95 See ICI Letter; Hunt Letter.

96 See Multiple-Markets Letter.

97 See DBRS Letter.

98 See ASF/SIFMA Letter.

99 See ICI Letter.

by market standards," stated that a three-month lag would be more than adequate to protect NRSROs' interest in selling data feeds and may be adequate to serve the purposes of the disclosure regime.[100] The commenter suggesting immediate disclosure argued that such disclosure was necessary to serve as a market check for "rating shopping."[101]

The amendment, as adopted, includes different grace periods depending on whether a rating is issuer-paid or not. For issuer-paid credit ratings, the amendment, as adopted, retains the proposed twelve month grace period between the time a ratings action is taken and the time it must be disclosed. This twelve month grace period is intended to provide a sufficient volume of historical credit ratings information to permit comparison of credit ratings performance without unduly affecting the revenues NRSROs derive from selling downloads of their current credit ratings and access to historic information about their outstanding credit ratings. As noted above, the Commission asked questions designed to quantify the amount of revenues derived by NRSROs from this activity but did not receive any revenue figures in response. The Commission notes, however, that one large NRSRO which primarily issues ratings under the issuer-paid business model stated that a twelve month delay would be "sufficient to protect the commercialization of ratings of any type."[102]

Based on the comments received, however, the Commission believes that a longer grace period is appropriate for ratings actions on ratings that are not issuer-paid. As such, the amendment, as adopted, allows for a delay of up to twenty-four months on ratings actions taken on such credit ratings. Issuer-paid credit ratings are generally made available on an NRSRO's Internet Web site free of charge for a designated period of

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100 See ICI Letter; Hunt Letter.

101 See Multiple-Markets Letter.

102 See Fitch Letter.

time. For the NRSROs issuing such ratings, therefore, the 100% disclosure requirement adds a requirement that the NRSRO take data that has already been made public and, after a twelve month grace period, make it permanently available in an aggregated form and in machine-readable (or later XBRL) format. In contrast, NRSROs operating under the subscriber-paid business model may only make their ratings available to paying subscribers. For these NRSROs, the 100% disclosure requirement will constitute a new disclosure, since it will require them to put into the public domain information that they generally do not make publicly available without collecting a fee.

In addition, although the Commission believes that the amended rule, as adopted, addresses the concerns raised by NRSROs regarding their ability to derive revenue from granting market participants access to their current credit ratings, the Commission also recognizes the possibility that this revenue may be negatively affected. If there were to be a negative impact, it will likely be disproportionately more significant for NRSROs that primarily or exclusively determine ratings paid for by subscribers compared to NRSROs that primarily or exclusively determine issuer-paid credit ratings.. NRSROs that determine issuer-paid credit ratings earn the majority of their revenues from fees paid by issuers, underwriters, or sponsors. On the other hand, NRSROs that primarily or exclusively issue ratings paid for by subscribers derive their revenues almost entirely from the fees they charge subscribers. If subscribers consider non-current credit ratings as a reasonable substitute for current credit ratings, they may reconsider their subscriptions. In this case, NRSROs that primarily or exclusively issue ratings paid for by subscribers are more likely to lose a more significant proportion of their revenue than NRSROs that determine issuer-paid credit ratings. The twenty-four month grace period for the disclosure of ratings actions on non-issuer paid credit ratings is designed to counterbalance this potentially disproportionate "substitution" effect. The Commission anticipates that the longer delay between the time a ratings action is taken on a non-issuer paid credit rating and the time it must be disclosed will significantly reduce the chances of users of credit ratings viewing the ratings histories to be disclosed as a viable substitute for subscribing to current credit ratings.

The parties that pay subscription fees for access to NRSRO credit ratings and who pay for access to downloadable packages of issuer-paid and unsolicited credit ratings obtain access to the NRSRO's current views on the creditworthiness of obligors and debt instruments. Based on the comments of credit rating users and staff discussions with investors, the Commission believes that it would be unlikely that those parties would reconsider their purchase of those products due to the public availability of non-current ratings action information. The ability to receive data on a ratings action twenty-four months after it takes place would not appear to be an adequate substitute for subscribing to an NRSRO's current credit ratings, nor would the ability to download current credit ratings be a substitute for downloading credit ratings that are 12 months old. The Commission further believes, however, that while increasing the length of the grace period from twelve to twenty-four months for credit ratings that are not issuer-paid will delay the emergence of the robust data set generated by the 100% disclosure requirement, the 100% disclosure requirement as adopted will have a positive effect on furthering the purposes of the Rating Agency Act to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.

Increasing the length of the grace period even further as suggested by some commenters would delay the development of a robust set of ratings history data and further reduce the ability to include more recent (and potentially relevant) ratings actions in an evaluation of ratings quality. Decreasing the grace period would increase the risk that NRSROs would lose revenues from subscribers to their current credit ratings and downloads of their current credit ratings, as well as increase the risk of lost revenues from selling access to historic information about outstanding credit ratings. The grace periods adopted (twelve and twenty-four months) are intended to strike a balance between these two concerns, taking into account the particular effects with respect to issuer-paid and non issuer-paid credit ratings as discussed above. Furthermore, as noted above, the amended rule does not require NRSROs to disclose the analysis and report that typically accompany the publication of credit ratings, which should serve to further mitigate any potential loss of subscriber revenues or downloads. However, as noted above, the Commission intends to monitor the impact on revenues resulting from this disclosure requirement, as well as the benefits generated by this requirement.

As noted above, several commenters argued that the proposed 100% disclosure requirement was not narrowly tailored.[103] The Commission notes in response that the grace periods as well as the restriction of applicability of the new disclosure requirement to ratings initially determined on or after June 26, 2007, the effective date of the Ratings Agency Act, serve to appropriately narrow the application of the new disclosure requirement. Furthermore, as discussed above, the 100% disclosure requirement will provide different information and, as a result, differing types and customization of analysis, than the 10% disclosure requirement. The 100% disclosure requirement will,

[103] See, e.g., DBRS Letter; Moody's Letter; S&P Letter.

for example, allow a more granular analysis of how NRSROs each rated a specific obligor, security, or money market instrument, thereby furthering the goals of the Rating Agency Act to foster accountability, transparency, and competition in the credit rating industry. The Commission therefore believes that the amendment, as adopted, is narrowly tailored to meet the purposes of the Exchange Act and the Rating Agency Act.

Finally, the Commission notes that it has not yet published the List of XBRL Tags for NRSROs on its Internet Web site. The disclosure requirements of paragraph (d) of Rule 17g-2 as adopted in the February 2009 Adopting Release, which require NRSROs to make publicly available, in XBRL format and on a six-month delayed basis, the ratings histories for a random sample of 10% of issuer-paid credit ratings, became effective on August 10, 2009. On August 5, 2009, the Commission provided notice that an NRSRO subject to those disclosure provisions can satisfy the requirement to make publicly available ratings history information in an XBRL format by using an XBRL format or any other machine-readable format, until such time as the Commission provides further notice.[104] Consistent with this approach, new paragraph (d)(3) as adopted will allow an NRSRO to make the required data available in an interactive data file in any machine-readable format, including XBRL, until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in XBRL format using the List of XBRL Tags for NRSROs published by the Commission.

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104 See Notice Regarding the Requirement to Use eXtensible Business Reporting Language Format to Make Publicly Available the Information Required Pursuant to Rule 17g-2(d) of the Exchange Act, Exchange Act Release No. 60451 (August 5, 2009), 74 FR 40246 (August 11, 2009).

For the reasons discussed above, the Commission is adopting the proposed new paragraph (d)(3) with the following modifications: (1) the disclosure requirement is not limited to issuer-paid credit ratings but rather applies to any type of NRSRO credit rating (i.e., issuer-paid, subscriber-paid, and unsolicited), (2) the grace period between the time a ratings action is taken and the time by which it must be disclosed has been increased from the proposed twelve months to twenty-four months for ratings actions related to non issuer-paid credit ratings, and (3) an NRSRO may make the required data available in an interactive data file in any machine-readable format, including XBRL, until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in XBRL format using the List of XBRL Tags for NRSROs.

As adopted, paragraph (d)(3)(i)(A) of Rule 17g-2 requires an NRSRO to make publicly available on its corporate Internet Web site in an interactive data file that uses a machine-readable format the ratings action information required to be retained pursuant to paragraph (a)(8) of Rule 17g-5 (the ratings history information for all current credit ratings) for any credit rating initially determined by the nationally recognized statistical rating organization on or after June 26, 2007. Paragraph (d)(3)(i)(B) of Rule 17g-2, as adopted, provides that any ratings action information required to be made and kept publicly available on the NRSRO's corporate Internet Web site pursuant to paragraph (d)(3)(i)(A) with respect to credit ratings paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated need not be made public less than twelve months from the date such ratings action is taken. Consequently, under this provision, the grace period for disclosing ratings history information for issuer-paid credit ratings is twelve months. Paragraph (d)(3)(i)(C), as adopted, provides that any ratings action information required to be made and kept publicly available on the NRSRO's corporate Internet Web site pursuant to paragraph (d)(3)(i)(A) with respect to credit ratings other than those referred to in paragraph (d)(3)(i)(B) need not be made public less than twenty-four months from the date such ratings action is taken. Consequently, under this provision, the grace period for disclosing ratings history information for any credit rating other than issuer-paid credit ratings is twenty-four months. This includes subscriber-paid credit ratings. Finally, as adopted, paragraph (d)(3)(ii) of Rule 17g-2 provides that in making the information required under paragraph (d)(3)(i)(A) available in an interactive data file on its corporate Internet Web site, the NRSRO shall use any machine-readable format, including but not limited to XBRL format, until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO shall make this information available in an interactive data file on its corporate Internet Web site in XBRL format using the List of XBRL Tags for NRSROs as published by the Commission on its Internet Web site.

The Commission is adopting these amendments, in part, under authority to require NRSROs to make and keep for specified periods such records as the Commission prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.[105] The Commission believes the new recordkeeping and disclosure requirements are necessary and appropriate in the public interest and for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.

105 See Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

As discussed above, the Commission recognizes that the amended rule could affect the revenues of NRSROs. Nevertheless, the Commission believes that the amended rule, as adopted, strikes an appropriate balance in furthering the purposes of the Rating Agency Act to increase transparency, accountability, and competition in the credit rating industry by providing users of credit ratings, investors, and other market participants and observers with the maximum amount of raw data with which to gauge the performance of NRSROs over time without unduly affecting NRSROs' ability to derive revenue from granting market participants access to their credit ratings and downloads of their credit ratings.

Accordingly, the Commission is adopting the amendments to paragraph (d) of Rule 17g-2 with the modifications discussed above.

III. FINAL AMENDMENTS TO RULE 17g-5 AND REGULATION FD

A. Summary and Background

Rule 17g-5[106] identifies a series of conflicts of interest arising from the business of determining credit ratings. Under the rule, some of these conflicts must be disclosed and managed, while others are prohibited outright. In the June 2008 Proposing Release, the Commission proposed amending the rule to place additional requirements with respect to the conflict of being paid by the arranger of a structured finance product to rate the product as well as three new categories of conflicts of interest to be prohibited outright.[107] In the February 2009 Adopting Release, the Commission adopted the three

[106] 17 CFR 240.17g-5.

[107] See June 2008 Proposing Release, 73 FR at 36128-36228. The Commission's set of initial regulations implementing the Rating Agency Act designated eight types of conflicts of interest required to be disclosed and managed and prohibited outright four types of conflicts of interest. See June 2007 Adopting Release, 72 FR at 33595-33599.

new categories of prohibited conflicts of interest.[108] The Commission did not, however, adopt the new requirements that would have been triggered by the conflict of being paid by an arranger to rate a structured finance product. Instead, in the February 2009 Proposing Release, the Commission re-proposed the amendments with substantial modifications.[109] As discussed in detail below, the Commission is adopting the amendments substantially as re-proposed.

In the June 2008 Proposing Release, the Commission proposed to amend paragraph (b) of Rule 17g-5 by re-designating the existing paragraph (b)(9) of the rule as (b)(10) and creating a new paragraph (b)(9) identifying the conflict: issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument.[110] In connection with specifying this type of conflict, the Commission proposed amendments to paragraph (a) of Rule 17g-5 that would have established additional conditions – beyond disclosing the conflict and establishing procedures to

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108 See February 2009 Adopting Release, 74 FR at 6465-6469. The three new categories of conflicts of interest prohibited outright are 1) issuing or maintaining a credit rating with respect to an obligor or security where the NRSRO or a person associated with the NRSRO made recommendations to the obligor or the issuer, underwriter, or sponsor of the security about the corporate or legal structure, assets, liabilities, or activities of the obligor or issuer of the security, 2) issuing or maintaining a credit rating where the fee paid for the rating was negotiated, discussed, or arranged by a person within the NRSRO who has responsibility for participating in determining or approving credit ratings or for developing or approving procedures or methodologies used for determining credit ratings, including qualitative and quantitative models, and 3) issuing or maintaining a credit rating where a credit analyst who participated in determining or monitoring the credit rating, or a person responsible for approving the credit rating received gifts, including entertainment, from the obligor being rated, or from the issuer, underwriter, or sponsor of the securities being rated, other than items provided in the context of normal business activities such as meetings that have an aggregate value of no more than $25.

109 See February 2009 Proposing Release, 74 FR at 6493-6497.

110 See June 2008 Proposing Release, 73 FR at 36219-36226, 36251.

manage it – that would need to be met for an NRSRO to issue or maintain a credit rating subject to this conflict.[111]

Specifically, the Commission proposed a new paragraph (a)(3) in the June 2008 Proposing Release that would have required, as a condition to the NRSRO rating a structured finance product, that the information provided to the NRSRO and used by the NRSRO in determining an initial credit rating and, thereafter, performing surveillance on the credit rating be disclosed through a means designed to provide reasonably broad dissemination of the information. The proposed amendments did not specify which entity – the NRSRO or the arranger – would need to disclose the information. The proposed amendments would have required further that, for offerings not registered under the Securities Act, the information would need to be disclosed only to investors and credit rating agencies on the day the offering price is set and, subsequently, publicly disclosed on the first business day after the offering closes.[112] The Commission also provided in the June 2008 Proposing Release three proposed interpretations of how the information could be disclosed under the requirements of the proposed rule in a manner consistent with the provisions of the Securities Act. These interpretations addressed disclosure under the proposed amendment in the context of public, private, and offshore securities offerings.[113]

As discussed in the February 2009 Proposing Release, the majority of commenters addressing the proposal to amend paragraphs (a) and (b) of Rule 17g-5 set

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111 See id.

112 See id. This proposed requirement would have been in addition to the current requirements of paragraph (a) that an NRSRO disclose the type of conflict of interest in Exhibit 6 to Form NRSRO; and establish, maintain and enforce written policies and procedures to address and manage the conflict of interest. 17 CFR 240.17g-5(a)(1) and (2).

113 See June 2008 Proposing Release, 73 FR at 36222-36226.

forth in the June 2008 Proposing Release opposed the proposed amendments or raised substantial practical or legal questions about how they would operate, particularly with respect to publicly disclosing the information.[114] In response to the concerns raised by commenters, the Commission made significant changes to the proposed amendments and re-proposed them for further comment. Under the re-proposed amendments: (1) NRSROs that are hired by arrangers to perform credit ratings for structured finance products would have been required to disclose on a password-protected Internet Web site the deals for which they have been hired and provide access to that site to non-hired NRSROs that have furnished the Commission with the certification described below; (2) NRSROs that are hired by arrangers to perform credit ratings for structured finance products would have been required to obtain representations from those arrangers that the arranger would provide information given to the hired NRSRO to non-hired NRSROs that have furnished the Commission with the certification described below as well; and (3) NRSROs seeking to access information maintained by the NRSROs and the arrangers pursuant to the new rule would have been required to furnish the Commission an annual certification that they are accessing the information solely to determine credit ratings and would determine a minimum number of credit ratings using the information.[115]

The Commission received letters from nineteen commenters in response to the re-proposed amendments to Rule 17g-5.[116] A majority of those commenters expressed their

114 See February 2009 Proposing Release, 74 FR at 6491-6492.

115 See February 2009 Proposing Release, 74 FR at 6492-6497.

116 See Marchywka Letter; JCR Letter; Council Letter; DBRS Letter; FSR Letter; Fitch Letter; Colorado PERA Letter; ASF/SIFMA Letter; ICI Letter; Hunt Letter; R&I Letter; S&P Letter; Moody's Letter; Realpoint Letter; ABA Committee Letter; CMSA Letter; CreditSights Statement; Moody's Statement; Realpoint Statement; RiskMetrics Statement; Egan-Jones Statement; ASF Statement.

general support for the proposal,[117] with several commenters expressing their belief that the disclosure required under the amendments would have a positive effect on competition within the credit rating industry.[118] One commenter favoring the re-proposed amendments noted the benefit of a "level playing field,"[119] while another expressed a belief that the proposed disclosure requirement would result in "true competition" in the credit rating industry.[120]

A smaller number of commenters, however, expressed their general disagreement with the re-proposed amendments.[121] One commenter argued that the re-proposed amendments would result in non-hired NRSROs being motivated to offer the most favorable preliminary ratings that the disclosed data would permit in order to encourage arrangers to abandon the originally hired NRSRO in favor of the non-hired NRSRO in order to obtain a "sweeter" final rating. The same commenter also argued that the proposal would favor large NRSROs with market power at the expense of smaller NRSROs.[122] Another commenter expressed concerns that the proposed new requirements would cause small originators of structured finance products to abandon that market due to the costs associated with the proposed disclosure requirements.[123]

One commenter cautioned that the proposal could reinforce, rather than diminish, an issuer's ability to engage in "ratings shopping" by creating incentives for issuers to shop for the NRSRO that will demand the least information in the initial rating

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117 See e.g., Marchywka Letter; Council Letter; FSR Letter; Colorado PERA Letter; Hunt Letter; Realpoint Letter; ABA Committee Letter; CreditSights Statement; Realpoint Statement; Riskmetrics Statement; Egan-Jones Statement

118 See e.g., Hunt Letter, Riskmetrics Statement, Egan-Jones Statement.

119 See Riskmetrics Statement.

120 See Egan-Jones Statement.

121 See e.g., JCR Letter; ASF/SIFMA Letter; Moody's Letter; Moody's Statement; ASF Statement.

122 See JCR Letter.

123 See R&I Letter.

process.[124] The Commission has expressed its concern over the practice of "ratings shopping" in the past.[125] In both the June 2008 Proposing Release and the February 2009 Proposing Release, the Commission noted that the amendments to Rule 17g-5 as proposed in the former release and re-proposed in the latter could help address ratings shopping by exposing an NRSRO that employed less conservative ratings methodologies in order to gain business.[126] In addition, the Commission has noted, the proposed amendments also could mitigate the impact of rating shopping, since NRSROs not hired to rate a deal could nonetheless issue a credit rating.[127]

The Commission recognizes that an increase in the number of credit ratings available to investors by definition entails an increase in the number of NRSROs issuing those ratings, thereby giving issuers a broader pool of NRSROs among which to "shop" for a rating. The Commission also recognizes the concern that NRSROs not hired by the arranger might have the incentive to use information accessed pursuant to Rule 17g-5 as amended to issue an unduly favorable rating in an attempt to procure future business from a particular arranger. The Commission believes that there are several factors counteracting this incentive. First, the 100% disclosure requirement set forth in Rule 17g-2(d), as amended, will facilitate the ability of investors, academics and other users of credit ratings to directly compare the credit rating performance of all NRSROs issuing a credit rating for a given structured finance product, whether the NRSROs are hired by the arranger to do so or instead are issuing unsolicited ratings based on information obtained under the disclosure requirements of Rule 17g-5 as amended. This will likely enhance

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124 See Moody's Letter.

125 See e.g., June 2008 Proposing Release, 73 FR at 36218.

126 See June 2008 Proposing Release, 73 FR at 36243; February 2009 Proposing Release, 74 FR 6506.

127 Id.

both hired and non-hired NRSRO's accountability for the ratings they issue. Second, the information available pursuant Rule 17g-5 will be accessible to all NRSROs, including NRSROs operating under the subscriber-paid model. Since the latter are not compensated by the structured products' arrangers, they can issue unsolicited ratings without the pressure of worrying about the effect that the unsolicited ratings might have on their future revenue stream from arrangers of structured finance. Finally, by facilitating the issuance of unsolicited ratings, the amendments to Rule 17g-5 may serve to mitigate the potential for ratings shopping, since an arranger that "shopped" in order to obtain a higher rating would still face the possibility of non-hired NRSROs issuing lower ratings.

The Commission is adopting the re-proposed amendments substantially as proposed in order to address conflicts of interest and improve the quality of credit ratings for structured finance products by making it possible for more NRSROs to rate structured finance products. Currently, when an NRSRO is hired to rate a structured finance product, some of the information it relies on to determine the rating is generally not made public. As a result, structured finance products frequently are issued with ratings from only one or two NRSROs that have been hired by the arranger, with the attendant conflict of interest that creates. The amendments to Rule 17g-5 are designed to increase the number of credit ratings extant for a given structured finance product and, in particular, to promote the issuance of credit ratings by NRSROs that are not hired by the arranger. This will provide users of credit ratings with more views on the creditworthiness of the structured finance product. In addition, the amendments are designed to reduce the ability of arrangers to obtain better than warranted ratings by exerting influence over

NRSROs hired to determine credit ratings for structured finance products. Specifically, opening up the rating process to more NRSROs will make it easier for the hired NRSRO to resist such pressure by increasing the likelihood that any steps taken to inappropriately favor the arranger could be exposed to the market through the credit ratings issued by other NRSROs.

B. Paragraph (b)(9) of Rule 17g-5

New paragraph (b)(9) of Rule 17g-5 identifies the following conflict required to be disclosed and managed under paragraph (a) of the rule: issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument.[128] The Commission intends this provision, which mirrors, in part, the text of Section 15E(i)(1)(B) of the Exchange Act (enacted as part of the Rating Agency Act),[129] to cover the full range of structured finance products, including, but not limited to, securities collateralized by static and actively managed pools of loans or receivables (e.g., commercial and residential mortgages, corporate loans, auto loans, education loans, credit card receivables, and leases), collateralized debt obligations, collateralized loan obligations, collateralized mortgage obligations, structured investment vehicles, synthetic collateralized debt obligations that reference debt securities or indexes, and hybrid collateralized debt obligations.

As the Commission noted when initially proposing new paragraph (b)(9) in the June 2008 Proposing Release, the conflict identified in new paragraph (b)(9) is a subset

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128 In connection with the adoption of new paragraph (b)(9) of Rule 17g-5, the Commission is re-designating the pre-existing paragraph (b)(9) as paragraph (b)(10).

129 15 U.S.C. 78o-7(i)(1)(B).

of the broader conflict already identified in paragraph (b)(1) of Rule 17g-5; namely, "being paid by issuers and underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite."[130] In the case of structured finance products, the Commission believes this "issuer/underwriter-pay" conflict is particularly acute because certain arrangers of structured finance products repeatedly bring ratings business to the NRSROs.[131] As sources of frequent, repeated deal-based revenue, some arrangers have the potential to exert greater undue influence on an NRSRO than, for example, a corporate issuer that may bring far less ratings business to the NRSRO.[132]

In the February 2009 Proposing Release, the Commission requested comment both generally on proposed new paragraph (b)(9) of Rule 17g-5 and on the specific question of whether the definition of the securities and money market instruments giving rise to the specific conflict – instruments issued by an asset pool or as part of an asset-backed or mortgage-backed securities transaction – should be broadened or narrowed.[133] One commenter argued that the definition as proposed was too broad and suggested that structured finance products should be defined identically to "asset-backed securities" in Regulation AB[134] or "expanded with sufficient precision to clarify the intended scope."[135] In both the June 2008 Proposing Release and the February 2009 Proposing Release,

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130 17 CFR 240.17g-5(b)(1). As the Commission noted when adopting Rule 17g-5, the concern with the conflict identified in paragraph (b)(1) "is that an NRSRO may be influenced to issue a more favorable credit rating than warranted in order to obtain or retain the business of the issuer or underwriter." June 2007 Adopting Release, 72 FR at 33595.

131 See e.g., Testimony of Professor John C. Coffee, Jr., Adolf A. Berle Professor of Law, Columbia University Law School, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs (April 22, 2008) pp. 4-6.

132 Id; see also, June 2008 Proposing Release, 73 FR at 36219.

133 See February 2009 Proposing Release, 74 FR at 6493.

134 See 17 CFR 1101(c).

135 See ABA Committee Letter.

however, the Commission explicitly stated its intention to broaden the scope of the proposed amendments rather than restrict it to structured finance products meeting narrower definitions such as the one set forth in Regulation AB.[136]

In the February 2009 Proposing Release, the Commission stated that its intent is to have the definition be sufficiently broad to cover all structured finance products and noted that Section 15E(i)(1)(B) of the Exchange Act (adopted as part of the Rating Agency Act) uses identical language to describe a potentially unfair, coercive or abusive practice relating the ratings of securities or money market instruments.[137] Furthermore, the Commission adopted Rule 17g-6(a)(4),[138] in part, under this statutory authority, and Rule 17g-6(a)(4) uses the same language – securities or money market instruments "issued by an asset pool or mortgage-backed securities transaction" – to describe the prohibitive practice. As used in Rule 17g-6 and Rule 17g-5, the Commission intends this definition to cover the broad range of structured finance products, including, but not limited to, securities collateralized by pools of loans or receivables (e.g., mortgages, auto loans, school loans, credit card receivables), collateralized debt obligations, collateralized loan obligations, synthetic collateralized debt obligations that reference debt securities or indexes, and hybrid collateralized debt obligations. The Commission continues to believe that the broader definition will appropriately result in the amended rules' application to a larger segment of credit ratings.

The Commission is adopting new paragraph (b)(9) of Rule 17g-5 as proposed.

C. Paragraph (a)(3) of Rule 17g-5

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136 See June 2008 Proposing Release, 73 FR at 36213 note 15; February 2009 Proposing Release, 74 FR 6493.

137 See 15 U.S.C. 780-7(i)(1)(B); see also February 2009 Proposing Release, 74 FR 6493.

138 17 CFR 240.17g-6(a)(4).

The Commission also is adopting new paragraphs (a)(3)(i), (ii), and (iii) of Rule 17g-5 substantially as proposed. New paragraph (a)(3)(i) requires an NRSRO subject to the conflict set forth in new paragraph (b)(9) to maintain a password-protected Internet Web site containing a list of each structured finance security or money market instrument for which it currently is in the process of determining an initial credit rating in chronological order and identifying the type of security or money market instrument, the name of the issuer, the date the rating process was initiated, and the Internet Web site address where the issuer, sponsor, or underwriter of the security or money market instrument represents that the information described in paragraphs (a)(3)(iii), as discussed below, can be accessed.[139]

New paragraph (a)(3)(ii) requires an NRSRO subject to the conflict to provide free and unlimited access to such password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification described in new paragraph (e) of Rule 17g-5 (discussed below) that covers that calendar year.[140] Taken together, new paragraphs (a)(3)(i) and (ii) of Rule 17g-5 create a mechanism requiring NRSROs hired to rate structured finance products to alert other NRSROs that an arranger has initiated the rating process and to promptly inform the

139 As noted in the February 2009 Proposing Release, the text of proposed paragraph (a)(3)(i) refers to transactions where the NRSRO is in the process of determining an ''initial'' credit rating. The Commission does not intend that the rule require the NRSRO to include on the Internet Web site information about securities or money market instruments for which the NRSRO has published an initial rating and is monitoring the rating. Consequently, upon publication of the initial rating, the NRSRO can remove the information about the security or money market instrument from the list it maintains on the Internet Web site. The Commission notes that the information on the arranger's Web site would remain available. If, however, the arranger decides to terminate the rating process before the hired NRSRO published an initial rating, the NRSRO would be permitted to remove the information from the list. See February 2009 Proposing Release, 74 FR at 6493-6494.

140 The Commission notes that, pursuant to Section 17 of the Exchange Act as well as the rules thereunder (including Rule 17g-2), representatives of the Commission will have access to the information required to be disclosed on the NRSRO's Internet Web site pursuant to Rule 17g-5.

other NRSROs where information being provided by the arranger to the hired NRSRO to determine the credit rating may be obtained.

Several commenters addressed the issue of the password protected Internet Web site to be maintained by hired NRSROs.[141] Three commenters expressed support for the concept, [142] with one noting that the requirements "to establish and maintain such websites and to post very limited information on such websites do not appear to be unduly burdensome to NRSROs."[143] Three other commenters opposed the requirement, arguing that the costs of creating and maintaining a Web site are significant and would negatively impact smaller NRSROs in addition to potentially creating security risks.[144] The Commission is sensitive to the costs of the new requirement but does not believe they are significant. All of the NRSROs currently maintain Internet web sites, in most cases with password-protected portals that their subscribers and registered users can access to obtain information posted by the NRSRO. Consequently, adding a portal for other NRSROs to access pending deal information is not expected to require significant additional Internet Web site design and maintenance.

The Commission requested comment as to whether the information required to be maintained on the NRSRO's Internet Web site would be sufficient to alert other NRSROs that the rating process has commenced and where they can locate information to determine an unsolicited rating, or whether the Commission should, for example, require an e-mail alert to be sent to all NRSROs that have access to the site as well.[145] One

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141 See, e.g., DBRS Letter, ASF/SIFMA Letter, S&P Letter, Realpoint Letter, ABA Committee Letter, CMSA Letter.

142 See Realpoint Letter; RiskMetrics Statement; ABA Committee Letter.

143 See ABA Committee Letter.

144 See DBRS Letter; ASF/SIFMA Letter; Moody's Letter.

145 See February 2009 Proposing Release, 74 FR at 6494.

commenter suggested that instead of requiring NRSROs to maintain the list of deals, the Commission require arrangers to notify non-hired NRSROs of new deals by email or, alternatively, that the Commission implement a pilot project to set up and maintain a website with information provided by the NRSROs and/or arrangers.[146] Two commenters, however, expressed their opposition to requiring NRSROs to send emails in addition to or in lieu of requiring them to maintain the Web site described in new paragraph (a)(3)(i), noting that monitoring such a Web site would be a simple and a non-time-consuming process for non-hired NRSROs.[147] One further noted that if emails were required, an NRSRO interested in determining its own ratings would have to monitor their email for update messages from other NRSROs and still check other NRSROs' Web sites in order to obtain the relevant information before checking the relevant issuer portals.[148] The second commenter also argued that an NRSRO should not have to send an email to other NRSROs that may have no interest in rating a particular transaction.[149]

The Commission is adopting the requirement that the hired NRSRO maintain an Internet Web site identifying pending deals as proposed. The Commission agrees with those commenters that are of the view that it is not necessary to require a hired NRSRO to send email alerts to other NRSROs every time it is hired to rate a new transaction, either in addition to or in lieu of the hired NRSRO maintaining a list of its transactions on a password-protected Internet Web site. Concentrating the information about pending deals at the Internet Web site maintained by the hired NRSRO will permit other NRSROs to sort through the list of pending transactions and decide which arranger web sites they

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146 See DBRS Letter.

147 See S&P Letter; Moody's Letter.

148 See Moody's Letter.

149 See S&P Letter.

want to access to obtain the information necessary to determine a credit rating. Further, the Commission requires the hired NRSRO to promptly disclose the required information on its Internet Web site, thereby notifying the non-hired NRSROs of the pending deal as soon as possible.[150] The Commission believes that the non-hired NRSRO will be better served by the ability to access, periodically at their own convenience, the lists of all pending transactions maintained on the hired NRSROs' Internet Web sites in order to determine whether any new deals have been initiated. The Commission does not believe that one-time notice emails are an adequate alternative in lieu of hired NRSROs maintaining lists of pending transactions. While the Commission does not believe it necessary to require hired NRSROs to send email notices in addition to maintaining such lists, the Commission encourages hired NRSROs to voluntarily supplement maintaining the required lists of pending transactions by offering to notify other registered NRSROs by email alert whenever they are hired to rate new transactions. This way the other NRSROs can decide for themselves whether they want to receive email alerts or monitor the Internet Web sites.

As the Commission noted in the February 2009 Proposing Release, the text of paragraph (a)(3)(i) refers to transactions where the NRSRO is in the process of determining an "initial" credit rating.[151] The rule does not require the NRSRO to include on the Internet Web site information about securities or money market instruments once the NRSRO has published the initial rating and is monitoring the rating. The amendment is designed to alert other NRSROs about new deals and direct them to the Internet Web

[150] The Commission will take seriously any indications that the hired NRSRO is not complying with the requirement to promptly disclose the information pursuant to new paragraph (a)(3)(i) of Rule 17g-5.

[151] See February 2009 Proposing Release, 74 FR at 6493.

site of the arranger where information to determine initial ratings and monitor the ratings can be accessed. Consequently, upon publication of the initial rating, the NRSRO can remove the information about the security or money market instrument from the list it maintains on the Internet Web site. Similarly, if the arranger decides to terminate the rating process before a hired NRSRO publishes an initial rating, the NRSRO would be permitted to remove the information from the list. As discussed in more detail below, however, the representations a hired NRSRO will be required to obtain from an arranger include a representation that once an instrument is rated, the arranger will be required to post on its password-protected Internet Web site any information provided to the hired NRSRO for surveillance purposes.

The Commission is making clarifying changes to the text of new paragraphs (a)(3)(ii) and (a)(3)(iii) of Rule 17g-5 as proposed. As discussed above, that paragraph requires an NRSRO subject to the conflict set forth in new paragraph (b)(9) of Rule 17g-5 to provide free and unlimited access to such password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification described in new paragraph (e) of Rule 17g-5 (discussed below) that covers that calendar year. The Commission is revising the proposed amendment to clarify that the hired NRSRO need only provide access to its password-protected Internet Web site to a non-hired NRSROs whose certification indicates that it has either (1) determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to Rule 17g-5(a)(3) as amended in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or (2) has not accessed information pursuant to Rule 17g-5(a)(3) as amended 10 or more times in the calendar year prior to the year covered by the certification. This revision ensures that hired NRSROs will only be required to provide access to their password-protected Internet Web sites to non-hired NRSROs that have met the requirements set forth in the certification to be provided to the Commission pursuant to new paragraph (e) of Rule 17g-5 as amended. The Commission is further clarifying that a non-hired NRSRO would not be precluded from accessing the hired-NRSRO's Internet Web site if at some point prior to the most recently ended calendar year the NRSRO accessed the Web site 10 or more times. For example, if a non-hired NRSRO accessed the Web site 10 or more times in year 1, but did not access the Web site in year 2, the non-hired NRSRO would then be permitted to access the Internet Web site in year 3.

Accordingly, the Commission is adopting the amendments establishing new paragraphs (a)(3)(i) and (ii) of Rule 17a-5 substantially as proposed, with the revisions to the text as proposed as discussed above.

New paragraph (a)(3)(iii) of Rule 17g-5, adopted substantially as proposed, requires an NRSRO subject to the conflict set forth in new paragraph (b)(9) to obtain four representations from an arranger that hires it to rate a structured finance product: (1) pursuant to paragraph (a)(3)(iii)(A) the arranger must represent that it will maintain the information described in paragraphs (a)(3)(iii)(C) and (a)(3)(iii)(D) of Rule 17g-5 available on an identified password-protected Internet Web site that presents the information in a manner indicating which information currently should be relied on to determine or monitor the credit rating; (2) pursuant to paragraph (a)(3)(iii)(B) of Rule 17g-5 the arranger must represent that it will provide access to that password-protected

Internet Web site to any NRSRO that provides it with a copy of the certification described in new paragraph (e) of Rule 17g-5 (discussed below) that covers the current calendar year; (3) pursuant to paragraph (a)(3)(iii)(C) of Rule 17g-5 the arranger must represent that it will post on that password-protected Internet Web site all information the arranger provides to the NRSRO for the purpose of determining the initial credit rating for the security or money market instrument, including information about the characteristics of the assets underlying or referenced by the security or money market instrument, and the legal structure of the security or money market instrument, at the same time such information is provided to the NRSRO;[152] and (4) pursuant to paragraph (a)(3)(iii)(D) of Rule 17g-5 the arranger must represent that it will post on the password-protected Internet Web site all information the arranger provides to the NRSRO for the purpose of undertaking credit rating surveillance on the security or money market instrument, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument at the same time such information is provided to the NRSRO.

The representations required to be obtained by an NRSRO, as described in new paragraphs (a)(3)(iii)(A) through (D) of Rule 17g-5, taken together, provide that an arranger of a structured finance product agrees to make the information it provides to hired NRSROs, whether provided for the purpose of determining an initial rating or for monitoring a rating, available to other NRSROs. The hired NRSRO must obtain from the arranger a representation that the arranger will post that information on the arranger's

[152] The Commission expects that all the information will be provided in the same format. For example, if the arranger provides information to the hired NRSRO in downloadable and/or searchable format, the Commission expects the arranger to provide the same information in the same format on its Internet Web site. The Commission will take seriously any concerns raised in this regard.

Internet Web site at the same time it is given to the hired NRSRO, and that any time the information is updated or new information is given to the hired NRSRO, the arranger will post that information on its Internet Web site contemporaneously. An NRSRO also will be required to obtain from the arranger a representation that the arranger will tag the information in a manner that informs NRSROs accessing the Web site which information currently is operative for the purpose of determining the credit rating in order to ensure that NRSROs accessing the Internet Web site use the correct information to determine their credit ratings. Paragraph (a)(3)(iii) of Rule 17a-5, as adopted, adds the word "written" to the proposed text in order to clarify that these representations must be obtained in writing in order to ensure that they are formally documented and executed.

An NRSRO will violate Rule 17a-5(a)(3) if it determines an initial credit rating or maintains an existing credit rating for a structured finance product that is paid for by an arranger unless that NRSRO obtains a written representation from the arranger, upon which the NRSRO can reasonably rely, that the arranger will take the steps set forth in paragraph (a)(3)(iii)(A) through (D). One commenter expressed concern over the proposed amendment's standard of "reasonable" reliance on an arranger's representations.[153] The question of whether reliance was reasonable will depend on the facts and circumstances of a given situation. Factors relevant to this analysis would include, but not be limited to: (1) ongoing or prior failures by the arranger to adhere to its representations; or (2) a pattern of conduct by the arranger where it fails to promptly correct breaches of its representations. Further, the Commission recognizes that Internet Web sites periodically malfunction. Depending on the facts, a limited Internet Web site

153 See Fitch Letter.

malfunction by itself would not cause the NRSRO to no longer be able to rely reasonably on a written representation from that arranger.

In addition to the scope of the safe harbor, commenters raised a number of other concerns in connection with paragraph (a)(3)(iii) as proposed.[154] Several commenters objected to the requirement that NRSROs obtain representations from arrangers, arguing that doing so inappropriately places NRSROs in the position of enforcing arranger compliance with disclosure requirements.[155] One commenter suggested that the required representations be made to the Commission instead of the hired NRSRO.[156] The Commission believes that the structure of the rule as amended is consistent with the Commission's regulation of NRSROs. The Commission notes that the rule as amended is designed to make clear the steps an NRSRO must take to provide a credit rating for a particular arranger. An NRSRO is not required to enforce compliance; however, if, for example, an NRSRO had knowledge that an arranger had not complied with its representations, the NRSRO would be on notice that future reliance on that arranger might not be reasonable. The Commission believes it is likely that the required representations will be part of the standard contracts entered into between NRSROs and arrangers and that an arranger that fails to comply with its representations will risk having the hired NRSRO withdraw the credit ratings paid for by that arranger and being denied the ability to obtain credit ratings from the hired NRSRO in the future, given that the hired NRSRO may not be able to reasonably rely on the safe harbor. The Commission believes that the consequences of losing the safe harbor should provide sufficient

154 See e.g., Council Letter; DBRS Letter; Fitch Letter; ASF/SIFMA Letter; Moody's Letter; Realpoint Letter; ABA Committee Letter; CMSA Letter; RiskMetrics Statement; Colorado PERA Letter.

155 See Fitch Letter; Moody's Letter; ABA Committee Letter.

156 See ABA Committee Letter.

incentive for NRSROs to ensure that they obtain the representations from arrangers as set forth in paragraph (a)(3)(iii) and that arrangers comply with their representations.

Another commenter argued that the duty to make the required information available should fall entirely on the hired NRSRO.[157] The Commission believes that arrangers are best positioned to disclose the information necessary to allow the NRSRO-users to determine credit ratings. The disclosure representation to be obtained from an arranger will apply to any information provided to a hired NRSRO, of which there may be more than one. One of the hired NRSROs may ask for more information than the other hired NRSROs. Allocating the responsibility of disclosure to the arranger will promote the most consistent and orderly dissemination of information to the NRSRO-users and allow them to access all relevant deal information in a single location rather than on multiple hired NRSROs' Internet Web sites.

Another commenter argued that requiring NRSROs to obtain such representations would have a chilling effect on oral communications by the issuer to the NRSRO and argued that the proposed amendment was an inappropriate means of regulating issuers' conduct.[158] The representations an NRSRO will be required to obtain from an arranger are not intended to result in the arranger providing different information to a hired NRSRO than it would otherwise, much less to "regulate" issuer conduct. The Commission acknowledges that the requirements of paragraph (a)(3) of Rule 17g-5 as a whole likely will formalize the process of information exchange from the arranger to the NRSRO for structured finance products, including the written submission of information that may, in the past, have been provided orally. However, the Commission believes this

157 See ASF/SIFMA Letter.
158 See Moody's Letter.

will be a positive development. First, conveying information in writing rather than orally may promote credit rating accuracy in that the NRSRO analyst will be able to refer back to a document containing the information rather than his or her memory. Second, a more formal process of information exchange will create a better record of the data provided to the NRSRO, which will make it easier for Commission staff to understand the process used to determine the credit rating during an after-the-fact review of whether the NRSRO adhered to its procedures and methodologies for determining such credit ratings. This will benefit the NRSRO's compliance and internal audit functions as well as the Commission's examination function and benefit users of credit ratings.

The Commission requested comment as to whether the NRSRO should be required to obtain a representation from the arranger that the arranger will not provide any information to the hired NRSRO that is material without also disclosing that information on the arranger's Internet Web site.[159] The three commenters directly addressing this issue responded in the affirmative.[160] The Commission believes, however, that the representations the hired NRSRO will be required to obtain from an arranger, as set forth in paragraphs (a)(3)(iii)(C) and (D) as proposed, are sufficient to advance the purposes of the rule as amended. One commenter suggested that the Commission broaden the proposed amendment to permit unsolicited, subscriber-paid NRSROs to contact an arranger with questions regarding the information provided, or to be provided, on its password-protected Internet Web site for purposes of determining or monitoring a credit rating.[161] The Commission believes that the representations an NRSRO will be required to obtain from an arranger are sufficient to accomplish the goals

159 See February 2009 Proposing Release, 74 FR at 6496.
160 See Council Letter; DBRS Letter; Realpoint Letter.
161 See Realpoint Letter.

of the rule, as amended, and that it would be beyond the intended scope of the rule, as amended, to require arrangers to take on the responsibility of answering questions from the non-hired NRSROs obtaining access to the information that the arranger has disclosed.

Finally, one commenter stated that arranger, trustee, servicer and special servicer information and reports should be included in the arrangers' representation to disclose under paragraph (a)(3)(iii) of Rule 17g-5.[162] The Commission agrees with this comment. The Commission recognizes that in many cases, the data required to monitor the rating of a structured finance product is provided by third parties such as trustees or loan servicers. In proposing the amendments to paragraph (a) of Rule 17g-5, the Commission did not intend to exclude such information from disclosure to non-hired NRSROs and potentially provide arrangers with an incentive to delegate the provision of information regarding a structured finance product to third parties in order to avoid such disclosure. Accordingly, the Commission is adding the language "or contracts with a third party to provide to the nationally recognized statistical rating organization" to new paragraphs (a)(3)(iii)(C) and (D) of Rule 17g-5 in order to clarify that the proposed language "all information the issuer, sponsor, or underwriter provides to the nationally recognized statistical rating organization for the purpose of determining the initial credit rating for the security or money market instrument" and "all information the issuer, sponsor, or underwriter provides to the nationally recognized statistical rating organization for the purpose of undertaking credit rating surveillance on the security or money market instrument" includes all information the issuer, sponsor or underwriter provides to the hired NRSRO either directly or by contracting with a third party.

[162] See Realpoint Letter.

The same commenter suggested that the Commission clarify that information made available to the arranger-paid NRSRO must be made available to the other NRSROs not only at the same time but also in the same manner, and with same search, access and other capabilities, as it is made available to the arranger-paid NRSRO.[163] The Commission notes that the nature of the relationship between the arranger and the hired NRSRO makes it inappropriate to mandate that all arranger information is made available in the same manner to non-hired NRSROs. For example, the rule as amended does not prohibit arrangers from continuing to deliver written materials directly to the hired NRSROs while posting that material on their password-protected Internet Web site for other NRSROs to access. Nevertheless, a hired NRSRO's reliance on an arranger's representations would not be reasonable if the arranger provided the information to non-hired NRSROs in an impaired manner such that it impeded the ability of the non-hired NRSROs to develop and maintain a credit rating.

The Commission is making one additional change to the text of new paragraph (a)(3)(iii)(B) of Rule 17g-5 as proposed. As discussed above, that paragraph requires a hired NRSRO to obtain from the arranger a representation that it will provide access to its password-protected Internet Web site during the applicable calendar year to any NRSRO that provides it with a copy of the certification described in new paragraph (e) of Rule 17g-5 (discussed below) that covers that calendar year. The Commission is revising the text of the amendment as proposed to clarify that the arranger, in the written representation it provides in the hired NRSRO, need only represent that it will provide access to its password-protected Internet Web site to a non-hired NRSROs whose certification indicates that it has either: (1) determined and maintained credit ratings for

163 See Realpoint Letter.

at least 10% of the issued securities and money market instruments for which it accessed information pursuant to Rule 17g-5(a)(3) as amended in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or (2) has not accessed information pursuant to Rule 17g-5(a)(3) as amended 10 or more times in the most recently ended calendar year. This revision ensures that the representations that a hired NRSRO will be required to obtain from an arranger in order to rate a structured finance product will limit access to the arranger's password-protected Internet Web sites to non-hired NRSROs that have met the requirements set forth in the certification to be provided to the Commission pursuant to new paragraph (e) of Rule 17g-5 as amended.

The Commission is adopting new paragraph (a)(3)(iii) of Rule 17g-5 substantially as proposed, with the revisions to the text as proposed as discussed above.

D. Paragraph (e) of Rule 17g-5

The Commission also is adopting new paragraph (e) of Rule 17g-5 substantially as proposed. This provision requires that in order to access the Internet Web sites maintained by NRSROs and arrangers pursuant to the requirements of Rule 17g-5(a)(3), an NRSRO must annually execute and furnish to the Commission a certification stating the following:

> The undersigned hereby certifies that it will access the Internet Web sites described in 17 CFR §240.17g-5(a)(3) solely for the purpose of determining or monitoring credit ratings. Further, the undersigned certifies that it will keep the information it accesses pursuant to 17 CFR §240.17g-5(a)(3) confidential and treat it as material nonpublic information subject to its written policies and procedures established, maintained, and enforced pursuant to section 15E(g)(1) of the Act (15 U.S.C. 78o-7(g)(1)) and 17 CFR §240.17g-4. Further, the undersigned certifies that it will

> determine and maintain credit ratings for at least 10% of the issued securities and money market instruments for which it accesses information pursuant to 17 CFR §240.17g-5(a)(3)(iii), if it accesses such information for 10 or more issued securities or money market instruments in the calendar year covered by the certification. Further, the undersigned certifies one of the following as applicable: (1) In the most recent calendar year during which it accessed information pursuant to 17 CFR §240.17g-5(a)(3), the undersigned accessed information for [Insert Number] issued securities and money market instruments through Internet Web sites described in 17 CFR §240.17g-5(a)(3) and determined and maintained credit ratings for [Insert Number] of such securities and money market instruments; or (2) The undersigned previously has not accessed information pursuant to 17 CFR §240.17g-5(a)(3) 10 or more times during the recently ended calendar year.[164]

The 10% threshold set forth in paragraph (e) of Rule 17g-5, as amended, is designed to require the NRSRO accessing arranger Internet Web sites to determine a meaningful amount of credit ratings without forcing it to undertake work that it may not have the capacity or resources to perform. The Commission expressed its belief in the February 2009 Proposing Release that there should be some minimum level of credit ratings issued to demonstrate that the NRSRO is accessing the information for the purpose of determining credit ratings. On the other hand, if an NRSRO accesses information about a proposed deal that involves a structure or a type of assets that are new and that the NRSRO has not developed a methodology to incorporate into its ratings, it would not be appropriate or prudent to require the NRSRO to determine a credit rating. The requirement that the NRSRO list the number of times it accessed the information for

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164 See February 2009 Proposing Release, 74 FR at 6496. The use of the term "issued securities and money market instruments" is intended to address potential deals that are posted on the Internet Web sites but that ultimately do not result in the publication of an initial rating because the arranger decides not to issue the securities or money market instruments. An NRSRO that accessed such information would not need to count it among the final deals that would be used to determine whether it met the 10% threshold. See id.

issued securities and money market instruments and the number of credit ratings determined using that information on its next annual certification pursuant to paragraph (e) is designed to provide a level of verification that the NRSRO is, in fact, accessing the information for purposes of determining credit ratings.

The Commission received five comments on proposed paragraph (e) of Rule 17g-5.[165] Two commenters argued that NRSROs accessing arranger information pursuant to the rule should be required to provide confidentiality agreements to the arranger.[166] The Commission is not requiring NRSROs accessing this information to enter into a confidentiality agreement with the arrangers. However, the Commission is sensitive to the concerns of commenters advocating such a requirement, namely that an arranger has a confidentiality agreement it could enforce directly itself. Accordingly, the representations an NRSRO must obtain from an arranger will not prevent the arranger from employing a simple process requiring non-hired NRSROs to agree to keep the information they obtain from the arranger confidential, provided that such a process does not operate to preclude, discourage, or significantly impede non-hired NRSROs' access to the information, or their ability to issue a credit rating based on the information. For example, an arranger could interpose a confidentiality agreement in a window (click-through screen) on the Internet Web site that appears after the NRSRO successfully enters its password to access the information and which requires the NRSRO to hit an "Agree" button before being directed to the information to be used to determine the credit rating. Presumably, this confidentiality agreement would contain the same terms as the confidentiality agreement between the arranger and the hired NRSRO. A process that

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165 See DBRS Letter; Fitch Letter; ASF/SIFMA Letter; Realpoint Letter; ABA Committee Letter.

166 See ASF/SIFMA Letter; ABA Committee Letter.

effectively operates to preclude, discourage, or significantly impede non-hired NRSROs' access to the arranger's information or ability to issue unsolicited ratings, however, would be contrary to the Commission's purpose in adopting the rule as amended and, depending on the facts, may affect whether a hired NRSRO may reasonably rely on the arranger's representations.

The Commission also specifically requested comment as to whether the 10% threshold should be adjusted higher or lower.[167] Two commenters argued against the requirement,[168] with one stating that the 10% threshold could cause a chilling effect on NRSROs seeking to determine credit ratings using the arrangers' Internet Web sites and recommended that the Commission eliminate the provision and instead add a new provision to Rule 17g-2(a) requiring a non-hired NRSRO to make and retain records showing each deal it accessed pursuant to proposed rule 17g-5(a)(3).[169] The Commission continues to believe that a 10% threshold strikes an appropriate balance between ensuring that the NRSRO is accessing the information for the purpose of determining credit ratings and not requiring the NRSRO to determine credit ratings for proposed deals that, upon review of the information provided, is beyond the current capabilities of the NRSRO. NRSROs that choose to access arrangers' Internet Web sites should do so with the intent to generate credit ratings, in which case a 10% threshold should not have a chilling effect. Eliminating the threshold requirement could have the undesirable effect of encouraging NRSROs to access the arranger Internet Web sites for reasons other than determining ratings, which would run contrary to the Commission's purposes for amending the rule.

167 See February 2009 Proposing Release, 74 FR at 6497.
168 See DBRS Letter, Realpoint Letter.
169 See DBRS Letter.

However, the Commission intends to closely monitor the effect of the 10% threshold requirement.

The Commission also specifically requested comment on whether an NRSRO should be prohibited from accessing the arranger information in the future if it accesses information 10 or more times in a calendar year and does not determine credit ratings for 10% or more of the deals.[170] One commenter directly addressed this question and stated that the NRSRO should not be barred from accessing the information in the future.[171] The Commission believes that an NRSRO should be required to meet the 10% threshold to continue to access the information as this provides some evidence that the NRSRO is using the information for purposes of determining credit ratings and not for other reasons. At the same time, the Commission recognizes that there may be legitimate reasons why an NRSRO does not meet the 10% threshold in a given year, and NRSROs may request appropriate relief in such cases. For example, an NRSRO may access the information for a new type of financial instrument which it believed it was capable of rating but, upon reviewing the information posted by the arranger, determine that it did not have the resources or capacity to do so. In such a case, it would not be in the public interest for the non-hired NRSRO to produce a rating; nor, however, would it be desirable to penalize that NRSRO for its good-faith re-evaluation of its ability to produce the rating.

The Commission is revising the text of paragraph (e) to correct a typographical error contained in the February 2009 Proposing Release by removing the word "the" prior to the phrase "such securities and money market instruments" in the final sentence of the certification. Additionally, the Commission is revising the text of paragraph (e) to

170 See February 2009 Proposing Release, 74 FR at 6497.
171 See Realpoint Letter.

clarify that the limit on accessing information 10 or more times occurred during the most recently ended calendar year.

Accordingly, the Commission is adopting paragraph (e) of Rule 17g-5 substantially as proposed.

E. Regulation FD

The Commission is adopting, substantially as proposed, the amendments to Regulation FD.[172] The amendments to Regulation FD will accommodate the information disclosure program that the Commission is establishing under paragraphs (a) and (b) of Rule 17g-5, and permit the disclosure of material, non-public information to an NRSRO, solely for the purpose of allowing the NRSRO to determine or monitor a credit rating, irrespective of whether the NRSRO makes its ratings publicly available. As noted in the February 2009 Proposing Release, the amendments accommodate subscriber-based NRSROs that do not make their ratings publicly available for free, as well as NRSROs that access the information under Rule 17g-5 but ultimately do not issue a credit rating using the information.

Currently, Rule 100(b)(2)(iii) of Regulation FD[173] provides that the requirements of Regulation FD do not apply to disclosures of material non-public information made to an entity whose primary business is the issuance of credit ratings, provided the information is disclosed solely for the purpose of developing a credit rating and the entity's ratings are publicly available. As amended, Rule 100(b)(2)(iii) will contain two exceptions related to the issuance of credit ratings. Rule 100(b)(2)(iii)(A) of Regulation

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172 17 CFR 243.100-243.103.

173 17 CFR 243.100(b)(2)(iii).

FD[174] will permit the disclosure of material, non-public information to an NRSRO, solely for the purpose of allowing the NRSRO to determine or monitor a credit rating pursuant to Rule 17g-5(a)(3), irrespective of whether the NRSRO makes its ratings publicly available. Rule 100(b)(2)(iii)(A) will apply only when the disclosures to NRSROs are made pursuant to Rule 17g-5(a)(3). Rule 100(b)(2)(iii)(B) of Regulation FD[175] will continue to permit issuers to disclose material, non-public information, solely for the purpose of determining or monitoring a credit rating, to any credit rating agency (including, but not limited to, NRSROs), as that term is defined in Section 3(a)(61) of the Exchange Act,[176] that makes its credit ratings publicly available.

The proposed amendment to Regulation FD elicited few comments. One commenter supported the proposed amendment, but suggested expanding it to expressly permit unsolicited NRSROs to contact an arranger with questions regarding the information provided, or to be provided, on its password-protected Internet Web site for purposes of determining or monitoring a credit rating, and to require arrangers to post on such Internet Web site any additional material information provided in response to such questions.[177] The Commission expects that arrangers will have an incentive to post any additional information provided to an NRSRO on its password-protected Internet Web site because if they do not do so, other NRSROs developing credit ratings by accessing the Internet Web site would be determining their credit ratings without the benefit of the additional information. A lack of access to this additional information could adversely impact the ratings and lead to more frequent rating actions during the surveillance

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174 17 CFR 243.100(b)(2)(iii)(A).

175 17 CFR 243.100(b)(2)(iii)(B).

176 15 U.S.C. 78c(a)(61).

177 See Realpoint Letter.

process. The purpose of the amendment to Regulation FD is to assure arrangers that providing information in compliance with Rule 17g-5(a)(3) will not violate Regulation FD. The Commission believes that the amendment, as adopted, will permit arrangers to post such additional information without causing a violation of Regulation FD, and that no expansion of the amendment is necessary.

Another commenter agreed that the disclosure regime proposed under Rule 17g-5 cannot operate effectively without the proposed amendment to Regulation FD, but suggested that such an expansion of the credit rating agency exemption presents a risk that none of the ratings determined for a structured finance product would be publicly available.[178] To address this potential risk, this commenter suggested that the exception be revised to allow information provided under Rule 17g-5(a)(3) to be disclosed to all NRSROs, provided that the ratings of at least one of those NRSROs are publicly available. The Commission does not believe this revision is necessary. Because the disclosure regime in Rule 17g-5(a)(3) will be triggered only when credit ratings for structured finance products are paid for by the issuer, sponsor, or underwriter, the Commission believes it is already very likely that such ratings will be made publicly available.

Some NRSROs expressed concern that the proposed amendments would lead to a greater risk of selective disclosure of material, non-public information.[179] These commenters suggested that the proposed amendment to Regulation FD would hurt investor confidence in the fairness of U.S. markets,[180] encourage market abuse and

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178 See DBRS Letter.

179 See S&P Letter, Moody's Letter.

180 See S&P Letter.

undermine the integrity of the U.S. market.[181] In particular, these commenters noted that the proposed amendment to the credit rating agency exemption in Regulation FD would permit NRSROs to obtain material non-public information from issuers and then selectively disclose it, or selectively disclose rating actions based upon it.[182]

One commenter argued that the proposed amendment to Regulation FD would undercut the policy justification for including a credit rating agency exception in Regulation FD.[183] This commenter highlighted that the Commission's rationale for exempting disclosure to credit rating agencies from Regulation FD was the widely available publication of the resulting credit rating.[184]

The Commission is sensitive to commenters' concerns and will monitor the operation of the rule.[185] To aid the monitoring, the Commission encourages NRSROs and other market participants to notify the Commission if they believe the selective availability of non-public information is being abused. However, the Commission believes that the proposed amendments will not lead to misuse of material, non-public information by NRSROs. As noted above, the Commission believes that in order to promote competition in the credit rating industry NRSROs should have access to material, non-public information from arrangers for the purpose of determining or

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181 See Moody's Letter.

182 See Moody's Letter, S&P Letter.

183 See S&P Letter.

184 See Selective Disclosure and Insider Trading, Securities Act Release No. 7881 (August 15, 2000), 65 FR 51716 (August 24, 2000) ("Regulation FD Adopting Release"). In the Regulation FD Adopting Release the Commission explained that while it was aware that "ratings organizations often obtain nonpublic information in the course of their ratings work" it was not aware of any incidents of selective disclosure involving ratings organizations.

185 Separately, the Commission reminds issuers and persons acting on their behalf of the need to consider whether information selectively disclosed under 17 CFR 243.100(b)(2)(iii)(A) or (B) also is required to be publicly disclosed in a registration statement, or periodic or current report, because disclosure of that information is necessary to make other statements made not misleading. In some circumstances, the fact that information is important to an NRSRO's analysis may be relevant to an issuer's evaluation of its other disclosure obligations.

monitoring unsolicited credit ratings for structured finance products. Because the Regulation FD exclusion added today is limited to NRSROs accessing the information in the context of Rule 17g-5(a)(3), entities receiving the material, non-public information will be subject to Section 15E(g) of the Exchange Act[186] and Rule 17g-4[187] thereunder. These statutory and regulatory provisions require NRSROs to establish, maintain and enforce policies and procedures reasonably designed to prevent the misuse of material, non-public information.

Moreover, an NRSRO will be required to furnish to the Commission prior to accessing a password-protected Internet Web site a certification under Rule 17g-5(e) that the NRSRO will keep the information it accesses pursuant to Rule 17g-5(a)(3) confidential and treat it as material, non-public information subject to its Section 15E(g) and Rule 17g-4 obligations. In addition, the disclosure regime in Rule 17g-5 will only be triggered when an issuer pays an NRSRO to issue or maintain a credit rating for a structured finance product. As a result, the Commission expects that a credit rating for such structured finance product will be issued publicly along with any unsolicited ratings from subscriber-based NRSROs.

In addition, the Commission is amending Rule 100(b)(2)(iii) to replace "developing" with "determining or monitoring[.]" This amendment to Rule 100(b)(2)(iii) is intended to mirror the use of "determining" in the Rating Agency Act[188] and other Commission rules regarding NRSROs.[189] The Commission also notes that this amendment will be consistent with the Rule 17g-5(e) certification that NRSROs will be

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186 15 U.S.C. 78o-7(g).

187 17 CFR 240.17g-4.

188 See, e.g., 15 U.S.C. 78o-7(a)(1)(B)(ii).

189 See, e.g., 17 CFR 240.17g-2.

required to furnish to the Commission and to arrangers in order to access an arranger's password-protected Internet Web site described in Rule 17g-5(a)(3). New Rule 17g-5(e) requires NRSROs to certify that the NRSRO will access the arranger's password-protected Internet Web site described in Rule 17g-5(a)(3) solely for the purpose of "determining or monitoring" credit ratings.

The Commission is also adopting, as proposed, the amendment to the text in Rule 100(b)(2)(iii)(B) of Regulation FD[190] to use the statutory definition of "credit rating agency" as defined in Section 3(a)(61) of the Exchange Act.[191] The Commission received one comment on this proposed amendment, which supported it.[192]

F. Conclusion

The Commission is adopting these amendments to Rule 17g-5, in part, pursuant to the authority in Section 15E(h)(2) of the Exchange Act.[193] The provisions in this section of the statute provide the Commission with authority to prohibit, or require the management and disclosure of, any potential conflict of interest relating to the issuance of credit ratings by an NRSRO.[194] The Commission believes that the amendments are necessary and appropriate in the public interest and for the protection of investors because they are designed to address conflicts of interest and improve the quality of credit ratings for structured finance products by making it possible for more NRSROs to rate these instruments.

The Commission believes that these amendments will advance the Rating Agency Act's goal of promoting competition in the credit rating industry by facilitating the

190 17 CFR 243.100(b)(2)(iii)(B).
191 15 U.S.C. 78c(a)(61).
192 See ABA Letter.
193 15 U.S.C. 78o-7(h)(2).
194 Id.

issuance of credit ratings by NRSROs that are not hired by the arranger. The Commission further believes that the resulting increase in the number of ratings extant for a given structured finance security or money market instrument will provide users of credit ratings with more views on the creditworthiness of the security or money market instrument. The amendments also are designed to make it more difficult for arrangers to exert influence over the NRSROs they hire to determine ratings for structured finance products. By facilitating the issuance of unsolicited ratings by non-hired NRSROs, the amendments will increase the likelihood that if a hired NRSRO issues a ratings that is higher than warranted, that fact will be revealed to the market through the lower ratings issued by other NRSROs.

For the reasons discussed above, the Commission is adopting the amendments to Rule 17g-5 and Regulation FD substantially as proposed.

IV. PAPERWORK REDUCTION ACT

Certain provisions of the rule amendments contain a "collection of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). The Commission published a notice requesting comment on the collection of information requirements in the February 2009 Proposing Release and submitted the proposed collection to the Office of Management and Budget ("OMB") for review in accordance with the PRA.[195] An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid control number. The titles for the collections of information are:

(1) Rule 17g-2, Records to be made and retained by nationally recognized statistical rating organizations (OMB Control Number 3235-0628); and

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195 See February 2009 Proposing Release, 74 FR 6498-6501.

(2) Rule 17g-5, Conflicts of interest (OMB Control Number 3235-0649).

The amendment to Regulation FD does not contain a collection of information within the meaning of the PRA.

A. Collections of Information under the Proposed Rule Amendments

The Commission is adopting rule amendments to impose additional disclosure and conflict of interest requirements on NRSROs. These amendments are designed to address concerns about the integrity of the credit rating procedures and methodologies at NRSROs and to promote transparency and objectivity in the NRSRO credit rating process by, among other things, increasing competition and making it easier for investors and other market participants and observers to assess the credit ratings performance of NRSROs. These amendments modify the Commission's rules, adopted in June 2007 and modified in February 2009, implementing registration, recordkeeping, financial reporting, and oversight rules under the Rating Agency Act. The amendments contain recordkeeping and disclosure requirements that are subject to the PRA.

In summary, the rule amendments require: (1) an NRSRO to make publicly available on its Internet Web site in an interactive data file that uses any machine-readable computer format (until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in XBRL format using the Commission's List of XBRL Tags for NRSROs) ratings action histories for all credit ratings initially determined on or after June 26, 2007, with each new ratings action that is related to issuer-paid credit ratings to be reflected in such publicly disclosed histories no later than twelve months after it was taken, and each new ratings action that is related to credit ratings that are not issuer-paid to be reflected in such publicly disclosed histories no later than twenty-four months after it was taken;[196] (2) an NRSRO that is hired by arrangers to issue credit ratings for structured finance products to disclose the deals for which they are in the process of determining such credit ratings to non-hired NRSROs that have furnished the Commission with the certification as described below; (3) an NRSRO that is hired by arrangers to perform credit ratings for structured finance products to obtain written representations from arrangers, on which the NRSRO can reasonably rely, that the arrangers will provide all the information given to the hired NRSRO to non-hired NRSROs that have furnished the Commission with the certification described below;[197] and (4) an NRSRO seeking to access the information maintained by the NRSROs and the arrangers pursuant to the amended rules to furnish the Commission an annual certification that it is accessing the information solely to determine credit ratings and will determine a minimum number of credit ratings using that information.[198]

B. Proposed Use of Information

The amendments enhance the framework for Commission oversight of NRSROs. As the Commission noted in the February 2009 Proposing Release,[199] the collections of information in the amendments are designed to provide users of credit ratings with information upon which to evaluate the performance of NRSROs and to enhance the accuracy of credit ratings for structured finance products by increasing competition among NRSROs who rate these products.

C. Respondents

196 See 17 CFR 240.17g-2(d)
197 See 17 CFR 240.17g-5(a)(3) and (b)(9).
198 See 17 CFR 240.17g-5(e).
199 See February 2009 Proposing Release, 74 FR at 6498.

In the June 2007 Adopting Release, the Commission estimated that approximately 30 credit rating agencies would be registered as NRSROs.[200] Since the initial set of rules under the Rating Agency Act became effective in June 2007, ten credit rating agencies have registered with the Commission as NRSROs.[201] The Commission, however, expects additional entities will register. The Commission received no comments on this estimate. The Commission believes that this estimate continues to be appropriate for identifying the number of respondents for purposes of the amendments.

In addition, under the amendments to paragraphs (a) and (b) of Rule 17g-5, NRSROs that are hired to rate structured finance products will be required to obtain representations from arrangers that the arrangers will provide information given to the hired NRSRO to other NRSROs. In the June 2008 Proposing Release and again in the February 2009 Proposing Release, based on staff information gained from the NRSRO examination process, the Commission estimated that approximately 200 arrangers would be respondents for the purpose of the PRA estimate.[202] The Commission received no comments on this estimate when originally proposed or re-proposed. The Commission continues to estimate, for purposes of this PRA, that approximately 200 arrangers will be affected.

D. Total Annual Recordkeeping and Reporting Burden

As discussed in further detail below, the Commission estimates the total recordkeeping burden resulting from the amendments will be approximately 71,550 hours

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200 See June 2007 Adopting Release, 72 FR at 33607.

201 A.M. Best Company, Inc.; DBRS Ltd.; Fitch, Inc.; Japan Credit Rating Agency, Ltd.; Moody's Investors Service, Inc.; Rating and Investment Information, Inc.; Standard & Poor's Ratings Service; LACE Financial Corp.; Egan-Jones Rating Company; and Realpoint LLC.

202 See June 2008 Proposing Release, 73 FR at 36237; February 2009 Proposing Release, 74 FR at 6498.

on a one-time basis[203] and 169,390 hours on an annual basis.[204] This represents an increase from the estimates of 69,315 hours on a one-time basis and 169,045 hours on an annual basis set forth in the February 2009 Proposing Release.[205] This increase is attributable in part to the fact that the amendments to Rule 17g-2(d) as adopted apply to all NRSROs, rather than only to NRSROs operating under the issuer-paid business model as proposed. The increase also reflects additional burdens, as described in detail below.

The total annual and one-time hour burden estimates for NRSROs described below are averages across all types of NRSROs expected to be affected by the amendments. The size and complexity of NRSROs range from small entities to entities that are part of complex global organizations employing thousands of credit analysts. The Commission notes that, given the significant variance in size between the largest NRSROs and the smallest NRSROs, the burden estimates, as averages across all NRSROs, are skewed higher because the largest firms currently predominate in the industry.

1. Amendments to Rule 17g-2

Rule 17g-2 requires an NRSRO to make and keep current certain records relating to its business and requires an NRSRO to preserve those and other records for certain prescribed time periods.[206] The amendments to paragraph (d) of Rule 17g-2 require an NRSRO to make publicly available on its Internet Web site in an interactive data file that uses a machine-readable computer format ratings action histories for all credit ratings

203 This total is derived from the total one-time hours set forth, in the order in which they are set forth, in the text below: 2,550 + 9,000 + 60,000 = 71,550.

204 This total is derived from the total annual hours set forth, in the order in which they are set forth, in the text below: 450 + 14,880 + 4,000 + 150,000 + 60 = 169,390.

205 February 2009 Proposing Release, 74 FR at 6498-6499.

206 17 CFR 240.17g-2.

initially determined on or after June 26, 2007, with each new ratings action to be reflected in such publicly disclosed histories no later than twelve months after it was taken for ratings actions related to issuer-paid credit ratings and twenty-four months after it was taken for ratings actions related to credit ratings that are not issuer-paid. An NRSRO will be allowed to use any machine-readable format to make this data publicly available until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in XBRL format using the Commission's List of XBRL Tags for NRSROs.[207]

The Commission requested comment in the February 2009 Proposing Release on all aspects of the burden estimates for the proposed amendments to Rule 17g-2(d) and received none.

In the February 2009 Adopting Release, the Commission determined that, in order to implement the Rule 17g-2(d) requirement that an NRSRO make public, in XBRL format and with a six-month grace period, the ratings action histories required under paragraph (a)(8) for a random sample of 10% of the credit ratings for each ratings class for which it has issued 500 or more issuer-paid credit ratings, an NRSRO subject to the requirements will spend, on average, approximately 30 hours to publicly disclose the rating action histories in XBRL format and, thereafter, 10 hours per year to update this information.[208] In the February 2009 Proposing Release, the Commission estimated, based on staff experience, that the proposed amendments to Rule 17g-2(d) requiring

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207 17 CFR 240.17g-2(d)(iii).

208 The Commission also based this estimate on the current one-time and annual burden hours for an NRSRO to publicly disclose its Form NRSRO. No alternatives to these estimates as proposed were suggested by commenters and the Commission adopted these hour burdens. See February 2009 Adopting Release, 74 FR at 6472.

NRSROs to publicly disclose ratings action histories of all issuer-paid credit ratings would increase by 50% the estimated hour burdens for the disclosure requirements of paragraph (d) of Rule 17g-2 as adopted at that time.[209] Therefore, the Commission estimated that the one time annual hour burden for each NRSRO affected by the rule would increase from 30 hours to 45 hours[210] and the annual hour burden would increase from 10 hours to 15 hours.[211] Although the Commission based its estimates for individual NRSROs' hour burdens of Rule 17g-2(d) as proposed on the assumption that the requirements of the rule would apply only to issuer-paid credit ratings, the Commission believes that the estimates are valid for NRSROs operating under the subscriber-paid business model, all of which already have an Internet Web site, as well.[212]

The Commission notes the February 2009 Proposing Release contemplated that NRSROs would provide the information in XBRL when it determined its estimates. The Commission does not believe that requiring the information to be disclosed initially in any machine readable format alters those burden estimates because we believe the steps to be taken are quite similar. The Commission also notes that currently seven NRSROs are providing the disclosure required pursuant to Rule 17g-2(d) (or the 10% requirement) in machine-readable format. The Commission does believe that there will be an hour burden associated with transitioning from disclosing the information in a machine-readable format into an XBRL format. Specifically, the Commission estimates that this hour burden will be approximately 40 hours per NRSRO. This estimate is based on

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209 See February 2009 Proposing Release, 74 FR at 6499.

210 50% of 30 hours = 15 hours + 30 hours = 45 hours.

211 50% of 10 hours = 5 hours + 10 hours = 15 hours.

212 See February 2009 Proposing Release, 74 FR at 6499.

Commission's staff experience regarding cost associated with XBRL programming. The 40 hours estimate includes time for the appropriate staff of the NRSRO[213] to research and become familiar with the List of XBRL Tags, map the information disclosed in the machine-readable format to the XBRL taxonomy and conduct initial testing.

Accordingly, the Commission estimates that the total aggregate one-time burden for NRSROs to make their ratings histories publicly available initially in machine-readable interactive format, and the one-time burden to transition the disclosure of information from machine-readable to XBRL will be approximately 2,550 hours,[214] and the total aggregate annual burden hours will be approximately 450 hours.[215] This represents an increase from the estimates of 210 hours on a one-time basis and 70 hours on an annual basis set forth in the February 2009 Proposing Release.[216] This increase is attributable to the fact that the amendments to Rule 17g-2(d) as adopted apply to all NRSROs, rather than only to NRSROs operating under the issuer-paid business model as originally proposed.

2. Amendments to Rule 17g-5

Rule 17g-5 requires an NRSRO to manage and disclose certain conflicts of interest[217] and prohibits certain other types of conflicts of interest outright.[218] The amendments to Rule 17g-5 add an additional conflict to paragraph (b) of Rule 17g-5 for NRSROs to manage: issuing or maintaining a credit rating for a security or money market

213 The Commission believes a Senior Programmer would be tasked to perform the transition of disclosing the information in machine-readable format to XBRL.

214 45 hours x 30 NRSROs = 1,350 hours, plus the one time burden to change from machine readable format to XBRL of 40 hours x 30 NRSROs = 1,200 hours; for a total one-time burden of 1,350 + 1,200 = 2,550.

215 15 hours x 30 NRSROs = 450 hours.

216 February 2009 Proposing Release, 74 FR at 6499.

217 17 CFR 240.17g-5(a) and (b).

218 17 CFR 240.17g-5(c).

instrument issued by an asset pool or as part of an asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument.[219] The amendments to paragraph (a) of the rule further specify that an NRSRO subject to this conflict is prohibited from issuing a credit rating for a structured finance product, unless certain information about the transaction and the assets underlying the structured finance product are disclosed or arranged to be disclosed by the NRSRO. Specifically, the amendments require an NRSRO that is hired by arrangers to perform credit ratings for structured finance products to disclose to other NRSROs the deals for which it is in the process of determining such credit ratings and to obtain written representations from arrangers that the arrangers will provide the same information given to the hired NRSRO to other NRSROs. An NRSRO rating such products will need to disclose to other NRSROs the following information on a password protected Internet Web site: a list of each such security or money market instrument for which it is currently in the process of determining an initial credit rating in chronological order and identifying the type of security or money market instrument, the name of the issuer, the date the rating process was initiated, and the Internet Web site address where the issuer, sponsor, or underwriter of the security or money market instrument represents that the information described in paragraphs (a)(3)(iii)(C) and (D) of Rule 17g-5 as amended can be accessed.[220]

The Commission estimated in the February 2009 Proposing Release that it would take an NRSRO approximately 300 hours to develop a system, as well as policies and

219 17 CFR 240.17g-5(b)(9).

220 Paragraph (a)(3)(i) of Rule 17g-5.

procedures, for the disclosures required.[221] This estimate was based on the Commission's experience with, and burden estimates for, the recordkeeping requirements for NRSROs.[222] In addition to the estimated one-time hour burden, the amendments will result in an annual hour burden to the NRSRO arising from the requirement to make disclosures for each deal being rated. Based on staff experience, the Commission estimated that it would take approximately 1 hour per transaction for an NRSRO to update the lists maintained on its password protected Internet Web sites.[223]

In the February 2009 Proposing Release, the Commission repeated its estimate, originally set forth in the June 2008 Proposing Release,[224] that a large NRSRO would have rated approximately 2,000 new RMBS and CDO transactions in a given year. The Commission based this estimate on the number of new RMBS and CDO deals rated in 2006 by two of the largest NRSROs which rated structured finance transactions. The Commission adjusted this number to 4,000 transactions in order to account for other types of structured finance products, including commercial real estate MBS and other consumer assets.[225] As noted in the February 2009 Proposing Release, the Commission recognizes that the number of new structured finance transactions has dropped precipitously since 2006 because of the credit market turmoil. Nonetheless, to account for future market developments, which is a more conservative approach, the Commission retained the estimate that a large NRSRO will rate 4,000 new deals per year.[226] The Commission received no comments on the estimate.

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221 See February 2009 Proposing Release, 74 FR at 6500.
222 See June 2007 Adopting Release, 72 FR at 33609.
223 See February 2009 Proposing Release, 74 FR at 6500.
224 See June 2008 Proposing Release, 73 FR at 36240.
225 See February 2009 Proposing Release, 74 FR at 6500.
226 Id.

Based on the number of outstanding structured finance ratings submitted by the ten registered NRSROs on their Form NRSROs, the Commission estimated that the three largest NRSROs account for 97% of the market for structured finance ratings. As explained in greater detail in the February 2009 Proposing Release, the Commission used that estimate of market share to estimate that the total structured finance ratings issued by all NRSROs in a given year would be 14,880.[227]

The Commission requested comment on its burden estimates for the proposed amendments to Rule 17g-5(a) and (b) and received one comment from a large NRSRO arguing that the Commission significantly underestimated the initial and recurring burdens associated with the proposed amendments.[228] Specifically, the commenter argued that developing the software and password-protected Internet Web page could require a thousand, if not thousands, of hours of work and that the development of policies and procedures and controls to implement the requirement could take at least a thousand hours, and that developing a training module and training affected staff could take at least 500 hours. The commenter further stated that it may take one to two hours per transaction to update the NRSRO Web site, depending on the frequency with which key data change during the rating process.[229]

The Commission is sensitive to the potential burdens imposed on NRSRO by these new disclosure requirements. However, based on staff experience, the Commission does not believe the cost will result in the burdens estimated by the sole commenter expressing disagreement with the Commission's original estimates. As previously noted, all of the NRSROs currently maintain Internet Web sites, in most cases with password-

227 Id.

228 See Moody's Letter.

229 See Moody's Letter.

protected portals that their subscribers and registered users can access to obtain information posted by the NRSRO. The Commission believes that adding a portal for other NRSROs to access pending deal information should not require significant additional Internet Web site design and maintenance.

Consistent with the estimates set forth in the February 2009 Proposing Release,[230] the Commission believes, based on staff experience, that an NRSRO will take approximately 300 hours on a one-time basis to implement a disclosure system to comply with the new requirements of Rule 17g-5(a)(3)(i) and (ii), resulting in a total one-time hour burden of 9,000 hours for 30 NRSROs.[231] The Commission further believes that based on its estimates that the total structured finance ratings issued by all NRSROs in a given year would be 14,880 and that it will take each NRSRO affected by the rule approximately 1 hour per transaction for the NRSRO to update the lists maintained on the NRSROs' password protected Internet Web sites, the total annual hour burden for the industry will be 14,880 hours.[232]

New paragraph (a)(3)(iii) of Rule 17g-5 requires that an NRSRO hired to rate a structured finance product obtain from the arranger a written representation on which it can reasonably rely that it will disclose the following information on a password-protected Internet Web site at the same time the information is provided to the NRSRO:

- all information the arranger provides to the NRSRO for the purpose of determining the initial credit rating for the security or money market instrument, including information about characteristics of the assets underlying or referenced

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230 See February 2009 Proposing Release, 74 FR at 6500.

231 300 hours x 30 NRSROs = 9,000 hours.

232 14,880 ratings x 1 hour = 14,880 hours.

by the security or money market instrument, and the legal structure of the security or money market instrument; and

- all information the arranger provides to the NRSRO for the purpose of undertaking credit rating surveillance on the security or money market instrument, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument.[233]

In the February 2009 Proposing Release, the Commission estimated that there would be approximately 200 arrangers affected by the proposed new paragraph (a)(iii) of Rule 17g-5 and that it would take each arranger approximately 300 hours to develop a system, including policies and procedures, for the disclosures.[234] These estimates were based on the Commission's experience with, and burden estimates for, the recordkeeping requirements for NRSROs.[235] The Commission further noted that in addition to this one-time hour burden, the proposed amendments would result in an annual hour burden for arrangers arising from the disclosure of information on a transaction-by-transaction basis each time an initial rating process is commenced. The Commission estimated, based on staff experience and the estimate of 4,000 new structured finance deals per year as discussed above, that each respondent would disclose information for approximately 20 new transactions per year[236] and that it would take approximately 1 hour per transaction to post the information to its password-protected Internet Web sites. The Commission noted that the number of new transactions per year would vary by the size of issuer, with larger respondents perhaps arranging in excess of 20 new deals per year and smaller

233 Paragraph (a)(3)(iii) of Rule 17g-5.

234 See February 2009 Proposing Release, 74 FR at 6500.

235 See June 2007 Adopting Release, 72 FR at 33609.

236 4,000 new transactions/200 issuers = 20 new transactions per issuer.

arrangers perhaps initiating less. The estimate of 20 new deals per year is therefore an average across all respondents.[237] Based on this analysis, the Commission estimated that it would take a respondent approximately 20 hours[238] to disclose this information, on an annual basis, for a total aggregate annual hour burden of 4,000 hours.[239] The Commission received no comments on this estimate, nor did the Commission receive any comments on an identical burden estimate in the original proposing release.

In addition, Rule 17g-5(a)(3)(iii)(D) requires that an NRSRO hired to rate a structured finance product obtain from the arranger a written representation on which it can reasonably rely that the arranger will disclose the information it provides to the hired NRSRO to be used for credit rating surveillance on a security or money market instrument on a password-protected Internet Web site at the same time the information is provided to the hired NRSRO. Because surveillance covers more than just initial ratings, the Commission estimated, in the June 2008 Proposing Release and the February 2009 Proposing Release, based on staff information gained from the NRSRO examination process, that monthly disclosure would be required with respect to approximately 125 transactions on an ongoing basis.[240] Also based on staff information gained from the NRSRO examination process, the Commission estimated that it would take a respondent approximately 0.5 hours per transaction to disclose the information.[241]

The Commission requested comment in the February 2009 Proposing Release on all aspects of its estimates for the amount of time arrangers would spend complying with

237 See February 2009 Proposing Release, 74 FR at 6501.
238 20 transactions x 1 hour = 20 hours.
239 20 hours x 200 respondents = 4,000 hours.
240 See infra note 286 and accompanying text.
241 See June 2008 Proposing Release, 73 FR at 36240; February 2009 Proposing Release, 74 FR at 6500.

the requirements of proposed paragraph (a)(3)(iii) of Rule 17g-5. The Commission did not receive any comments in response to this request.

Accordingly, the Commission believes, based on its estimate that an arranger will take approximately 300 hours on a one-time basis to implement a disclosure system consistent with the representations to be made pursuant to new paragraph (a)(3)(iii) of Rule 17g-5, that the total one-time hour burden for arrangers will be 60,000 hours.[242] The Commission further believes, based on its estimate of an average of 125 ongoing transactions each month and 30 minutes spent on the monthly disclosure for each transaction, that each respondent will spend approximately 750 hours[243] on an annual basis disclosing information consistent with the representations to be made pursuant to new paragraph (a)(3)(iii) of Rule 17g-5, for a total aggregate annual burden of 150,000 hours.[244]

An NRSRO that wishes to access information on another NRSRO's Internet Web site or on an arranger's Internet Web site pursuant to Rule 17g-5(a)(3) as amended is required to provide the Commission with an annual certification described in proposed new paragraph (e) to Rule 17g-5. In the February 2009 Proposing Release, the Commission estimated that this annual certification would become a matter of routine over time and should take less time than it takes an NRSRO to submit its annual certification under Rule 17g-1(f).[245] The annual certification required under Rule 17g-1(f) involves the disclosure of substantially more information than the certification in proposed paragraph (e) of Rule 17g-5. The Commission estimated that it will take an

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242 300 hours x 200 respondents = 60,000 hours.

243 125 transactions x 30 minutes x 12 months = 45,000 minutes/60 minutes = 750 hours.

244 750 hours x 200 respondents = 150,000 hours.

245 17 CFR 240.17g-1(f). See February 2009 Proposing Release, 74 FR at 6501.

NRSRO approximately 10 hours to complete the Rule 17g-1(f) annual certification.[246] Given that the paragraph (e) certification requires much less information, the Commission estimated, based on staff experience, that it would take an NRSRO approximately 20% of the time it takes to do the Rule 17g-5 annual certification, or 2 hours.[247] The Commission assumed that all 30 NRSROs ultimately registered with the Commission would complete the certification. The Commission requested comment on this estimate but did not receive any. Accordingly, the Commission estimates it will take an NRSRO approximately 2 hours to complete the proposed paragraph (e) certification for an aggregate annual hour burden to the industry of 60 hours.[248]

To comply with the requirement under Rule 17g-5(a)(3)(iii) that it obtain from the issuer, sponsor or underwriter a written representation that reasonably can be relied upon, an NRSRO likely will include such a representation in the standardized contract it uses in each transaction the NRSRO contracts to rate. The Commission notes that the Rule 17g-5(a)(3)(iii) includes representations an NRSRO is required to obtain from an arranger. The Commission expects an NRSRO's in-house attorney to draft the representations based on this text, which will be inserted into the NRSRO's existing standardized contracts. Based on staff experience, the Commission estimates that there will be a one-time burden of five hours for this language to be drafted, negotiated and added to the NRSRO's standardized contract. This estimate is based in part on the two hour burden estimate that the Commission believes would result from an NRSRO completing the certification required under paragraph (e) of Rule 17g-5. However, the added hours reflect the additional time needed to draft the representations because the specific

246 See June 2007 Adopting Release, 72 FR at 33609.

247 20% of 10 hours = 2 hours.

248 2 hours x 30 NRSROs = 60 hours.

language is not included in the rule. Therefore, there will be a total one-time aggregate hour burden of 150 hours.[249]

E. Collection of Information Is Mandatory

The recordkeeping and notice requirements for the amendments are mandatory for credit rating agencies that choose to register as NRSROs with the Commission.[250]

F. Confidentiality

The disclosures required under the amendments to Rule 17g-2(d) will be public. Pursuant to the representations an NRSRO hired to rate a structured finance product is required to obtain under the amendments to Rule 17g-5, arrangers will make the information they provide to the hired NRSRO available to other NRSROs. Pursuant to Rule 17g-5(e), the NRSROs are required to provide certifications to the Commission agreeing to keep the information they access under Rule 17g-5(a)(3) confidential.

The information an NRSRO posts on its Internet Web site pursuant to Rule 17g-5(a)(3)(i) and (ii) will be available only to NRSROs that have provided to the NRSRO that posts the information a certification that was furnished to the Commission pursuant to subparagraph (e). The representations made by the arranger and provided to the NRSRO will not be made public, unless the NRSRO or arranger chooses to make them public. All documents maintained by an NRSRO are subject to inspection by representatives of the Commission. The Commission will not make public the certifications provided by NRSROs pursuant to subparagraph (e). NRSROs will also provide copies of their certifications to arrangers when accessing arranger Web sites. Arrangers are not expected to make these certifications public.

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249 5 hours x 30 NRSROs = 150 hours.

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

V. COSTS AND BENEFITS OF THE AMENDED RULES

The Commission is sensitive to the costs and benefits that result from its rules. In the February 2009 Proposing Release, the Commission identified certain costs and benefits of the amendments and requested comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis.[251] The Commission sought comment and data on the value of the benefits identified. The Commission also solicited comments on the accuracy of its cost estimates in each section of this cost-benefit analysis, and requested commenters to provide data so the Commission could improve the cost estimates, including identification of statistics relied on by commenters to reach conclusions on cost estimates. Finally, the Commission requested 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 the rule amendments.

A. Benefits

The purposes of the Rating Agency Act, as stated in the accompanying Senate Report, are to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating

251 For the purposes of the cost/benefit analysis set forth in the February 2009 Proposing Release, the Commission used salary data from the Securities Industry and Financial Markets Association ("SIFMA") Report on Management and Professional Earnings in the Securities Industry 2007, which provides base salary and bonus information for middle-management and professional positions within the securities industry. The Commission believes that the salaries for these securities industry positions would be comparable to the salaries of similar positions in the credit rating industry. The salary costs derived from the report and referenced in this costs and benefits section, are modified to account for an 1,800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. Hereinafter, references to data derived from this SIFMA report as modified in the manner described above will be cited as SIFMA 2007 Report as Modified. For the purposes of this costs and benefits section, the Commission is using updated salary data from SIFMA's Management and Professional Earnings in the Securities Industry 2008 with similar modifications. Hereinafter, references to data derived from the most recent SIFMA report as modified in the manner described above will be cited as SIFMA 2008 Report as Modified.

industry.[252] As the Senate Report states, the Rating Agency Act establishes "fundamental reform and improvement of the designation process" with the goal that "eliminating the artificial barrier to entry will enhance competition and provide investors with more choices, higher quality ratings, and lower costs."[253]

The amendments are designed to improve the transparency of credit ratings performance and promote competition by making histories of credit ratings actions publicly available and creating a mechanism for NRSROs to determine unsolicited credit ratings for structured finance products.

The amendments to Rule 17g-2(d) require NRSROs to publicly disclose all of their ratings actions histories for credit ratings in an interactive data file that uses a machine-readable computer format either with a twelve month or twenty-four month grace period, depending on whether the credit rating was issuer-paid or not. An NRSRO will be allowed to use any machine-readable format to make this data publicly available until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in XBRL format using the Commission's List of XBRL Tags for NRSROs. This disclosure will allow the marketplace to better compare the performance of NRSROs determining credit ratings. The Commission believes that making this information publicly available will benefit users of credit ratings by providing them with useful metrics with which to compare NRSROs. The Commission also notes that the 100% requirement will be useful to market participants and observers

252 Senate Report, p. 2.
253 Id, p. 7.

within a short period of the rule being effective as the vast majority will be available at twelve months.

Analyzing ratings history information for outstanding credit ratings is the most direct means of comparing the performance of two or more NRSROs. The access to ratings history data provided by the rule as amended will facilitate the ability of users of credit ratings to compare how each NRSRO that maintains a credit rating for a particular obligor or debt instrument initially rated the instrument and, thereafter, how and when it adjusted its credit rating over time. This will provide the benefit of allowing the person reviewing the credit rating histories of the NRSROs to reach conclusions about which NRSROs did the best job in determining an initial rating and, thereafter, making appropriate and timely adjustments to the credit rating. Increased disclosure of ratings history for credit ratings will make the performance of the NRSROs more transparent to the marketplace and, thereby, highlight those firms that do a better job assessing creditworthiness. This may cause users of credit ratings to give greater weight to credit ratings of NRSROs that distinguish themselves by a better history of credit rating performance than their peers. Moreover, to the extent this improves the quality of the credit ratings, persons that use credit ratings, for example, to make investment or lending decisions will have better information upon which to base their decisions.

In addition to facilitating the ability of individual comparisons of NRSRO ratings performance, the Commission believes the ratings history disclosures will enable market observers and participants to generate statistics about NRSRO performance by compiling and processing the information in the aggregate. The ratings history disclosure requirements adopted today will facilitate the ability of market observers and participants and other users of credit ratings to complement the standardized performance metrics disclosure required under Commission rules by designing their own performance metrics in order to generate the performance statistics most meaningful to them. Specifically, the raw data to be provided by NRSROs will allow market participants to develop performance measurement statistics that would supplement those required to be published by the NRSROs themselves in Exhibit 1 to Form NRSRO, tapping into the expertise of credit market observers and participants in order to create better and more useful means to compare the performance of NRSROs. In addition, the Commission believes that the new disclosure requirements will provide the benefit of fostering greater accountability for NRSROs as well as promoting competition among NRSROs by making it easier for users of credit ratings to analyze the actual performance of credit ratings in terms of accuracy (as defined by each individual user of credit ratings) in assessing creditworthiness, regardless of the business model under which an NRSRO operates. These disclosures may also enhance competition by making it easier for smaller and less established NRSROs to develop proven track records of determining accurate credit ratings.

As discussed above and below in the cost discussion, the Commission recognizes that the amended rule may negatively affect the revenues of NRSROs. Nevertheless, as explained in greater detail above, the Commission believes that the amended rule, as adopted, strikes an appropriate balance between providing users of credit ratings, investors, and other market participants and observers with a sufficient volume of raw data with which to gauge the performance of different NRSROs' ratings over time while at the same time addressing concerns raised by NRSROs regarding their ability to derive revenue from granting market participants access to their credit ratings and downloads of their credit ratings. In particular, by providing 100% of credit ratings histories for ratings initially determined after June 26, 2007, the rule as amended will over time provide a robust data set for users of credit ratings, investors, and other market participants and observers.

At the same time, the Commission believes that the twenty-four month grace period before a credit rating action that is not issuer-paid is required to be disclosed, as well as requiring only the disclosure of the credit ratings and not any analysis or report accompanying the publication of a rating, will not lead to significant or undue lost revenues to NRSROs operating under the subscriber-paid business model. Additionally, the Commission believes that the disclosure of a credit rating action that is issuer-paid on a twelve month delayed basis also will not lead to undue lost revenue. As noted previously, the Commission understands that the revenue derived from payments for downloads of their ratings represents a relatively small percentage of their total net revenue. The rule does not require an NRSRO to disclose any analysis or report along with the rating history. Therefore, the Commission does not believe the fees that NRSROs derive from selling their analysis along with their ratings will be significantly impacted. Further, the ability to receive data on a ratings action twenty-four months after it takes place would not appear to be an adequate substitute for subscribing to an NRSRO's current credit ratings, nor would the ability to download credit ratings that are twelve months old be a substitute for downloading current credit ratings.

The amendments to paragraphs (a) and (b) of Rule 17g-5 require NRSROs that are paid by arrangers to determine credit ratings for structured finance products to maintain a password-protected Internet Web site that lists each deal they have been hired to rate. They also will be required to obtain written representations from the arranger hiring the NRSRO, on which the NRSRO can reasonably rely, that the arranger will post all information provided to the NRSRO to determine the rating and, thereafter, to monitor the rating on a password protected Internet Web site. NRSROs not hired to determine and monitor the ratings will then be able to access the NRSRO Internet Web sites to learn of new deals being rated and access the arranger Internet Web sites to obtain the information being provided by the arranger to the hired NRSRO during the initial rating process and, thereafter, for the purpose of surveillance. However, the ability of NRSROs to access these NRSRO and arranger Internet Web sites will be limited to NRSROs that certify to the Commission on an annual basis, among other things, that they are accessing the information solely for the purpose of determining or monitoring credit ratings, that they will keep the information confidential and treat it as material non-public information, and that they will determine credit ratings for at least 10% of the deals for which they obtain information if they access such information for ten or more structured finance products in the calendar year covered by the certification. They are also required to disclose in the certification the number of deals for which they obtained information through accessing the Internet Web sites and the number of ratings they issued using that information during the year covered by their most recent certification, or, alternatively that they previously had not accessed such information ten or more times in the most recently ended calendar year.

The Commission is adopting these amendments to Rule 17g-5, in part, pursuant to the authority in Section 15E(h)(2) of the Exchange Act.[254] These provisions provide the Commission with authority to prohibit, or require the management and disclosure of, any potential conflict of interest relating to the issuance of credit ratings by an NRSRO.[255] The amendments are designed to address conflicts of interest and improve competition and the quality of credit ratings for structured finance products by making it possible for more NRSROs to rate structured finance products. Generally, the information relied on by the hired NRSROs to rate structured finance products is non-public. This makes it difficult for other NRSROs to rate these securities and money market instruments. As a result, the products frequently are issued with ratings from only one or two NRSROs and only by NRSROs that are hired by the issuer, sponsor, or underwriter (i.e., NRSROs that are subject to the conflict of being repeatedly paid by certain arrangers to rate these securities and money market instruments).

The Commission's goal is to increase the number of ratings extant for a given structured finance security or money market instrument and, in particular, promote the issuance of ratings by NRSROs that are not hired by the arranger. This will provide users of credit ratings with a broader range of views on the creditworthiness of the security or money market instrument than is currently available. The amendments are also designed to make it more difficult for arrangers to exert influence over the NRSROs they hire to determine ratings for structured finance products. Specifically, by opening up the rating process to more NRSROs, the amendments may make it easier for the hired NRSRO to resist such pressure by increasing the likelihood that any steps taken to inappropriately

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

255 Id.

favor the arranger could be exposed to the market through the ratings issued by other NRSROs.

As discussed in detail above, the Commission recognizes that the amendments to Rule 17g-5 will increase the number of credit ratings available to investors by increasing the number of NRSROs issuing those ratings, thereby potentially giving arrangers a broader pool of NRSROs among which to "shop" for a rating. The Commission also recognizes the concern that NRSROs not hired by the arranger might have the incentive to use information accessed pursuant to Rule 17g-5 as amended to issue an unduly favorable rating in an attempt to procure future business from a particular arranger. The Commission believes that there are several factors counteracting this incentive. First, the 100% disclosure requirement set forth in Rule 17g-2(d), as amended, will facilitate users of credit ratings to compare the credit rating performance of all NRSROs issuing a credit rating for a given structured finance product, whether the NRSROs are hired by the arranger to do so or instead are issuing unsolicited ratings based on information obtained under the provisions of Rule 17g-5 as amended. This will likely enhance both hired and non-hired NRSRO's accountability for the ratings they issue. Second, the information disclosed pursuant Rule 17g-5 will be available to all NRSROs, including NRSROs operating under the subscriber-paid model. Since the latter are not compensated by the structured products' arrangers, they can issue unsolicited ratings without the pressure of worrying about the effect that the unsolicited ratings might have on their future revenue stream from arrangers of structured finance. Finally, by facilitating the issuance of unsolicited ratings, the amendments to Rule 17g-5 may serve to mitigate the potential for ratings shopping, since an arranger that "shopped" in order to obtain a higher rating would still face the possibility of non-hired NRSROs issuing lower ratings.

The Commission generally requested comment on all aspects of the benefits of the amendments as proposed.[256] In addition, the Commission requested specific comment on the 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. The Commission did not receive any specific comments in response.

The amendment to Regulation FD will accommodate the information disclosure program that the Commission is establishing under paragraphs (a) and (b) of Rule 17g-5. Specifically, it will permit issuers to rely on Regulation FD in providing information to NRSROs that require subscriptions to access their ratings. In this way, the amendment will not favor a particular NRSRO business model. Furthermore, to the extent that it increases the number of NRSRO credit ratings for structured finance products, users of credit ratings will have more choices. Finally, the amendment to Regulation FD will provide legal certainty to arrangers who provide access to the information to NRSROs consistent with the mechanisms established by Rule 17g-5.

B. Costs

As discussed below, the amendments will result in costs to NRSROs, arrangers, and others. The costs to a given NRSRO arising from the amendments adopted today will depend on its size and the complexity of its business activities. The size and complexity of NRSROs vary significantly. Therefore, the cost to implement these rule amendments will vary significantly across NRSROs. The cost to NRSROs will also vary

[256] See February 2009 Proposing Release, 74 FR at 6473.

depending on which classes of credit ratings an NRSRO issues and how many outstanding ratings it has in each class. NRSROs which issue credit ratings for structured finance products may incur higher compliance costs than those NRSROs which do not issue such credit ratings or issue very few credit ratings in that class. For these reasons, the cost estimates represent the average cost across all NRSROs.

1. Amendment to Rule 17g-2

The amendments to paragraph (d) of Rule 17g-2 require NRSROs to make 100% of their ratings action histories for any credit rating initially determined on or after June 26, 2007 publicly available in an interactive data file that uses a machine-readable format, with either a twelve month or twenty-four month grace period, depending on whether the rating action relates to an issuer-paid credit rating or not.[257] An NRSRO will be allowed to use any machine-readable format to make this data publicly available until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in XBRL format using the Commission's List of XBRL Tags for NRSROs. As discussed with respect to the PRA, the Commission estimates that the total aggregate one-time burden to the industry to make the history of its rating actions publicly available initially in a machine-readable format, and subsequently in XBRL, will be 2,550 hours[258] and the total aggregate annual burden hours will be 450 hours.[259] For cost purposes, the Commission believes that a senior programmer will perform the functions required to comply with these requirements. Accordingly, the Commission

257 See 17 CFR 240.17g-2(d).

258 45 hours x 30 NRSROs = 1,350 hours + 5 hours x 30 NRSROs for the one time burden of switching the disclosure to XBRL for a total of 1,500; see also supra note 209 at accompanying text.

259 15 hours x 30 NRSROs = 450 hours; see also supra note 210 at accompanying text.

estimates that an NRSRO will incur an average one-time cost of $24,820 and an average annual cost of $4,380, as a result of the proposed amendment.[260] The Commission does not believe the NRSRO will incur any additional software cost from initially providing the information in machine-readable format prior to transitioning to XBRL. Based on staff experience, the Commission believes that NRSROs already have the necessary software to provide this disclosure in machine-readable format. Moreover, the Commission notes that currently seven NRSROs are providing the disclosure required pursuant to Rule 17g-2(d) (or the 10% requirement) in machine-readable format. Therefore, the Commission estimates the total aggregate one-time paperwork cost to the industry will be $744,600[261] and the total aggregate paperwork costs annual cost to the industry will be $131,400.[262]

In the February 2009 Proposing Release, the Commission noted that the amendments may impose other costs. For example, making some information about ratings action histories available to the public for free may have some impact on the business models of NRSROs, although the amendment is designed to minimize any such impact. Further, the rule may affect NRSROs with different revenue sources and business models differently.

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260 The SIFMA 2008 Report as Modified indicates that the average hourly cost for a Senior Programmer is $292. Therefore, the average one-time cost would be $24,820 [(45 hours x $292 per hour) + (40 hours x $292 per hour for the transition to disclose the information in XBRL)] and the average annual cost would be $4,380 (15 hours per year x $292 per hour). In the February 2009 Proposing Release, the Commission based its estimate on an average hourly cost of $289 for a Senior Programmer as set forth in the SIFMA 2007 Report as Modified, which resulted in estimates of a one-time cost of $13,005 [(45 hours x $289 per hour) and an average annual cost of $4,335 (15 hours per year x $289 per hour).

261 $24,820 x 30 NRSROs = $744,600. The estimate set forth in the February 2009 Proposing Release was $390,050 ($13,005 x 30 NRSROs).

262 $4,380 x 30 NRSROs = $131,400. The estimate set forth in the February 2009 Proposing Release was $130,150 ($4,335 x 30 NRSROs).

The Commission generally requested comment on all aspects of these cost estimates for the proposed amendments to paragraph (d) of Rule 17g-2. In addition, the Commission requested specific comment on the costs, for example, costs that will result from lost revenues incurred because NRSROs subject to the rule may not be able to sell ratings action histories if they are required to be publicly disclosed.[263] The Commission received seven letters that addressed the costs associated with complying with the proposed amendments to paragraph (d) of Rule 17g-2.[264] Several commenters argued that the proposed amendments entailed a higher likelihood of substantial financial harm to subscriber-paid NRSROs,[265] potentially resulting in fatal harm to the viability of the subscriber-paid business model.[266] Three commenters stated that without a longer grace period, the subscriber-based NRSROs would suffer a negative impact on sales of their products.[267] Two commenters stated that the proposed amendment would reduce the diversification of their revenue sources.[268] None of these commenters, however, provided any figures quantifying these costs.

As discussed in detail above,[269] the Commission believes that the grace periods in the rule will significantly mitigate the negative impact on NRSRO revenues that are derived from selling access to current ratings and downloads of current ratings. The Commission believes that the parties that pay subscription fees for access to NRSRO credit ratings and who pay for access to downloadable packages of issuer-paid and unsolicited credit ratings are unlikely to reconsider their purchase of those products due

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263 See February 2009 Proposing Release 74, FR at 6503.

264 See JCR Letter, ASF/SIFMA Letter, R&I Letter, Realpoint Letter, Moody's Letter, and S&P Letter.

265 See e.g., Hunt Letter; Realpoint Letter; Rapid Ratings Statement.

266 See e.g., Rapid Ratings Statement.

267 See JCR Letter, R&I Letter, and Realpoint Statement.

268 See Moody's Letter, S&P Letter.

269 See supra discussion in Section II.D.

to the public availability of twelve to twenty-four month-old ratings action information. The Commission believes that most of the persons who pay for these services want access to the NRSRO's current views on the creditworthiness of obligors and debt instruments; as such, it is not likely that they will view credit ratings that maybe as much as twenty-four months old as an adequate substitute for access to the NRSRO's current credit ratings. Furthermore, the amended rule, as adopted, does not require the disclosure of the analysis and report that typically accompany the publication of a credit rating. NRSROs will continue to be able to distribute such information as they see fit, including selling information to subscribers, which should serve to mitigate any such potential loss. As explained in detail above, the Commission's goals in adopting the amendments are to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry, and the Commission has balanced carefully its goals with the potential costs. While the Commission believes that NRSRO revenues derived from selling access to current ratings and downloads of current ratings will not be affected significantly by these new disclosure requirements, as previously stated, the Commission intends to closely monitor the impact, if any, they have on those revenues.

To the extent NRSROs derive revenues from selling access to their ratings histories, the Commission acknowledges that the new rule may well have a negative impact on this revenue stream. As noted above, the amended rule does not require NRSROs to disclose the analysis or report that typically accompany a credit rating, which is expected to mitigate any potential loss of revenue. Also, as noted above, information gathered by Commission staff over the course of discussions with NRSROs indicates that the amount of revenues they derived from selling access to ratings histories is not significant when compared to the revenues derived from other credit rating services. Nonetheless, the Commission will monitor this issue and, as part of that monitoring, the Commission encourages an NRSRO to notify the Commission if the rule causes a loss of this revenue source that is significant when compared to its total revenues.

While the Commission intends to closely monitor the impact, if any, of the rule amendments being adopted today on the revenue derived from selling access to current and historical ratings as discussed above, the Commission notes that a decrease in revenues could be the result of a number of factors. External factors, such as a reduction in regulatory emphasis on credit ratings, an increase in the level of independent analysis performed by investors, and a loss of confidence in the quality of ratings generally could result in an industry-wide loss of revenues unrelated to the rule amendments being adopted today. In addition, the increased transparency provided by the rule may cause users of credit ratings to shift their business to an NRSRO that the marketplace views as providing better credit ratings.

One commenter raised an issue regarding the costs associated with supplying the disclosure with the required CUSIP, stating that it anticipates an increase in transaction costs to amend its CUSIP license as well as a potentially higher annual licensing fee[270] The Commission notes that it addressed the potential increased costs associated with CUSIP licensing security in the February 2009 Adopting Release and that it believes that the estimates and evaluations of the costs set forth at that time continue to be valid.[271]

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270 See Moody's Letter.

271 See February 2009 Adopting Release, 74 FR at 6477.

2. Amendment to Rule 17g-5.

Rule 17g-5 requires an NRSRO to manage and disclose certain conflicts of interest[272] and prohibits certain other types of conflicts of interest outright.[273] The amendments to Rule 17g-5 add an additional conflict to paragraph (b) of Rule 17g-5 for NRSROs to manage: issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of an asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument.[274] The amendments further specify that an NRSRO subject to this conflict is prohibited from issuing a credit rating for a structured finance product, unless certain information about the transaction and the assets underlying the structured finance product are disclosed: the amendments require an NRSRO that is hired by arrangers to perform credit ratings for structured finance products to disclose to other NRSROs the deals for which it is in the process of determining such credit ratings and to obtain representations from arrangers that the arrangers will provide the same information given to the hired NRSRO to other NRSROs. Specifically, an NRSRO rating such products will need to disclose to other NRSROs the following information on a password protected Internet Web site: a list of each such security or money market instrument for which it is currently in the process of determining an initial credit rating in chronological order and identifying the type of security or money market instrument, the name of the issuer, the date the rating process was initiated, and the Internet Web site address where the issuer, sponsor, or underwriter

[272] 17 CFR 240.17g-5(a) and (b).
[273] 17 CFR 240.17g-5(c).
[274] Paragraph (b)(9) of Rule 17g-5.

of the security or money market instrument represents that the information described in paragraphs (a)(3)(iii)(C) and (D) of Rule 17g-5 as amended can be accessed.[275]

The Commission estimates that the average one-time cost to each NRSRO to establish the Internet Web site required under the rule as amended would be $66,900,[276] resulting in a total aggregate one-time cost to all NRSROs of $2,007,000.[277] As discussed with respect to the PRA, the Commission estimates a total aggregate annual hour burden of 14,880 hours.[278] The Commission estimates that the average annual cost to a large NRSRO would be $799,280, the average annual cost to an NRSRO not in that category would be $24,720,[279] and the total aggregate annual cost to NRSROs will be $3,065,280.[280]

The amendments also require the hired NRSRO to obtain representations from the arranger that the arranger will disclose the following information:

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275 Paragraph (a)(3)(i) of Rule 17g-5.

276 The Commission believes that an NRSRO would have a Compliance Manager and a Programmer Analyst perform these responsibilities, and that each would spend 50% of the estimated hours performing these responsibilities. The SIFMA 2008 Report as Modified indicates that the average hourly cost for a Compliance Manager is $258 and the average hourly cost for a Programmer Analyst is $193. Therefore, the average one-time cost to an NRSRO would be (150 hours x $253) + (150 hours x $193) = $66,900. In the February 2009 Proposing Release, the Commission based its estimate on an average hourly cost of $245 for a Compliance Manager and $194 for a Programmer Analyst as set forth in the SIFMA 2007 Report as Modified, which resulted in an estimate of an average one-time cost to an NRSRO of (150 hours x $245) + (150 hours x $194) = $65,850.

277 $66,900 x 30 NRSROs = $2,007,000. The estimate set forth in the February 2009 Proposing Release was $1,975,500 ($65,850 x 30 NRSROs).

278 (3,880 hours per large NRSRO x 3) + (120 hours per NRSRO not in that category x 27) = 14,880 hours.

279 The Commission believes that an NRSRO would have a Webmaster perform these responsibilities. The SIFMA 2008 Report as Modified indicates that the average hourly cost for a Webmaster is $206. Therefore, the average annual cost for a large NRSRO averaging 3,880 structured finance ratings would be $799,280 (3,880 hours x $206) and the average annual cost for an NRSRO not in that category averaging 120 structured finance ratings would be $24,720 (120 hours x $206). In the February 2009 Proposing Release, the Commission based its estimate on an average hourly cost of $205 for a Webmaster as set forth in the SIFMA 2007 Report as Modified, which resulted in an estimate of an average annual cost to a large NRSRO of $795,400 (3,880 hours x $205) and an average annual cost to NRSROs not in that category of $24,600 (120 hours x $205 = $24,600.)

280 ($799,280 x 3) + ($24,720 x 27) = $3,065,280.

- All information the issuer, sponsor, or underwriter provides to the nationally recognized statistical rating organization for the purpose of determining the initial credit rating for the security or money market instrument, including information about the characteristics of the assets underlying or referenced by the security or money market instrument, and the legal structure of the security or money market instrument, at the same time such information is provided to the nationally recognized statistical rating organization; and
- All information the issuer, sponsor, or underwriter provides to the nationally recognized statistical rating organization for the purpose of undertaking credit rating surveillance on the security or money market instrument, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument at the same time such information is provided to the nationally recognized statistical rating organization.[281]

For purposes of the PRA, as discussed above, the Commission estimates that it will take an NRSRO approximately 5 hours to develop the written representation that the NRSRO is required to obtain from the issuer, sponsor or underwriter. The Commission estimates that the average one-time cost to an NRSRO would be $1,525 and the total aggregate one-time cost to NRSROs will be $45,750.[282]

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281 See 17 CFR 240.17g-5(a)(3)(iii).

282 The Commission believes that the NRSRO would have an in-house Attorney perform these responsibilities. The SIFMA 2008 Report as Modified indicates that the average hourly cost for an Attorney is $305. Therefore, the average one-time cost to an NRSRO would be (5 hours x $305) = $1525, and the aggregate one-time cost to an NRSRO would be 30 NRSROs x $1,525 = $45,750.

For purposes of the PRA, as discussed above, the Commission estimates that it will take an arranger approximately 300 hours to develop a system, as well as policies and procedures to disclose the information. This results in a total one-time hour burden of 60,000 hours for 200 arrangers.[283] For these reasons, the Commission estimates that the average one-time cost to each arranger will be $66,900[284] and the total aggregate one-time cost to the industry would be $13,380,000.[285]

As discussed with respect to the PRA, in addition to the one-time hour burden, arrangers also will disclose the information on a transaction by transaction basis. Based on staff experience and the estimate of 4,000 new structured finance deals per year, as discussed above, the Commission estimates that the amendments will result in each arranger disclosing information with respect to approximately 20 new transactions per year and that it will take approximately 1 hour per transaction to make the information publicly available.[286] Therefore, as discussed with respect to the PRA, the Commission

283 300 hours x 200 respondents = 60,000 hours.

284 The Commission believes that an arranger would have a Compliance Manager and a Programmer Analyst perform these responsibilities, and that each would spend 50% of the estimated hours performing these responsibilities. The SIFMA 2008 Report as Modified indicates that the average hourly cost for a Compliance Manager is $258 and the average hourly cost for a Programmer Analyst is $193. Therefore, the average one-time cost to an arranger would be (150 hours x $253) + (150 hours x $193) = $66,900. In the February 2009 Proposing Release, the Commission based its estimate on an average hourly cost of $245 for a Compliance Manager and $194 for a Programmer Analyst as set forth in the SIFMA 2007 Report as Modified, which resulted in an estimate of an average one-time cost to an arranger of (150 hours x $245) + (150 hours x $194) = $65,850.

285 $66,900 x 200 arrangers = $13,380,000. The estimate set forth in the February 2009 Proposing Release was $13,117,000 ($65,850 x 200 arrangers = $13,117,000).

286 This estimate is based on the arranger already implementing the system and policies and procedures for disclosure. The Commission cannot estimate the number of initial transactions per year with certainty. The Commission believes that the number of deals on which each arranger will disclose information will vary widely based on the size of the arranger. In addition, the Commission believes that the number of asset-backed or mortgaged-backed issuances being rated by NRSROs in the next few years is difficult to predict given the recent credit market turmoil. The estimates, however, reflect the Commission's best assessment of the number of transactions based on experience and the available data.

estimates that the total aggregate annual hour burden for arrangers will be 4,000 hours.[287] The Commission estimates that the average annual cost to a respondent to be $4,120[288] and the total annual cost to the industry to be $824,000.[289]

Rule 17g-5(a)(3)(iii)(D) requires hired NRSROs to obtain representations from the arranger that the arranger will disclose information provided to the hired NRSRO to undertake credit rating surveillance on a structured product. Because surveillance covers more than just initial ratings, the Commission estimates that an arranger will disclose information with respect to approximately 125 transactions on an ongoing basis and that the information will be provided to the hired NRSRO on a monthly basis. As discussed with respect to the PRA, the Commission estimates a total aggregate annual burden hours of 150,000 hours.[290] The Commission estimates that the average annual cost to a respondent will be $154,500[291] and the total annual cost to the industry will be $30,900,000.[292]

An NRSRO that wishes to access information on another NRSRO's Web site or on an arranger's Web site will need to provide the Commission with an annual

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287 20 hours x 200 respondents = 4,000 hours.

288 The Commission believes that an arranger would have a Webmaster perform these responsibilities. The SIFMA 2008 Report as Modified indicates that the average hourly cost for a Webmaster is $206. Therefore, the average one-time cost to a respondent would be 20 hours x $206 = $4,120. In the February 2009 Proposing Release, the Commission based its estimate on an average hourly cost of $205 for a Webmaster as set forth in the SIFMA 2007 Report as Modified, which resulted in an estimate of an average one-time cost to an arranger of $4,100 (20 hours x $205 = $4,100.)

289 $4,120 x 200 respondents = $824,000. The estimate set forth in the February 2009 Proposing Release was $820,000 ($4,100 x 200 respondents = $820,000.)

290 750 hours x 200 respondents = 150,000 hours.

291 The Commission believes that an arranger would have a Webmaster perform these responsibilities. The SIFMA 2008 Report as Modified indicates that the average hourly cost for a Webmaster is $206. Therefore, the average annual cost to a respondent would be 750 hours x $206 = $154,500. In the February 2009 Proposing Release, the Commission based its estimate on an average hourly cost of $205 for a Webmaster as set forth in the SIFMA 2007 Report as Modified, which resulted in an estimate of an average annual cost to an arranger of $153,750 (750 hours x $205 = $153,750.)

292 $154,500 x 200 respondents = $30,900,000. The estimate set forth in the February 2009 Proposing Release was $30,750,000 ($153,750 x 200 respondents = $30,750,000).

certification described in proposed new paragraph (e) to Rule 17g-5. In the PRA, the Commission estimates an aggregate annual hour burden to the industry of 60 hours.[293] For these reasons, the Commission estimates it will cost an NRSRO approximately $516 dollars per year[294] and the industry $15,480 per year to comply with the certification requirement.[295]

The Commission requested comment on all aspects of these cost estimates for the amendments to Rule 17g-5. In addition, the Commission requested specific comment on whether the proposals impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs; and whether there would be additional costs not identified.[296] The Commission received three comment letters that addressed the costs associated with the amendments to Rule 17g-5.[297] One commenter stated that the consideration of financial impact should be based on the economic value a given entity contributes to the economy and not the company's financial health.[298] Another stated that the proposal would create the need for additional technology and staff, especially in consideration of the strong controls needed to protect the proprietary data published on the Web site.[299] The third commenter raised the concern that the formulations of the disclosures and information-sharing proposals could create costs that

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293 2 hours x 30 NRSROs = 60 hours.

294 The Commission believes that an NRSRO would have a Compliance Manager prepare the annual certification. The SIFMA 2008 Report as Modified indicates that the average hourly cost for a Compliance Manager is $258. Therefore, the average annual cost to an arranger would be $516 (2 hours x $258 = $516). In the February 2009 Proposing Release, the Commission based its estimate on an average hourly cost of $245 for a Compliance Manager which resulted in an estimate of an average annual cost to an arranger of $490 (2 hours x $245 = $490.)

295 $516 x 30 NRSROs = $15,480. The estimate set forth in the February 2009 Proposing Release was $14,700 ($490 x 30 NRSROs = $14,700).

296 See February 2009 Proposing Release, 74 FR at 6505.

297 See Marchywka Letter, FSR Letter, ASF Statement.

298 See Marchywka Letter.

299 See FSR Letter.

outweigh any burden.[300] As discussed above, the Commission believes the benefits of the enhanced disclosure requirements pursuant to Rule 17g-5 justify the costs.

Lastly, the Commission notes that the conforming amendment to Regulation FD needed to facilitate the disclosure requirements under Rule 17g-5 will not result in any additional costs.

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

Section 23(a)(2) of the Exchange Act[301] requires the Commission, when making rules and regulations under the Exchange Act, to consider the impact a new rule would have on competition. In addition, Section 23(a)(2) of the Exchange Act 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. Section 3(f) of the Exchange Act[302] requires the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, to consider whether the action would promote efficiency, competition, and capital formation.

As discussed in detail above, the amendments to paragraph (d) of Rule 17g-2 are designed to provide the marketplace with additional information for comparing the ratings performance of NRSROs and, therefore, provide users of credit ratings with more useful metrics with which to compare these NRSROs. Increased disclosure of ratings history for credit ratings will make the performance of the NRSROs more transparent to the marketplace and, thereby, highlight those firms that do a better job analyzing credit

300 See ASF Statement.
301 15 U.S.C. 78w(a).
302 15 U.S.C. 78c(f).

risk. This may cause users of credit ratings to give greater weight to credit ratings of NRSROs that distinguish themselves by creating a track record of better credit rating performance than their peers. Moreover, to the extent this improves the quality of the credit ratings, persons that use credit ratings to make investment or lending decisions would have better information upon which to base their decisions. As a consequence, the rule may result in a more efficient allocation of capital and loans to issuers and obligors based on the risk appetites of the investors and lenders. The Commission believes that this enhanced disclosure will benefit smaller NRSROs that determine issuer-paid credit ratings to the extent they do a better job of assessing creditworthiness because these smaller NRSROs will be better able to compete with the larger NRSROs for new business; users of credit ratings will be able to compare credit rating performance, allowing smaller NRSROs more easily to compete based on quality and creditability of their ratings.

Also as discussed in detail above, the amendments to paragraphs (a) and (b) of Rule 17g-5 are designed to enhance competition among NRSROs. The goal of these amendments is to provide a mechanism to enhance the ability of NRSROs to prepare unsolicited credit ratings, which would provide users of credit ratings with more assessments of the creditworthiness of a structured finance product. This mechanism may expose NRSROs whose procedures and methodologies for determining credit ratings are less conservative in order to gain business. In the same way, by creating a mechanism for a range of NRSROs to issue ratings, it also may mitigate the impact of rating shopping if ratings issued by NRSROs not hired to rate a deal differ from those of hired NRSROs. These potential impacts of the amendments may help to restore confidence in credit ratings and, thereby, promote capital formation. The Commission further believes that these amendments could promote the more efficient allocation of capital by investors to the extent the quality of credit ratings is improved. In addition, these amendments could increase competition by creating a mechanism for smaller NRSROs to obtain the information necessary to rate structured products and to market themselves based on a demonstrated proficiency in rating these structured products.

The Commission generally requested comment on all aspects of this analysis of its consideration of the effect on competition and promotion of efficiency, competition, and capital formation. Several commenters argued that the proposed amendments entailed a higher likelihood of substantial financial harm to subscriber-paid NRSROs,[303] potentially resulting in fatal harm to the viability of the subscriber-paid business model.[304] Three commenters stated that without a longer grace period, the subscriber-based NRSROs would suffer a negative impact on sales of their products.[305]

As discussed in detail above, the Commission acknowledges the different grace periods provided for ratings disclose with respect to credit ratings that are issuer-paid or not.[306] The Commission believes that any competitive effects are limited because of the tailored time periods. The Commission believes that the twenty-four month grace period will significantly mitigate the negative impact on NRSRO revenues that are derived from selling subscriptions to their credit ratings and that the twelve month grace period will mitigate the impact on NRSRO revenues that are derived from selling downloadable access to their current credit ratings. Furthermore, the Commission believes that the

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303 See e.g., Hunt Letter; Realpoint Letter; Rapid Ratings Statement.

304 See e.g., Rapid Ratings Statement.

305 See JCR Letter, R&I Letter, and Realpoint Statement.

306 See supra discussion in Section II.D

parties that pay subscription fees for access to NRSRO credit ratings are unlikely to reconsider their purchase of those products due to the public availability of twenty-four month-old ratings action information. Likewise, the Commission believes that persons who pay for downloadable access to their current credit ratings are unlikely to re-consider their purchase of those products due to the public availability for databases containing twelve-month-old ratings action information.[307] The Commission believes that most of the persons who pay for these services want access to the NRSRO's current views on the creditworthiness of obligors and debt instruments; as such, it is not likely that they will view credit ratings that are twelve to twenty-four months old as an adequate substitute for access to the NRSRO's current credit ratings. As noted previously, the amended rule, as adopted, does not require the disclosure of the analysis and report that typically accompany the publication of a credit rating. NRSROs will continue to be able to distribute such information as they see fit, including restricting access to such information to paying subscribers, which should serve to mitigate any potential loss of subscribers.

As stated above, the Commission's goals in adopting the amendments are to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry. Enacting regulations that would threaten the ability of competitors to enter and compete with existing NRSROs in a manner consistent with the Exchange Act would be adverse to these goals. While the Commission believes that NRSRO revenues derived from selling access to current credit ratings will not be affected significantly by these new

[307] Id.

disclosure requirements, as previously stated, the Commission intends to closely monitor the impact, if any, they have on those revenues.

VII. FINAL REGULATORY FLEXIBILITY ANALYSIS

The Commission proposed amendments to Rules 17g-2 and 17g-5 under the Exchange Act. An Initial Regulatory Flexibility Analysis ("IRFA") was published in the February 2009 Proposing Release.[308] The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA"), in accordance with the provisions of the Regulatory Flexibility Act,[309] regarding the amendments to Rules 17g-2 and 17g-5 under the Exchange Act.

A. Need for and Objective of the Amendments

The amendments prescribe additional requirements for NRSROs to address concerns relating to the transparency of ratings actions and the conflicts of interest at NRSROs. The objectives of the Rating Agency Act are "to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry."[310] The amendments are designed to improve the transparency of credit ratings performance by making credit ratings actions publicly available and the accuracy of credit ratings for structured finance products by increasing competition among the NRSROs that rate these securities and money market instruments.

B. Significant Issues Raised by Commenters

The Commission sought comment with respect to every aspect of the IRFA, including comments with respect to the number of small entities that may be affected by

308 See February 2009 Proposing Release, 74 FR at 6506.
309 5 U.S.C. 603.
310 See Senate Report.

the amendments.[311] The Commission asked commenters to specify the costs of compliance with the proposed rules and suggest alternatives that would accomplish the goals of the rules.[312] The Commission did not receive any comments on the IRFA. The Commission, did, however receive comments arguing that the amendments requiring disclosure of 100% of ratings actions would negatively impact the revenue of NRSROs operating under the subscriber-paid model, although these commenters did not address whether their comments pertained to entities that would be small businesses for purposes of Regulatory Flexibility Act analysis.[313]

As stated above, the Commission believes that the twenty-four month grace period will significantly mitigate any negative impact on NRSRO revenues that are derived from selling subscriptions to current ratings. The parties that pay subscription fees for access to NRSRO credit ratings are unlikely to reconsider their purchase of those products due to the public availability of twenty-four month-old ratings action information. Furthermore, the amended rule, as adopted, does not require the disclosure of the analysis and report that typically accompany the publication of a credit rating. NRSROs will continue to be able to distribute such information as they see fit, including restricting access to such information to paying subscribers, which should serve to mitigate any potential loss of subscribers. While the Commission believes that NRSRO revenues derived from selling access to current credit ratings will not be affected significantly by these new disclosure requirements, the Commission will closely monitor the impact, if any, they have on those revenues. If this monitoring reveals that users of credit ratings are ceasing to purchase access to current credit ratings or downloads of

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311 See February 2009 Proposing Release 74 FR at 6506.
312 Id.
313 See e.g. JCR Letter; R&I Letter; Realpoint Statement.

current credit ratings because of the public disclosure of the histories of those ratings, the Commission will re-examine the rule and, if appropriate, consider modifications. At the same time, the Commission notes that the purpose of the rule is to allow users of credit ratings to better assess and compare the performance of NRSROs. The increased transparency provided by the rule could cause users of credit ratings to shift their business to an NRSRO that the marketplace views as providing the highest quality credit ratings. As a result, smaller NRSROs may benefit to the extent that they are better able to establish a reputation for providing high quality ratings and therefore increase their market share.

Although, the Commission did not receive any comments on the IRFA with respect to the re-proposed amendments to Rule 17g-5, the Commission did receive comments that addressed the proposal. Specifically, one commenter argued that the new disclosure requirement would favor large NRSROs with market power at the expense of small NRSROs.[314] The Commission notes that the rule is designed, among other things, to benefit small NRSROs to allow them the opportunity to rate structured finance products even if they are not hired by the arranger to determine the credit rating. The Commission recognizes that small NRSROs that are hired by an arranger to rate a structured finance product will incur a burden by having to make this information available to other NRSROs and conceivably lose business if other NRSROs develop a track record for doing a better job. However, the Commission believes that the burden of having to disclose the information is not significant. Moreover, with respect to losing business the rule is designed to foster competition and create a market where an NRSRO must perform well in determining a credit rating to succeed.

[314] See JCR Letter.

Three other comments argued that the costs of creating and maintaining a Web site are significant and would negatively impact smaller NRSROs in addition to potentially creating security risks.[315] As noted above, the Commission is sensitive to the costs of the new requirement but does not believe they are significant. As previously discussed, all of the NRSROs currently maintain Internet web sites, in most cases with password-protected portals that their subscribers and registered users can access to obtain information posted by the NRSRO. Consequently, the Commission believes that adding a portal for other NRSROs to access pending deal information is not expected to require significant additional Internet Web site design and maintenance.

C. Small Entities Subject to the Rule

Paragraph (a) of Rule 0-10 provides that for purposes of the Regulatory Flexibility Act, a small entity "[w]hen used with reference to an 'issuer' or a 'person' other than an investment company" means "an 'issuer' or 'person' that, on the last day of its most recent fiscal year, had total assets of $5 million or less."[316] The Commission believes that an NRSRO with total assets of $5 million or less qualifies as a "small" entity for purposes of the Regulatory Flexibility Act.

As noted in the June 2007 Adopting Release,[317] the Commission believes that approximately 30 credit rating agencies ultimately would be registered as an NRSRO. Currently, there are two NRSROs that are classified as "small" entities for purposes of the Regulatory Flexibility Act.[318]

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315 See DBRS Letter; ASF/SIMFA Letter; Moody's Letter.
316 17 CFR 240.0-10(a).
317 June 2007 Adopting Release, 72 FR at 33618.
318 See 17 CFR 240.0-10(a).

D. Projected Reporting, Recordkeeping, and Other Compliance Requirements

The amendments to paragraph (d) Rule 17g-2 add the requirement that an NRSRO disclose ratings actions histories in an interactive data file that uses a machine-readable format for all credit ratings initially determined on or after June 26, 2007, with each new ratings action to be reflected in such publicly disclosed histories no later than twelve months after the action for rating actions related to credit ratings that are issuer-paid, and no later than twenty-four months after it is taken for rating actions related to credit ratings that are not issuer-paid.[319] An NRSRO will be allowed to use any machine-readable format to make this data publicly available until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the NRSRO will be required to make the information available in XBRL format using the Commission's List of XBRL Tags for NRSROs.[320] This new disclosure requirement applies to all NRSRO credit ratings regardless of the business model under which they are determined.

The amendments to paragraphs (a) and (b) of Rule 17g-5 being adopted today require an NRSRO that is hired by arrangers to perform credit ratings for structured finance products (1) to disclose to non-hired NRSROs that have furnished the Commission with the certificate described below the deals for which they are in the process of determining such credit ratings and (2) to obtain written representations from arrangers on which the NRSRO can reasonably rely that the arrangers will provide information given to the hired NRSRO to non-hired NRSROs that have furnished the

319 See Paperwork Reduction Act, supra Section IV.
320 See 17 CFR 240.17g-2(d).

Commission with the certificate described below.[321] In addition, a new paragraph (e) of Rule 17g-5 requires NRSROs seeking to access the information maintained by the NRSROs and the arrangers pursuant to the amended rules to furnish the Commission an annual certification that they are accessing the information solely to determine credit ratings and will determine a minimum number of credit ratings using that information.[322]

E. Significant Alternatives

Pursuant to Section 3(a) of the Regulatory Flexibility Act,[323] the Commission must consider certain types of alternatives, including: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

The Commission is not establishing different compliance or reporting requirements or timetables but is using performance standards. The Commission believes that obtaining comparable information from NRSROs regardless of size is important. Moreover, because the amendments are designed to improve the overall quality of ratings by promoting transparency, accountability, and competition, and to enhance the Commission's oversight, the Commission believes that small entities should be covered by the rule.

VIII. STATUTORY AUTHORITY

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321 See 17 CFR 240.17g-5(a)(3) and (b)(9); see also Paperwork Reduction Act, supra Section IV.

322 See 17 CFR 240.17g-5(e).

323 5 U.S.C. 603(c).

The Commission is amending Rule 17g-2 and Rule 17g-5 pursuant to the authority conferred by the Exchange Act, including Sections 3(b), 15E, 17, and 23(a).[324]

Text of the Amendments

List of Subjects in 17 CFR Parts 240 and 243

17 CFR Part 240

Brokers, Reporting and recordkeeping requirements, Securities.

17 CFR 243

Regulation FD.

In accordance with the foregoing, the Commission amends Title 17, Chapter II of the Code of Federal Regulations as follows.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read in part as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et seq.; and 18 U.S.C. 1350, unless otherwise noted.

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2. Section 240.17g-2 is amended by revising paragraph (d) to read as follows:

§ 240.17g-2 Records to be made and retained by nationally recognized statistical rating organizations.

* * *

(d)(1) Manner of retention. An original, or a true and complete copy of the original, of each record required to be retained pursuant to paragraphs (a) and (b) of this

324 15 U.S.C. 78c(b), 78o-7, 78q, and 78w.

section must be maintained in a manner that, for the applicable retention period specified in paragraph (c) of this section, makes the original record or copy easily accessible to the principal office of the nationally recognized statistical rating organization and to any other office that conducted activities causing the record to be made or received.

(2) A nationally recognized statistical rating organization must make and keep publicly available on its corporate Internet Web site in an XBRL (eXtensible Business Reporting Language) format the ratings action information for ten percent of the outstanding credit ratings required to be retained pursuant to paragraph (a)(8) of this section, selected on a random basis, for each class of credit rating for which it is registered and for which it has issued 500 or more outstanding credit ratings paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated. Any ratings action required to be disclosed pursuant to this paragraph (d)(2) need not be made public less than six months from the date such ratings action is taken. If a credit rating made public pursuant to this paragraph is withdrawn or the instrument rated matures, the nationally recognized statistical rating organization must randomly select a new outstanding credit rating from that class of credit ratings in order to maintain the 10 percent disclosure threshold. In making the information available on its corporate Internet Web site, the nationally recognized statistical rating organization shall use the List of XBRL Tags for NRSROs as specified on the Commission's Internet Web site.

(3)(i)(A) A nationally recognized statistical rating organization must make publicly available on its corporate Internet Web site in an interactive data file that uses a machine-readable format the ratings action information required to be retained pursuant to paragraph (a)(8) of this section for any credit rating initially determined by the nationally recognized statistical rating organization on or after June 26, 2007.

(B) Any ratings action information required to be made and kept publicly available on a nationally recognized statistical rating organization's corporate Internet Web pursuant to paragraph (d)(3)(i)(A) with respect to credit ratings paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated need not be made public less than twelve months from the date such ratings action is taken.

(C) Any ratings action information required to be made and kept publicly available on a nationally recognized statistical rating organization's corporate Internet Web pursuant to paragraph (d)(3)(i)(A) with respect to credit ratings other than those ratings described in paragraph (d)(3)(i)(B) need not be made public less than twenty-four months from the date such ratings action is taken.

(ii) In making the information required under paragraph (d)(3)(i) available in an interactive data file on its corporate Internet Web site, the nationally recognized statistical rating organization shall use any machine-readable format, including but not limited to XBRL format, until 60 days after the date on which the Commission publishes a List of XBRL Tags for NRSROs on its Internet Web site, at which point the nationally recognized statistical rating organization shall make this information available in an interactive data file on its corporate Internet Web site in XBRL format using the List of XBRL Tags for NRSROs as published by the Commission on its Internet Web site.

* * * * *

3. Section 240.17g-5 is amended by:

a. Removing the word "and" at the end of paragraph (a)(1);

b. Removing the period at the end of paragraph (a)(2) and in its place adding "; and";

c. Adding paragraph (a)(3);

d. Redesignating paragraph (b)(9) as paragraph (b)(10);

e. Adding new paragraph (b)(9); and

f. Adding new paragraph (e).

The additions read as follows:

§ 240.17g-5 Conflicts of interest.

(a) * * *

(3) In the case of the conflict of interest identified in paragraph (b)(9) of this section relating to issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction, the nationally recognized statistical rating organization:

(i) Maintains on a password-protected Internet Web site a list of each such security or money market instrument for which it is currently in the process of determining an initial credit rating in chronological order and identifying the type of security or money market instrument, the name of the issuer, the date the rating process was initiated, and the Internet Web site address where the issuer, sponsor, or underwriter of the security or money market instrument represents that the information described in paragraphs (a)(3)(iii)(C) and (a)(3)(iii)(D) of this section can be accessed;

(ii) Provides free and unlimited access to such password-protected Internet Web site during the applicable calendar year to any nationally recognized statistical rating organization that provides it with a copy of the certification described in paragraph (e) of this section that covers that calendar year, provided that such certification indicates that the nationally recognized statistical rating organization providing the certification either:

(A) Determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to 17 CFR §240.17g-5(a)(3)(iii) in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or

(B) Has not accessed information pursuant to 17 CFR §240.17g-5(a)(3) 10 or more times during the most recently ended calendar year; and

(iii) Obtains from the issuer, sponsor, or underwriter of each such security or money market instrument a written representation that can reasonably be relied upon that the issuer, sponsor, or underwriter will:

(A) Maintain the information described in paragraphs (a)(3)(iii)(C) and (a)(3)(iii)(D) of this section available at an identified password-protected Internet Web site that presents the information in a manner indicating which information currently should be relied on to determine or monitor the credit rating;

(B) Provide access to such password-protected Internet Web site during the applicable calendar year to any nationally recognized statistical rating organization that provides it with a copy of the certification described in paragraph (e) of this section that covers that calendar year, provided that such certification indicates that the nationally recognized statistical rating organization providing the certification either:

(1) determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to 17 CFR §240.17g-5(a)(3)(iii) in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or

(2) has not accessed information pursuant to 17 CFR §240.17g-5(a)(3) 10 or more times during the most recently ended calendar year.

(C) Post on such password-protected Internet Web site all information the issuer, sponsor, or underwriter provides to the nationally recognized statistical rating organization, or contracts with a third party to provide to the nationally recognized statistical rating organization, for the purpose of determining the initial credit rating for the security or money market instrument, including information about the characteristics of the assets underlying or referenced by the security or money market instrument, and the legal structure of the security or money market instrument, at the same time such information is provided to the nationally recognized statistical rating organization; and

(D) Post on such password-protected Internet Web site all information the issuer, sponsor, or underwriter provides to the nationally recognized statistical rating organization, or contracts with a third party to provide to the nationally recognized statistical rating organization, for the purpose of undertaking credit rating surveillance on the security or money market instrument, including information about the characteristics and performance of the assets underlying or referenced by the security or money market instrument at the same time such information is provided to the nationally recognized statistical rating organization.

* * * * *

(b)(9) Issuing or maintaining a credit rating for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction that was paid for by the issuer, sponsor, or underwriter of the security or money market instrument;

* * * * *

(e) Certification. In order to access a password-protected Internet Web site described in paragraph (a)(3) of this section, a nationally recognized statistical rating organization must furnish to the Commission, for each calendar year for which it is requesting a password, the following certification, signed by a person duly authorized by the certifying entity:

> The undersigned hereby certifies that it will access the Internet Web sites described in 17 CFR §240.17g-5(a)(3) solely for the purpose of determining or monitoring credit ratings. Further, the undersigned certifies that it will keep the information it accesses pursuant to 17 CFR §240.17g-5(a)(3) confidential and treat it as material nonpublic information subject to its written policies and procedures established, maintained, and enforced pursuant to section 15E(g)(1) of the Act (15 U.S.C. 78o-7(g)(1)) and 17 CFR §240.17g-4. Further, the undersigned certifies that it will determine and maintain credit ratings for at least 10% of the issued securities and money market instruments for which it accesses information pursuant to 17 CFR §240.17g-5(a)(3)(iii), if it accesses such information for 10 or more issued securities or money market instruments in the calendar year covered by the certification. Further, the undersigned certifies one

of the following as applicable: (1) In the most recent calendar year during which it accessed information pursuant to §17 CFR 240.17g-5(a)(3), the undersigned accessed information for [Insert Number] issued securities and money market instruments through Internet Web sites described in 17 CFR §240.17g-5(a)(3) and determined and maintained credit ratings for [Insert Number] of such securities and money market instruments; or (2) The undersigned previously has not accessed information pursuant to 17 CFR §240.17g-5(a)(3) 10 or more times during the most recently ended calendar year.

PART 243 -- REGULATION FD

4. The authority citation for part 243 continues to read as follows:

Authority: 15 U.S.C. 78c, 78i, 78j, 78m, 78o, 78w, 78mm, and 80a-29, unless otherwise noted.

* * * * *

5. Section 243.100 is amended by revising paragraph (b)(2)(iii) to read as follows:

§ 243.100 General rule regarding selective disclosure.

* * * * *

(b)(2)(iii) To the following entities solely for the purpose of determining or monitoring a credit rating:

(A) any nationally recognized statistical rating organization, as that term is defined in Section 3(a)(62) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(62)), pursuant to § 240.17g-5(a)(3) of this chapter; or

(B) any credit rating agency, as that term is defined in Section 3(a)(61) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(61)), that makes its credit ratings publicly available; or

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: November 23, 2009

SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249b

[Release No. 34-61051; File No. S7-28-09]

RIN 3235-AK14

Proposed Rules for Nationally Recognized Statistical Rating Organizations

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

ACTION: Proposed rules.

SUMMARY: The Commission is proposing rule amendments and a new rule that would impose additional requirements on nationally recognized statistical rating organizations ("NRSROs"). The proposed amendments and rule would require an NRSRO: (1) to furnish a new annual report describing the steps taken by the firm's designated compliance officer during the fiscal year with respect to compliance reviews, identifications of material compliance matters, remediation measures taken to address those matters, and identification of the persons within the NRSRO advised of the results of the reviews; (2) to disclose additional information about sources of revenues on Form NRSRO; and (3) to make publicly available a consolidated report containing information about revenues of the NRSRO attributable to persons paying the NRSRO for the issuance or maintenance of a credit rating. The Commission is proposing these rules, in conjunction with a separate release being issued today adopting certain rule amendments, to further address concerns about the integrity of the credit rating procedures and methodologies at NRSROs. Finally, at this time, the Commission is announcing that it is deferring consideration of action with respect to a proposed rule that would have required an NRSRO to include, each time it published a credit rating for a structured finance

product, a report describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments, or, alternatively, to use distinct ratings symbols for structured finance products that differentiated them from the credit ratings for other types of financial instruments. The Commission is also soliciting comments regarding alternative measures that could be taken to differentiate NRSROs' structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example, enhanced disclosures of information. The Commission also is soliciting comment on whether the rule amendments being adopted today in a separate release designed to remove impediments to determining and monitoring non-issuer-paid credit ratings for structured finance products should be extended to create a mechanism for determining non-issuer-paid credit ratings for structured finance products that were issued prior to the rule becoming effective (e.g., to allow for non-issuer-paid credit ratings for structured finance products of the 2004-2007 vintage). The Commission strongly encourages market participants and all others to provide their views.

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

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

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-28-09 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 Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-28-09. 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, on official business days between the hours of 10:00 am and 3:00 pm. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available.

FOR FURTHER INFORMATION CONTACT: Michael A. Macchiaroli, Associate Director, at (202) 551-5525; Thomas K. McGowan, Deputy Associate Director, at (202) 551-5521; Randall W. Roy, Assistant Director, at (202) 551-5522; Joseph I. Levinson, Special Counsel, at (202) 551-5598; Sheila Dombal Swartz, Special Counsel, at (202) 551-5545; Rose Russo Wells, Special Counsel, at (202) 551-5527; Rebekah E. Goshorn, Attorney, at (202) 551-5514; Marlon Q. Paz, Senior Counsel to the Director, at (202) 551-5756; Division of Trading and Markets, Securities and Exchange Commission, 100 F

Street, NE, Washington, DC 20549-7010.

I. BACKGROUND

On February 2, 2009, the Commission adopted amendments to its existing rules governing the conduct of NRSROs under the Securities Exchange Act of 1934 ("Exchange Act").[1] The Commission proposed these rule amendments in June 2008 to further the purposes of the Credit Rating Agency Reform Act of 2006 ("Rating Agency Act") to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.[2] The amendments also were designed to further address concerns about the integrity of the process by which NRSROs rate structured finance products, particularly mortgage related securities.[3] Concurrent with the adoption of those final rule amendments, the Commission proposed, in a separate release, additional amendments to Rule 17g-2(d) and re-proposed amendments to paragraphs (a) and (b) of Rule 17g-5 as well as a new

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1 See Amendments to Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59342 (February 2, 2009), 74 FR 6485 (February 9, 2009) ("February 2009 Adopting Release").

2 Exchange Act Release No. 57967 (June 16, 2008), 73 FR 36212 (June 25, 2008) ("June 2008 Proposing Release"). The Commission adopted the initial set of NRSRO rules in June 2007. See Oversight of Credit Rating Agencies Registered as Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564 (June 18, 2007) ("June 2007 Adopting Release"). In July 2008, the Commission also proposed a series of amendments to rules under the Exchange Act, Securities Act of 1933 ("Securities Act"), and Investment Company Act of 1940 ("Investment Company Act") that would eliminate references to ratings issued by NRSROs in certain rules and forms. See References to Ratings of Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 58070 (July 1, 2008), 73 FR 40088 (July 11, 2008); Securities Ratings, Securities Act Release No. 8940 (July 1, 2008), 73 FR40106 (July 11, 2008); References to Ratings of Nationally Recognized Statistical Rating Organizations, Investment Company Act Release No. 28327 (July 1, 2008), 73 FR 40124 (July 11, 2008).

3 The term "structured finance product" as used throughout this release refers broadly to any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. This broad category of financial instrument includes, but is not limited to, asset-backed securities such as residential mortgage-backed securities ("RMBS") and to other types of structured debt instruments such as collateralized debt obligations ("CDOs"), including synthetic and hybrid CDOs, or collateralized loan obligations ("CLOs").

paragraph (e) to Rule 17g-5 and a conforming amendment to Regulation FD.[4] In separate releases, the Commission is adopting, with revisions, the rule amendments proposed in the February 2009 Proposing Release,[5] and proposing amendments to Regulation S-K, and rules and forms under the Securities Act, the Exchange Act and the Investment Company Act to require disclosure regarding credit ratings that a registrant uses in connection with a registered offering.[6] The Commission also is adopting amendments to remove references to NRSROs in certain Commission rules and forms and re-opening the comment period to extend the time to comment on proposals to remove references to NRSROs in other Commission rules.[7]

In this release, the Commission is proposing amendments to Rule 17g-3 to require an NRSRO to furnish a new unaudited annual report to the Commission describing the steps taken by the NRSRO's designated compliance officer[8] during the fiscal year to fulfill the compliance officer's responsibilities as set forth in Section 15E(j) of the Exchange Act.[9] That statutory provision requires an NRSRO to designate an individual responsible for (1) administering the policies and procedures that are required to be established pursuant to Sections 15E(g) and (h) of the Exchange Act; and (2) ensuring

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4 See Re-proposed Rules for Nationally Recognized Statistical Rating Organizations, Exchange Act Release No. 59343 (February 2, 2009), 74 FR 6456 (February 9, 2009) ("February 2009 Proposing Release").

5 Exchange Act Release No. 61050 ("Companion Release").

6 Securities Act No. 9070 (October 7, 2009) 74 FR 53086 (October 15, 2009).

7 See Exchange Act Release No. 60789 (October 5, 2009), 74 FR 53258 (October 9, 2009) (adopting release to remove references to NRSROs); see also Securities Act Release No. 9069 (October 5, 2009) 74 FR 53274 (October 9, 2009) (release to re-open for comment proposals to remove references to NRSROs).

8 See 15 U.S.C. 78o-7(j). Section 15E(j) of the Exchange Act requires an NRSRO to "designate an individual responsible for administering the policies and procedures that are required to be established pursuant to [Section 15E(g) and Section 15E(h) of the Exchange Act], and for ensuring compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to [Section 15E of the Exchange Act]." 15 U.S.C. 78o-7(j).

9 See 15 USC 78o-7(j).

compliance with securities laws and rules and regulations, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.[10] Pursuant to the proposed amendment to Rule 17g-3, an NRSRO would be required to furnish a report to the Commission describing compliance reviews undertaken by the compliance officer during the fiscal year, material compliance matters identified during the reviews, measures implemented to remediate the material compliance issues identified, and persons within the NRSRO who were advised of the results of the reviews.

In addition, the Commission is proposing in this release to amend the Instructions to Exhibit 6 to Form NRSRO to require a credit rating agency applying to be registered as an NRSRO or an NRSRO providing its annual update to Form NRSRO to publicly disclose: (1) the percentage of the net revenue of the applicant/NRSRO attributable to the 20 largest users of credit rating services of the applicant/NRSRO; and (2) the percentage of the revenue of the applicant/NRSRO attributable to services and products other than credit rating services. The Commission notes that the first proposed disclosure would be an aggregate in that it would be the sum of the amount of net revenue attributed to the 20 largest users of credit rating services (i.e. not 20 separate net revenue amounts). In conjunction with this proposed amendment to the Instructions to Exhibit 6, the Commission is proposing to move the definitions of certain terms currently included in the Instructions to Exhibit 10 to the Explanation of Terms section of the Form NRSRO Instructions in order to make those definitions applicable to Form NRSRO as a whole.

Finally, the Commission is proposing a new rule – Rule 17g-7 – that would require an NRSRO, on an annual basis, to make publicly available on its Internet Web site a consolidated report that shows three items of information with respect to each

10 Id.

person that paid the NRSRO to issue or maintain a credit rating. First, the NRSRO would be required to disclose the percent of the net revenue attributable to the person that were earned by the NRSRO for that fiscal year from providing services and products other than credit rating services. Second, the NRSRO would have to indicate the relative standing of the person in terms of the person's contribution to the revenue of the NRSRO for the fiscal year as compared with other persons who provided the NRSRO with revenue. Third, the NRSRO would be required to identify all outstanding credit ratings paid for by the person.

As discussed in detail below, the proposed amendments seek to further advance the goals of the Commission's current oversight program for NRSROs, including increasing transparency and disclosure, and diminishing conflicts, as well as continuing to further the goals of the Rating Agency Act "to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating agency industry."[11]

The Commission believes that the proposed amendment to Rule 17g-3 to require NRSROs to furnish the Commission with an additional unaudited annual report would further improve the integrity of the ratings process and enhance accountability by requiring the designated compliance officer to annually report on actions taken to fulfill the officer's statutory responsibilities. While each NRSRO has a designated compliance officer under Section 15E(j) of the Exchange Act, the requirement to provide the Commission with such a report would, the Commission believes, help establish or further reinforce a discipline and rigor in the compliance officer's performance of his or her

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

duties.[12] It also is designed to strengthen the Commission's existing oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating processes and by providing an additional tool for the Commission to determine whether the NRSRO's designated compliance officer is fulfilling the responsibilities prescribed in Section 15E of the Exchange Act.[13] In addition, this information is designed to assist the Commission staff in its examination of NRSROs. The proposed amendments to the Exhibit 6 Instructions to Form NRSRO that would require additional disclosures are designed to further increase transparency by allowing users of credit ratings to more effectively evaluate the integrity of an NRSRO's credit ratings and analyze whether the NRSRO is effectively managing its conflicts of interests. Finally, the Commission believes that proposed new Rule 17g-7 also would further increase transparency as well as enhance disclosures with respect to an NRSRO's management of its conflicts of interest by providing users of credit ratings with information about the potential risk of undue influence that arises when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument.

In addition to the proposed rule amendments, the Commission is announcing today that it is deferring the consideration of action with regard to the rule proposed in the June 2008 Proposing Release that would have required an NRSRO to include, each time it published a credit rating for a structured finance product, a report describing how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments, or,

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12 The Commission also notes that other areas of the Commissions rules and regulations also require an annual report by a chief compliance officer with respect to investment companies and investment advisers. See generally, Rule 38a-1, 17 CFR 270.38a-1, and Rule 206(4)-7, 17 CFR 275.206(4)-7.

13 15 U.S.C. 78o-7(j).

alternatively, to use distinct ratings symbols for structured finance products that differentiated them from the credit ratings for other types of financial instruments. Instead, the Commission is soliciting comment regarding alternative measures that could be taken to differentiate NRSROs' structured finance credit ratings from the credit ratings they issue for other types of financial instruments through, for example, enhanced disclosures of information. The Commission also is soliciting comment on whether the rule amendments being adopted today in the Companion Release designed to remove impediments to determining and monitoring non-issuer-paid credit ratings for structured finance products should be extended to create a mechanism for determining non-issuer-paid credit ratings for structured finance products that were issued prior to the rule becoming effective (e.g., to allow for non-issuer-paid credit ratings for structured finance products of the 2004-2007 vintage). Specifically, the Commission is soliciting comment on whether the rule's goal could be furthered by applying its requirements or similar requirements to structured finance products that were issued prior to the compliance date of the rule as amended.

II. PROPOSED AMENDMENT TO RULE 17g-3

The Commission adopted Rule 17g-3 pursuant to authority in Section 15E(k)[14] of the Exchange Act, which requires an NRSRO to furnish to the Commission, on a confidential basis[15] and at intervals determined by the Commission, such financial statements and information concerning its financial condition as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. The statute also provides that the Commission may, by rule, require that the

14 15 U.S.C. 78o-7(k).

15 An NRSRO can request that the Commission keep this information confidential. See Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b-2, 17 CFR 200.80 and 17 CFR 200.83.

financial statements be certified by an independent public accountant.[16] In addition, Section 17(a)(1) of the Exchange Act[17] requires an NRSRO to make and keep such records, and make and disseminate such reports, as the Commission prescribes by rule as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Exchange Act.[18]

Rule 17g-3 currently requires an NRSRO to furnish to the Commission on an annual basis the following reports: audited financial statements; unaudited consolidating financial statements of the parent of the NRSRO, if applicable; an unaudited report concerning revenues by category of revenue; an unaudited report concerning compensation of the NRSRO's credit analysts; an unaudited report listing the largest customers of the NRSRO; and an unaudited report on the number of credit rating actions taken during the fiscal year in each class of credit ratings for which the NRSRO is registered with the Commission.[19] The rule further requires an NRSRO to furnish the Commission these reports within 90 days of the end of its fiscal year.[20]

The Commission's staff understands that the designated compliance officer of some NRSROs may, in some cases, not be fulfilling the compliances officer's statutorily mandated duties, as prescribed by Section 15E(j) of the Exchange Act.[21] Further, during examinations in 2008 of three of the largest NRSRO's, Commission staff also identified issues with respect to each NRSROs policies and procedures and improvements that

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16 Id.
17 15 U.S.C. 78q(a)(1).
18 See Section 5 of the Rating Agency Act and 15 U.S.C. 78q(a)(1).
19 17 CFR 240.17g-3(a)(1)-(6).
20 17 CFR 240.17g-3(a).
21 15 U.S.C. 78o-7(j).

could be made.[22] In light of these concerns and the importance of an effective NRSRO compliance program, the Commission is proposing to amend Rule 17g-3 by adding paragraph (a)(7), which would require an NRSRO to furnish to the Commission an additional unaudited annual report. This report would be furnished to the Commission, on a confidential basis, consistent with the other reports required under Rule 17g-3.[23]

Proposed new paragraph (a)(7)(i) of Rule 17g-3 would provide that the new report must describe the steps taken by the NRSRO's designated compliance officer during the fiscal year to: (1) administer the policies and procedures that are required to be established pursuant to Sections 15E(g) and (h) of the Exchange Act; and (2) ensure compliance with securities laws and rules and regulations, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.[24] Proposed new paragraph (a)(7)(ii) of Rule 17g-3 would provide that the new report must include: (1) a description of any compliance reviews of the activities of the NRSRO; (2) the number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such matter; (3) a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO; and (4) a description of the persons within the NRSRO who

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22 See generally, Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies (July 8, 2008). The report is available on the Commission's Internet Web site, located at http://www.sec.gov/news/studies/2008/craexamination070808.pdf.

23 See supra notes 14 and 15; see also June 2007 Adopting Release, 72 FR at 33590, footnote 300 and June 2008 Proposing Release, 73 FR 36234, footnote 143.

24 Section 15E(g) of the Exchange Act provides, in pertinent part, that an NRSRO must establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such NRSRO, to prevent the misuse of material, nonpublic information. 15 USC 78o-7(g). Section 15E(h) of the Exchange Act, provides, in pertinent part, that an NRSRO must establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of such NRSRO and affiliated persons and affiliated companies thereof, to address and manage any conflicts of interest that can arise from such business. 15 U.S.C. 78o-7(h).

were advised of the results of the reviews.[25] Finally, the Commission is proposing to amend paragraph (b) to Rule 17g-3 to require that the proposed new report required under paragraph (a)(7) be accompanied by a statement signed by the NRSRO's designated compliance officer stating that the person has responsibility for the report and, to the best of the knowledge of the designated compliance officer, the report fairly presents, in all material respects, steps taken by the designated compliance officer for the period presented.

The proposed new report would be unaudited, consistent with the other unaudited reports currently required under Rule 17g-3.[26] As discussed below, the Commission preliminarily believes that the proposed amendment would improve the integrity of the credit ratings process by establishing a more structured discipline under which the NRSRO's designated compliance officer would need to report to the Commission the steps taken to fulfill the officer's statutory responsibilities. The act of reporting these steps is designed to promote the active engagement of the designated compliance officer in reviewing an NRSRO's compliance with the securities laws and its own internal policies and procedures. The Commission preliminarily believes that because the compliance officer would be required to report these steps, the act of reporting should, in turn, foster improved compliance. Furthermore, the requirement in the report to identify the persons within the NRSRO advised of the results of the review could also promote the appropriate escalation of compliance issues to the management of the NRSRO.

The report also is designed to further strengthen the Commission's oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating processes and

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[25] See proposed Rule 17g-3(a)(7)(ii).

[26] 17 CFR 240.17g-3(a)(2)-(6). Under Rule 17g-3, the only required audited report is the NRSRO's financial statements as of its most recent fiscal year. 17 CFR 240.17g-3(a)(1).

providing an additional tool for the Commission to determine whether the NRSRO's designated compliance officer is fulfilling the responsibilities prescribed in Section 15E of the Exchange Act.[27] For example, if an NRSRO reports a large number of material compliance matters in a particular area, the Commission examination staff could focus on that particular area as part of their next review of the NRSRO. Alternatively, if a report indicates no problems, but a subsequent Commission staff examination reveals material compliance matters, this could be brought to the attention of the NRSRO's management for appropriate action.

The report is also designed to assist the Commission in its oversight of NRSROs to the extent they reveal trends across NRSROs or material compliance matters that could migrate from one NRSRO to other NRSROs because, for example, they arise from rating similar products or debt issued by a particular issuer that engages more than one NRSRO.

Finally, the Commission preliminarily believes that the proposed report would also help facilitate the Commission's examination staff efforts to conduct each exam of an NRSRO in an organized and efficient manner and thus to allocate resources to maximize investor protection.[28] The Commission notes that the proposed report would not be the sole factor the Commission's exam staff would use to determine the particular focus of an exam, but would be one of many factors used to make that determination.

A. Proposed New Paragraph 17g-3(a)(7)(i)

As stated above, the proposed amendments to Rule 17g-3 would require an NRSRO to provide the Commission with an unaudited annual report describing the steps

27 15 U.S.C. 78o-7(j).

28 The Commission also notes that other areas of the Commission's rules and regulations also require an annual report by a chief compliance officer with respect to investment companies and investment advisers. See generally, Rule 38a-1, 17 CFR 270.38a-1, and Rule 206(4)-7, 17 CFR 275.206(4)-7.

taken by the NRSRO's designated compliance officer during the fiscal year.[29] Specifically, the amendments would add a new paragraph (a)(7)(i) to Rule 17g-3, which would require an NRSRO to provide the Commission with a report describing the steps taken by the NRSRO's designated compliance officer during the fiscal year to:

- Administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act (15 U.S.C. 78o-7(g) and (h));[30] and
- Ensure compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.[31]

These are the areas of responsibility for the designated compliance officer prescribed in Section 15E(j) of the Exchange Act.[32] The report would require a description of the steps taken by the compliance officer during the most recently ended fiscal year to fulfill these responsibilities. As noted above, the purpose of the report is to impose a yearly discipline under which the compliance officer must describe the steps taken to fulfill the officer's statutory responsibilities. The Commission's goal in proposing this amendment is to further enhance the compliance function within the NRSRO by prescribing a process that promotes the active engagement of the compliance officer in reviewing the NRSRO's compliance with internal policies and procedures and with the securities laws and rules and regulations.

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29 See 15 U.S.C. 78o-7(j).
30 See proposed Rule 17g-3(a)(7)(i)(A).
31 See proposed Rule 17g-3(a)(7)(i)(B).
32 15 U.S.C. 78o-7(j).

The first area of responsibility of the compliance officer under Section 15E(j) of the Exchange Act – to administer the policies and procedures that are required pursuant to Sections 15E(g) and (h) of the Exchange Act – is identified in proposed new paragraph (a)(7)(i)(A) of Rule 17g-3. Sections 15E(g) and (h) of the Exchange Act require an NRSRO to establish, maintain, and enforce written policies and procedures reasonably designed, taking into consideration the nature of the business of the NRSRO, to prevent the misuse of material nonpublic information and to address and manage any conflicts of interest, respectively.[33] The Commission preliminarily believes that requiring the designated compliance officer to describe the steps taken during the fiscal year in this area of responsibility could, to the extent it encourages the compliance officer to undertake more rigorous compliance reviews, uncover compliance weaknesses with respect to the treatment of material nonpublic information and the management of conflicts of interest by the NRSRO. This would afford the NRSRO the opportunity to consider whether corrective action is necessary to remediate such weaknesses.

The second area of responsibility of the compliance officer under Section 15E(j) of the Exchange Act – to ensure compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act – is identified in proposed new paragraph (a)(7)(i)(B) of Rule 17g-3. The Commission preliminarily believes that requiring the designated compliance officer to describe the steps taken during the fiscal year to meet this responsibility could, to the extent it encourages the compliance officer to undertake more rigorous compliance reviews, assist the NRSRO in identifying areas where its activities may be in contravention of securities laws and regulations and, therefore, allow it to take

33 Id.

appropriate action. The goal of the proposed compliance report is to enhance the compliance function and potentially mitigate compliance failures when they occur. The Commission preliminarily believes that the proposed report the designated compliance officer would be required to furnish may serve as an incentive to further strengthen the NRSRO's existing compliance program.

The Commission notes that the size and scope of an NRSRO's existing compliance program would vary depending on the size and complexity of the NRSRO. Larger NRSROs with comprehensive compliance programs may already periodically review portions of their compliance programs. In contrast, smaller NRSROs may have less extensive compliance programs because they have simpler organizational structures, fewer employees and fewer sources of revenue than larger NRSROs, which may be part of a complex global organization with thousands of employees. Therefore, while the Commission believes that the proposed report would serve as incentive to further strengthen each NRSRO's existing compliance program, the extent of the effect of the proposed report on improving an NRSRO's existing compliance program may vary from one NRSRO to another.

B. Proposed New Paragraph 17g-3(a)(7)(ii)

The proposed amendment to Rule 17g-3 also would set forth specific items to be included in the proposed new report under Rule 17g-3(a)(7). In requiring the inclusion of certain information, the Commission does not intend to dictate how a designated compliance officer should fulfill the officer's responsibilities as set forth in the Rating Agency Act. The Commission expects the designated compliance officer to design and execute a compliance program taking into account: the business of the NRSRO; the procedures and methodologies used by the NRSRO to determine credit ratings; the NRSRO's size; the NRSRO's (and its affiliates') conflicts of interest; and the complexity of the NRSRO's operations. The Commission believes that the information that would be required in the report is the type of information a compliance program would generate regardless of the specific design of a particular program.

More specifically, the amendments to Rule 17g-3 would include new paragraph (a)(7)(ii), which would require that the report include:

- A description of any compliance reviews of the activities of the NRSRO;
- The number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such matter;
- A description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO; and
- A description of the persons within the NRSRO who were advised of the results of the reviews.

The first item the Commission is proposing to require in the report is a description of any compliance reviews of the activities of the NRSRO.[34] One of the functions of a typical compliance department is to proactively review business activities to identify potential regulatory, compliance, and reputational risks and to design ways to minimize such risks.[35] The Commission intends that the designated compliance officer would describe all such reviews conducted during the most recently ended fiscal year.

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34 See proposed Rule 17g-3(a)(7)(ii)(A).

35 See e.g., White Paper on the Role of Compliance, Securities Industry Association, Compliance and Legal Division (October 2005); available at http://www.sifmacl.org/attachments/articles/8/Role%20of%20Compliance.pdf.

Therefore, this description would provide the Commission with an understanding of the scope of the designated compliance officer's reviews of the NRSRO's activities and possibly highlight any areas that were not reviewed.

The second item the Commission is proposing be included in the report is the number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such matter. The Commission preliminarily intends a "material compliance matter" to mean a determination by the NRSRO or a person within the NRSRO that there has been a violation of the securities laws[36] or the rules thereunder or a failure to adhere to the policies, procedures, or methodologies established, maintained and enforced by the NRSRO to, for example, determine credit ratings, prevent the misuse of material nonpublic information, manage conflicts of interest, and comply with the Commission's NRSRO rules.[37] A material compliance matter also would include a determination that there was a weakness in the design or implementation of the policies and procedures of the NRSRO.[38] The proposed requirement to report a material compliance matter would be designed to alert the Commission to issues identified by the designated compliance officer that may raise questions about the integrity of the NRSRO's activities and operations. It also could assist the Commission's oversight of NRSROs to the extent a reported material

[36] The term "securities laws" is defined in Section 3(a)(47) of the Exchange Act.

[37] See e.g., 17 CFR 270.38a-1(e)(2). Rule 38a-1 prescribes compliance procedures and practices for investment companies registered with the Commission under the Investment Company Act of 1940. Paragraph (a)(4) of Rule 38a-1 requires the investment company to designate an individual responsible for administering the fund's policies and procedures to, among other things, prevent violation of the Federal Securities Laws by the fund (the fund's "chief compliance officer"). Paragraph (a)(4)(iii) of Rule 38a-1 requires the fund's chief compliance officer to provide a written report to the fund's board, at least annually, that addresses, among other things, each "Material Compliance Matter" that occurred since the last report. Paragraph (e)(2) of Rule 38a-1 defines a "Material Compliance Matter" to be, among other things, a violation of the Federal Securities Law by the fund or its employees, a violation of the policies and procedures of the fund, or a weakness in the implementation or design of the policies and procedures of the fund.

[38] Id.

compliance matter is one that could arise in other NRSROs because, for example, it relates to a new type of debt instrument that is being rated by more than one NRSRO or involves potentially inappropriate interactions with an issuer that hired several NRSROs to rate its securities. Finally, the Commission preliminarily believes that requiring the proposed report to include the number of material compliance matters identified would provide Commission examiners with an additional tool to assist them in identifying possible trends and issues with respect to material compliance matters at an NRSRO after the first year of reporting. For example, numerous material compliance violations over a period of years could be indicative of possible lax compliance at an NRSRO.

The third item the Commission is proposing be included in the report is a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO.[39] The Commission preliminarily intends "remediation measures" to include changes made by the NRSRO in response to the identification of a material compliance matter that are designed to prevent the re-occurrence of a similar material compliance matter. The reporting of these measures would assist the Commission in evaluating the risk of re-occurrences. It also could shed a light on potential "best practices" for mitigating the risk of future material compliance matters. Further, it is designed to reinforce the discipline of an NRSRO to review for potential material compliance matters and take steps to address them when they occur.

The fourth item the Commission is proposing to include in the report is a description of the persons within the NRSRO who were advised of the results of the reviews. The Commission intends that the description of the persons who were advised

[39] See proposed Rule 17g-3(a)(7)(ii)(C).

of the results of the reviews at the NRSRO would include only key personnel , i.e., those who have the authority to act on the results of the reviews or direct others to act. The Commission does not intend that the persons advised of the results of the reviews would be so broad in scope as to include persons such as administrative employees, for example, who may have typed a report related to a material compliance matter.

The information with respect to those persons who were advised of the results of reviews is designed to provide the Commission with an understanding of how the NRSRO responds to material compliance matters and the role and structure of the compliance program within the NRSRO. For example, it would indicate whether the compliance officer reported the matters to the NRSRO's board or senior management or only to the business unit that underwent the compliance review. This is designed to promote the appropriate escalation of compliance issues to the management of the NRSRO. The Commission also believes that this proposed information would be a useful tool for examiners to focus examination resources on practices related to material compliance matters reported and assist in making risk-based decisions on whether to initiate an examination of a particular NRSRO. The Commission notes that this information would only be one of many factors the Commission's exam staff may use to determine the particular focus of an exam.

C. Proposed Amendment to Paragraph 17g-3(b)

The Commission also is proposing to amend paragraph (b) of Rule 17g-3 to create two subparagraphs, Rule 17g-3(b)(1) and (b)(2).[40] Subparagraph (b)(1) would carry forward, unchanged, the requirement in current Rule 17g-3(b). The current text of Rule 17g-3(b) requires that an NRSRO must attach to each financial report furnished pursuant

[40] See proposed Rule 17g-3(b)(1) and (2).

to paragraphs (a)(1) through (a)(6) of Rule 17g-3 a signed statement by a duly authorized person associated with the NRSRO stating that the person has responsibility for the financial report and, to the best knowledge of the person, the financial report fairly presents, in all material respects, the financial conditions, results of operations, cash flows, revenues, analyst compensation, and credit rating actions of the NRSRO for the period presented. This requirement does not specify who within the NRSRO should have responsibility for the reports and for providing the required signed statement.

Proposed subparagraph (b)(2) would establish a similar requirement for a signed statement to accompany the report under proposed new paragraph (a)(7) to Rule 17g-3, but would specify that the designated compliance officer is required to provide that statement. Specifically, proposed paragraph (b)(2) of Rule 17g-3 would require that an NRSRO attach to the report furnished pursuant to proposed paragraph (a)(7) of Rule 17g-3 a signed statement by the designated compliance officer of the NRSRO stating that the officer has responsibility for the report and, to the best knowledge of the designated compliance officer, the report fairly presents, in all material respects, the information in paragraph (a)(7)(ii) of Rule 17g-3 for the period presented. The Commission preliminarily believes that the designated compliance officer should have responsibility for providing the statement since the information to be submitted in the report is directly within that individual's statutorily mandated responsibilities under Section 15E(j) of the Exchange Act; namely, to administer the NRSRO's policies and procedures and to ensure compliance with the securities laws and regulations.

D. Summary of Amendments to Rule 17g-3 and Request for Comment

The Commission is proposing these amendments to Rule 17g-3 under its authority to require an NRSRO to "make and disseminate such reports as the Commission, by rule, may prescribe as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Exchange Act]."[41] The Commission preliminarily believes these proposed amendments are necessary or appropriate in the public interest, for the protection of investors and in furtherance of the Exchange Act because they are designed to further improve the quality of credit ratings and help protect the integrity of the credit rating process by requiring that an NRSRO describe the steps taken during the fiscal year by the designated compliance officer to administer required policies and procedures and to ensure compliance with the securities laws and regulations.

The Commission preliminarily believes that requiring the designated compliance officer to provide such a report would encourage a more rigorous compliance program and, thereby, promote the identification of compliance failures and weaknesses in the NRSRO's policies and procedures. In addition, the reporting requirements may encourage an NRSRO to promptly resolve compliance issues identified, and thereby improve the quality and integrity of the NRSRO's credit ratings and credit rating processes.[42]

The proposed rule amendments also would further enhance the Commission's oversight of NRSROs by providing the Commission staff an additional resource with which to evaluate the performance of the designated compliance officers in carrying out

41 See Section 17(a)(1) of the Exchange Act (15 U.S.C. 78q(a)(1)).

42 The Commission notes that this information would only be one of many factors the Commission's exam staff may use to determine the particular focus of an exam.

their statutory responsibilities prescribed in Section 15E(j) of the Exchange Act. Finally, the proposed report would help identify areas within the NRSRO that Commission staff examiners may want to include within the scope of their examinations and that could be indicative of potentially broader issues across NRSROs.

The Commission generally requests comment on all aspects of these proposed amendments. In addition, the Commission requests comment on the following questions related to the proposal:

- Should the proposal require that the report be furnished to the NRSRO's board or a body performing similar functions of a board or to the NRSRO's senior management in addition to requiring that it be furnished to the Commission or as an alternative to it being furnished to the Commission? Could the requirement to furnish the report to the Commission alter the way the compliance officer conducts compliance reviews or reports the results of those reviews to others within the NRSRO? Would the requirement that it be furnished to the Commission potentially impact the designated compliance officer's incentive to perform a comprehensive and in depth review of the NRSRO's activities, policies, and procedures or to identify material compliance matters? Would requiring the report instead be sent to the board, to a similar body, or to senior management result in a more or less comprehensive review?
- Should the Commission require other items to be included in the report in addition to those prescribed in proposed paragraph (a)(7)(ii) of Rule 17g-3? Commenters believing this would be beneficial should specifically

identify the additional items and describe how the additional information would be useful to the Commission or to the NRSRO.

- Should the Commission exclude any of the items currently identified in proposed paragraph (a)(7)(ii) of Rule 17g-3? Commenters believing this would be beneficial should specifically identify the items to be deleted and describe why they would not be useful information for the Commission or the NRSRO?
- Should the Commission define the term "material compliance matter" in Rule 17g-3? If so, what should the definition be? Alternatively, is the interpretation of the term "material compliance matter" set forth in the release sufficient and appropriate? Should there be limitations on what constitutes a material compliance matter? If so, what should these limitations be? For example, are there securities laws violations that do not rise to the level of concern that they would need to be reported? If so, should such violations be reported if the number of occurrences passes a certain threshold? How should the Commission evaluate what that threshold would be (e.g. taking into account the number of occurrences and the severity of the violation)?
- As noted above, the Commission has proposed an interpretation of the category of person that would trigger the reporting requirement if such person were apprised of the finding of the compliance officer. Is the proposed interpretation sufficiently clear to indicate when the reporting requirement applies? For example, should the rule specify that it is a

decision maker, someone with authority to implement remedial measures, or some other defined category of person? How should that category be defined?

- Should the Commission permit or require someone other than the designated compliance officer certify the report? If so, which person(s) should it be?
- To what extent, if any, should the designated compliance officer be able to rely on subcertifications? What purpose would the subcertifications serve? In some cases, would the designated compliance office not have all the relevant information in order to sign the statement required by proposed Rule 17g-3(b)(2) without subcertifications? If this is true, would this in some way negate any of the objectives of the proposed amendments to Rule 17g-3?
- What effect would the proposed requirement to furnish the report to the Commission have on the designated compliance officer's duties? How could any adverse effects be addressed?
- Should the Commission as an alternative to the proposed report from the compliance officer consider proposing a requirement that an independent third party perform a review of the NRSRO's adherence to its policies and procedures and its compliance with the securities laws. Commenters who believe such a requirement would be appropriate are asked to provide data with respect to the costs and benefits associated with such a review.

III. AMENDMENTS TO THE INSTRUCTIONS TO FORM NRSRO

The Commission is proposing to amend the instructions for Exhibit 6 to Form NRSRO to require a credit rating agency in an application for registration as an NRSRO or an NRSRO providing its annual update to disclose: (1) the percentage of the net revenue of the applicant/NRSRO attributable to the 20 largest users of credit rating services of the applicant/NRSRO; and (2) the percentage of the net revenue of the applicant/NRSRO attributable to other services and products of the applicant/NRSRO. In conjunction with this proposed amendment to the instructions to Exhibit 6, the Commission is proposing to move the definitions of certain terms currently included in the instructions to Exhibit 10 to the "Explanation of Terms" section of the Form NRSRO Instructions in order to make those definitions applicable to Form NRSRO as a whole.

A credit rating agency that seeks to register as an NRSRO must furnish an application for registration to the Commission. Section 15E(a)(1)(A) of the Exchange Act provides that the credit rating agency must furnish the application in a form prescribed by Commission rule.[43] After registration, the credit rating agency – now an NRSRO – must publicly disclose most of the information in its application.[44] Section 15E(b)(1) of the Exchange Act requires the NRSRO to promptly amend the application if, after registration, any information or document provided as part of the application becomes materially inaccurate.[45] Section 15E(b)(2) of the Exchange Act provides that the information on credit ratings performance statistics required to be disclosed in the application pursuant to Section 15E(a)(1)(B) of the Exchange Act must be updated annually.[46] In addition, Section 15E(b)(2) of the Exchange Act requires an NRSRO to

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43 15 U.S.C. 78o-7(a)(1)(A).
44 17 CFR 240.17g-1(i).
45 15 U.S.C. 78o-7(b)(1).
46 Id.

furnish the Commission with an amendment to its registration not later than 90 days after the end of each calendar year (the "annual certification").[47] This section further provides that the NRSRO must (1) certify that the information and documents provided in the application for registration continue to be accurate and (2) list any material change to the information and documents during the previous calendar year.[48]

With respect to the contents of the application, Section 15E(a)(1)(B) of the Exchange Act prescribes certain minimum information the applicant must provide in the application. Furthermore, Section 15E(a)(1)(B)(x) of the Exchange Act provides that the Commission can require any other information and documents as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[49] In the Commission's initial rulemaking implementing the Rating Agency Act – which established the registration and oversight program for NRSROs – the Commission adopted Rule 17g-1 and Form NRSRO and its accompanying instructions.[50] In February 2009, the Commission amended Form NRSRO to require additional disclosures.[51]

Rule 17g-1 prescribes, among other things, how a credit rating agency must apply to be registered with the Commission as an NRSRO, keep its information up-to-date after registration, and comply with the statutory requirement to furnish the Commission with an annual certification.[52] In particular, all of these actions must be accomplished by furnishing the Commission with a Form NRSRO. As described below, Form NRSRO

47 15 U.S.C. 78o-7(b)(2).
48 Id.
49 15 U.S.C. 78o-7(a)(1)(B).
50 See June 2007 Adopting Release, 72 FR at 33566-33582.
51 See February 2009 Adopting Release, 74 FR at 6457-6460.
52 See 17 CFR 240.17g-1.

requires information about the credit rating agency applying for registration and, after registration, about the NRSRO, including the information required under 15E(a)(1)(B) of the Exchange Act and additional information prescribed by the Commission.[53]

Form NRSRO contains 8 line items and 13 exhibits. The line items require information about the applicant/NRSRO such as its address; corporate form; credit rating affiliates that would be, or are, a part of its registration; the classes of credit ratings for which it is seeking to be, or is, registered as an NRSRO; the number of credit ratings it has issued in each class and the date it began issuing credit ratings in each class; and whether it or a person associated with it has committed or omitted any act, been convicted of any crime, or is subject to any order or findings identified in Section 15(d) of the Exchange Act.[54]

The 13 exhibits to Form NRSRO elicit the information required under Sections 15E(a)(1)(B)(i) through (ix) of the Exchange Act and additional information prescribed by the Commission.[55] Exhibits 1 through 9 require certain information about the applicant/NRSRO, including credit rating performance statistics, its methodologies and procedures used to determine credit ratings, its policies and procedures designed to prevent the misuse of material non-public information, its organizational structure, its code of ethics, the conflicts of interest inherent in its business operations, its policies and procedures for managing those conflicts of interest, summary data about the qualifications of its credit analysts, and the identity of its chief compliance officer. An NRSRO must make Exhibits 1 through 9 publicly available after it is registered.

53 15 U.S.C. 78o-7(a)(1)(B).
54 15 U.S.C. 78o(d).
55 15 U.S.C. 78o-7(a)(1)(B)(i) – (x).

Exhibits 10 through 13 require financial information about the applicant credit rating agency that the Commission evaluates in deciding whether it can make the finding required under Section 15E(a)(2)(C)(ii) of the Exchange Act[56] that the applicant fails to maintain adequate financial and managerial resources to consistently produce credit ratings with integrity and to materially comply with the procedures and methodologies disclosed pursuant to Section 15E(a)(1)(B) of the Exchange Act[57] and established pursuant Sections 15E(g), (h), (i) and (j) of the Exchange Act.[58] These Exhibits are not required to be publicly disclosed by the NRSRO after the applicant is granted registration as an NRSRO. If registration is granted, the NRSRO is required to furnish financial information to the Commission in an annual report required by Rule 17g-3 that is similar to the information required in Exhibits 10 through 13.[59] The rules do not require that the annual reports furnished to the Commission pursuant to Rule 17g-3 be made publicly available by the NRSRO.[60]

The Commission is proposing amending the instructions for Exhibit 6 to augment the information about conflicts of interest currently required to be disclosed in Form NRSRO. The Commission prescribed the current requirements for Exhibit 6 to implement Section 15E(a)(1)(B)(vi) of the Exchange Act, which requires that an application for registration contain information regarding any conflict of interest relating to the issuance of credit ratings by the applicant/NRSRO.[61] The Exchange Act does not define or identify the types of conflicts of interest that should be disclosed pursuant to

56 15 U.S.C. 78o-7(a)(2)(C)(ii).

57 15 U.S.C. 78o-7(a)(1)(B).

58 15 U.S.C. 78o-7(g), (h), (i) and (j).

59 See 17 CFR 240.17g-3 and 15 U.S.C. 78o-7(k).

60 See Rule 17g-3 and 15 U.S.C. 78o-7(k); see also June 2007 Adopting Release, 72 FR at 33590.

61 See 15 U.S.C. 78o-7(a)(1)(B)(vi); June 2007 Adopting Release, 72 FR at 33577.

Section 15E(a)(1)(B)(vi) of the Exchange Act.[62] The Commission, in adopting Form NRSRO and its accompanying instructions, required that an applicant/NRSRO provide in Exhibit 6 a list of the types of conflicts of interest relating to its issuance of credit ratings.[63] To assist the applicant/NRSRO and promote consistent disclosures, the instructions to the Exhibit contain a list of potential conflicts of interest that may apply to an applicant/NRSRO based on its business model and activities.[64] The instructions further provide that the applicant/NRSRO can use the descriptions provided in the instructions to identify an applicable conflict of interest.[65] An applicant/NRSRO also can choose to provide its own description of the conflict or provide further explanations to one of the descriptions in the instructions.[66] Finally, Exhibit 6 to Form NRSRO is one of the public exhibits that the NRSRO is required to make readily accessible to the public and to keep current through furnishing updated information on Form NRSRO.[67]

One purpose of the disclosure in Exhibit 6 is to alert users of credit ratings to the potential conflicts of interest inherent in the NRSRO's business model.[68] The information also is designed to allow users of credit ratings to assess an NRSRO's procedures for managing conflicts by comparing the types of conflicts disclosed in Exhibit 6 with its procedures for managing conflicts of interest disclosed in Exhibit 7.[69]

The disclosure also is designed to assist the Commission in evaluating whether an NRSRO has sufficient financial and managerial resources to comply with the procedures

62 Id.
63 See Form NRSRO Instructions for Exhibit 6.
64 Id.
65 Id.
66 Id.
67 See Form NRSRO General Instructions.
68 See June 2007 Adopting Release, 72 FR at 33577.
69 Id.

for managing conflicts of interest required under Section 15E(h) of the Exchange Act.[70] Being informed of the conflicts of interest identified by the applicant/NRSRO in Exhibit 6 to Form NRSRO assists the Commission in evaluating whether the disclosed financial and managerial resources of the NRSRO appear to be sufficient in light of the magnitude and extent of any conflicts.[71]

The Commission is proposing to amend Exhibit 6 to require an applicant/NRSRO to disclose information regarding the revenues it receives from major clients as well as the revenues attributable to services other than determining credit ratings. The proposed new disclosure is designed to assist users of NRSRO credit ratings in assessing the conflicts of interest, including the potential magnitude of such conflicts, inherent in a given NRSRO's business operations. In particular, an NRSRO's disclosure of information about revenues received from major clients and revenues attributable to other services provided to clients would allow users of credit ratings to have more information about the dimensions of the conflict arising from NRSROs being paid to determine credit ratings as well as the conflict of offering other services to persons who pay for credit ratings. It would also provide investors and other users of credit ratings more specific information about the extent to which NRSRO revenues are from a concentrated group of clients. Users of NRSRO credit ratings could then use this information to evaluate the integrity of the credit ratings issued by the NRSRO and whether they believe the NRSRO is effectively managing these conflicts of interests. Also, an NRSRO's disclosure of this information in Exhibit 6 to Form NRSRO would allow users of credit ratings to ascertain the types and dimensions of a given NRSRO's conflicts of interest. The ready

70 15 U.S.C. 78o-7(h).

71 See Section 15E(a)(2)(C) of the Exchange Act (15 U.S.C. 780-7(a)(2)(C)); June 2007 Adopting Release, 72 FR at 33577.

availability of this information in a single location would facilitate the evaluation by users of credit ratings of the probability that the conflicts of interest could adversely impact the integrity of the NRSRO's credit ratings and credit rating processes. Users of credit ratings could then judge for themselves whether they believe that certain conflicts of interests are adversely impacting the integrity of an NRSRO's credit ratings and credit ratings processes based on their evaluation of the information disclosed in Exhibit 6.

Because the proposed amendment would require that the information be provided as part of the application to register as an NRSRO, the Commission would be able to review the disclosures before they would be required to be made public (ten business days after the credit rating agency is granted registration).[72] The information also would assist the Commission in evaluating whether an applicant has sufficient financial and managerial resources to comply[73] with the procedures for managing conflicts of interest required under Section 15E(h) of the Exchange Act after consideration of the conflicts of interest identified by the applicant, including the magnitude of such conflicts.[74]

The Commission proposes dividing Exhibit 6 into a Part A and a Part B. Part A would require an applicant/NRSRO to provide the information on conflicts of interest currently required to be disclosed by Exhibit 6. Part B would require an applicant/NRSRO to provide new disclosures relating to revenues from its most recently ended fiscal year. In particular, Part B to Exhibit 6 would require an applicant/NRSRO to provide the following disclosures, as applicable:

- The percentage of the applicant/NRSRO's net revenue attributable to the 20 largest users of credit rating services of the applicant/NRSRO; and

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72 See 17 CFR 240.17g-1(i).

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

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

- The percentage of the applicant/NRSRO's revenue attributable to services and products other than credit rating services of the applicant/NRSRO.

To perform the calculations to determine these disclosures, the applicant/NRSRO would be required to use the definitions of "net revenue" and "credit rating services" currently specified in Exhibit 10 to Form NRSRO.[75] The Commission is proposing to move these definitions from the instructions to Exhibit 10 to the "Explanation of Terms" section of the Form NRSRO Instructions in order to make them applicable to Form NRSRO as a whole, including the proposed amendment to Exhibit 6. The Commission does not propose otherwise altering those definitions. The Commission believes that it is appropriate to place these definitions in the Explanation of Terms section of the Form NRSRO Instructions because, in addition to the NRSROs being familiar with these definitions, the definitions are appropriate in light of the disclosure objectives of the proposed rule.[76] Finally, the Commission notes that using the same terms throughout the Form NRSRO Instructions would promote consistency for comparison purposes with respect to the financial information the applicant/NRSRO furnishes to the Commission.

As defined in the instructions to Exhibit 10 of Form NRSRO, the term "net revenue" means revenue earned by the applicant or NRSRO for any type of service or product, regardless of whether related to credit rating services, and net of any rebates and allowances paid or owed to the person by the applicant or NRSRO.[77] The Commission explained in the June 2007 Adopting Release that this definition excludes revenues

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75 See Form NRSRO Instructions for Exhibit 10. The same definitions also are used in Rule 17g-3 for purposes of calculating the list of largest users of credit ratings to be furnished in an NRSRO's annual financial report to the Commission. See 17 CFR 240.17g-3(a)(5) and accompanying note.

76 See June 2007 Adopting Release, 72 FR at 33580-33581.

77 See Form NRSRO Instructions for Exhibit 10.

received by affiliates that are not part of the credit rating organization.[78] Also, the intent in defining "net revenues" as payables net of any "rebates or allowances" was to limit the allowable offsets that reduce net revenue to items that directly reduce a payable on the revenue side and to exclude unrelated payables (e.g., payables for utility bills).[79] Finally, by using the term "revenue earned" the Commission stated that the applicant/NRSRO must apply its standard accounting convention for recognizing revenue as this will make revenue calculations consistent across the various financial reports required in Form NRSRO and Rule 17g-3.[80] As discussed above, the Commission is proposing to move the definition of "net revenue" from the instructions to Exhibit 10 of Form NRSRO to the "Explanation of Terms" section of the Form NRSRO Instructions, making the definition applicable to Form NRSRO as a whole, including the proposed amendments to Exhibit 6.

As defined in the instructions to Exhibit 10 of Form NRSRO, the term "credit rating services" means any of the following: rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings, credit ratings data, or credit ratings analysis to a subscriber.[81] The Commission explained in the June 2007 Adopting Release that this definition includes – along with persons that pay for credit ratings and subscriptions – persons that are rated, or whose securities or money market instruments are rated, but that did not pay for the credit rating.[82] Even though these persons may not have paid for the credit rating, they potentially could have undue

78 See June 2007 Adopting Release, 72 FR at 33580-33581.
79 Id.
80 Id.
81 See Form NRSRO Instructions for Exhibit 10.
82 See June 2007 Adopting Release, 72 FR at 33580-33581.

influence on the credit rating agency if they provide substantial net revenue for other services or products.[83] The Commission preliminarily believes that it is appropriate to include these persons within the definition to the proposed amendment to Exhibit 6 to Form NRSRO. By applying the same definitions, the proposed calculations in Exhibit 6 to Form NRSRO would continue to be consistent across the various financial reports required in Form NRSRO and Rule 17g-3. Also, as explained in the June 2007 Adopting Release, the term "subscribers" in the definition of "net revenue" was intended to include persons who pay for credit ratings data and the analysis behind credit ratings because it may be difficult to separate these subscribers from other subscribers.[84] As the Commission has previously noted, credit rating agencies that make their credit ratings publicly available for free sometimes offer subscriptions to receive feeds of the credit ratings or to receive reports detailing the analysis behind the credit ratings.[85] The Commission is proposing to move the definition of "credit rating services" from the instructions to Exhibit 10 of Form NRSRO to the "Explanation of Terms" section of the Form NRSRO Instructions, making the definition applicable to Form NRSRO as a whole, including the proposed amendments to Exhibit 6.

As noted above, under proposed amendments to the Instructions to Exhibit 6, the applicant/NRSRO would need to make two new types of disclosures. The first proposed new disclosure in Exhibit 6 would require that an applicant/NRSRO disclose the percentage of net revenue attributable to the 20 largest users of credit rating services of the applicant/NRSRO. The proposed instructions further provide that the applicant/NRSRO would be required to calculate this ratio by dividing the amount of net

83 Id.

84 Id.

85 Id.

revenue earned by the applicant/NRSRO attributable the 20 largest users of credit rating services by the total amount of the four classifications of revenue of the applicant as reported in Exhibit 12 to Form NRSRO or in the financial report furnished to the Commission under Exchange Act Rule 17g-3(a)(4).[86] As noted above, Exhibit 12 and Rule 17g-3(a)(4) currently elicit information regarding: (1) revenue from determining and maintaining credit ratings; (2) revenue from subscribers; (3) revenue from granting licenses or rights to publish credit ratings; and (4) revenue from all other services and products offered by the applicant/NRSRO.[87] The proposed disclosures would be calculated annually, as of the end of the fiscal year of the applicant/NRSRO.

The Commission preliminarily believes that the proposed disclosure of the percentage of net revenue attributable to the 20 largest users of credit rating services of the applicant/NRSRO would provide investors and other users of credit rating services with useful disclosure, as explained below, related to a significant sample of the largest users of credit rating services of the applicant/NRSRO. The Commission preliminarily believes this proposed new disclosure would assist investors and other users of credit ratings by providing them with information concerning the degree to which revenues earned by the NRSRO come from a concentrated base of customers. This could be useful in understanding the conflicts inherent in the NRSRO's business. Specifically, a large percentage of revenues attributable to a concentrated group of clients could increase the potential risk that those clients' contribution to the NRSRO's revenues could influence the objectivity of its credit ratings. Making the degree of this concentration more

86 See Form NRSRO Instructions for Exhibit 12 and 17 CFR 240.17g-3(a)(4).

87 Id. The Commission intends that an applicant/NRSRO apply its standard accounting convention for recognizing revenue to make revenue calculations consistent across the various financial reports required in Form NRSRO and Rule 17g-3. The Commission notes it is proposing to use the terms revenue and net revenue as originally adopted by the Commission.

transparent in Exhibit 6 to Form NRSRO would allow investors and market participants to take this potential risk into account when considering the reliability of the NRSRO's credit ratings. The proposed new disclosures also would assist users of credit ratings in comparing concentration of revenues across all NRSROs.

The second proposed new disclosure in Exhibit 6 to Form NRSRO would require the applicant/NRSRO to disclose the percentage of revenue attributable to other services and products of the applicant/NRSRO. The proposed instructions to Exhibit 6 would provide that the applicant/NRSRO must calculate this ratio by dividing the total amount of revenue earned by the applicant for "all other services and products" as reported in Exhibit 12 to Form NRSRO or as reported in the annual financial report furnished to the Commission under Exchange Act Rule 17g-3(a)(4) by the total amount of the four classifications of revenue of the applicant as reported in Exhibit 12 or of the NRSRO as reported in the financial report furnished pursuant to 17g-3(a)(4). As noted above, Exhibit 12 and Rule 17g-3(a)(4) elicit the same information about revenues.[88]

The Commission preliminarily believes this information would be useful to investors and other users of credit ratings because it would provide information about the relative size of revenues an NRSRO earns from providing services other than credit ratings. There is the potential that an NRSRO that obtains substantial revenues from other services might be inclined to favor a client that purchases those other services when determining credit ratings solicited by that client. Consequently, creating greater transparency about the revenues generated from other services could provide increased information to assist investors and other users of credit ratings in assessing the potential risks to the NRSRO's objectivity.

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88 See Form NRSRO Instructions for Exhibit 12 and 17 CFR 240.17g-3(a)(4).

With respect to the two proposed new disclosures, the proposed amended instructions to Form NRSRO would provide that an applicant must provide the information for the fiscal year ending immediately before the date of the applicant's initial application to the Commission. The Commission is proposing this timeframe as it is consistent with the current instructions for the financial information elicited in Exhibits 10, 12, and 13.[89]

Further, after registration, an NRSRO would be required to provide the proposed information as of the end of its most recent fiscal year. As such, the Commission is proposing amendments to the Instructions to Exhibit 6 to provide that after registration, an NRSRO with a fiscal year end of December 31 must update the information in Exhibit 6, Part B, as part of its annual certification. Rule 17g-1(f) requires an NRSRO to furnish the annual certification no later than 90 days after the calendar year.[90] This also is the time frame for NRSROs with December 31 fiscal year-ends to furnish their annual financial reports required pursuant to Rule 17g-3.[91] Moreover, the information furnished in the annual reports would be needed to generate the proposed Exhibit 6 disclosures.

Further, the proposed instructions would require that an NRSRO with a fiscal year end that is not December 31 must provide this information with an Update of Registration no later than 90 days after the end of each fiscal year. These provisions would require the disclosure within 90 days of the closing of an NRSRO's books regardless of whether the

89 Exhibit 11 requires financial statements for the three calendar or fiscal years ending immediately before the date of the application. This proposed timeframe also is consistent with the requirements for the reports required to be published by NRSROs in Rule 17g-3(a). 17 CFR 240.17g-3(a).

90 17 CFR 240.17g-1(f).

91 17 CFR 240.17g-3.

year-end is December 31 or some other date. This also is the time frame for NRSROs to furnish their annual financial reports required pursuant to Rule 17g-3.[92]

The Commission is proposing these amendments to Exhibit 6 to Form NRSRO to further implement Section 15E(a)(1)(B)(vi) of the Exchange Act, which requires that an application for registration as an NRSRO contain information regarding any conflict of interest relating to the issuance of credit ratings by the applicant and NRSRO.[93] It also is proposing the amendments, in part, pursuant to Section 15E(a)(1)(B)(x) of the Exchange Act, which provides that the Commission can require any other information and documents as the Commission by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors.[94] The proposed disclosures are designed to increase transparency regarding sources of revenue that might create conflicts of interest for an NRSRO, and, thereby, allow investors and users of credit ratings to better assess these potential conflicts of interest that could influence an NRSRO's objectivity in determining credit ratings. Finally, the proposed amendments are designed to enhance the disclosures already made by NRSROs in Exhibit 6 to Form NRSRO and to provide users of credit ratings with tools to compare concentrations of revenues across all NRSROs. The proposed additional disclosures would provide more detail about an NRSRO's conflicts of interest, and thereby, allow users of credit ratings to better evaluate the potential risk that an NRSRO's credit ratings could be compromised.

The Commission generally requests comment on all aspects of these proposed amendments. In addition, the Commission requests comment on the following questions related to the proposal.

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92 17 CFR 240.17g-3.

93 15 U.S.C. 78o-7(a)(1)(B)(vi).

94 15 U.S.C. 78o-7(a)(1)(B).

- Should the proposed disclosure of information about the percentage of revenues attributable to the 20 largest clients use a different number of clients? For example, should it be a lesser number such as the 5, 10, or 15 largest clients or a larger number such as the 25, 30, or 35 largest clients?
- Are the revenues attributable to the 20 largest clients an appropriate proxy for an NRSRO's "major clients?" Might there be notable differences between the percentage of revenue attributable to the largest client and the percentage of revenue attributable to, say, the twentieth largest client?
- Would including revenue earned by persons directly or indirectly controlling, controlled by, or under common control with, the NRSRO (i.e., affiliates) in calculating revenues attributable to the 20 largest clients, be useful information for investors and other users of credit ratings?
- Should the proposed disclosure of information about the percentage of revenues derived from services other than determining credit ratings be expanded to include revenues earned by persons directly or indirectly controlling, controlled by, or under common control with, the NRSRO (i.e., affiliates)? If so, would it be useful for investors and other users of credit ratings to have this information?
- If the term affiliate was added to the proposed disclosures in Exhibit 6 to Form NRSRO, should the Commission define the term affiliate? For example, if an NRSRO controlled less than 51% of an entity, should the entity be considered an affiliate? If a natural person controlled or owned an NRSRO, should other entities the individual owns or controls be

considered affiliates of the NRSRO for purposes of the proposed rule?

- For the purposes of calculating the percentage of net revenue attributable to the 20 largest users of credit rating services of the applicant/NRSRO in Exhibit 6 to Form NRSRO, should the Commission only count "users" to be persons who paid for the service? For example, if the payer of a rating is the underwriter, should the Commission also attribute the payment to the issuer in calculating the percentage of net revenue to the NRSRO for the purpose of showing how much of the NRSRO's revenue is being earned from rating this particular issuer's securities? Similarly, if the payer of the rating is an issuer, should the Commission also attribute the payment to the underwriter in the calculation for purposes of highlighting whether this particular underwriter is a frequent or dominant underwriter that is involved in many deals rated by that NRSRO?
- Would the proposed rule give investors and other users of credit ratings sufficient information to assess the potential risk to objectivity? If not, is there other information that would be useful for this purpose?
- Is it appropriate to use existing definitions of "net revenue" and "credit rating services?
- Do any other NRSRO services lend themselves more to potential conflicts of interest that could influence the quality of the rating?
- Will the proposed rule generate additional information that is useful to users of NRSRO credit ratings?

- Is Exhibit 6 of Form NRSRO the most practical place for an NRSRO to make the proposed additional disclosures? Are there alternative places where an NRSRO could make these proposed disclosures that would be more useful to an investor or other users of an NRSRO's credit ratings? For example, would it be more useful for investors of other users of credit ratings if the proposed amendments to Exhibit 6 to Form NRSRO were disclosed along with the information required in the new Rule 17g-7?
- Is the most recent fiscal year an appropriate timeframe for the proposed disclosure? If not, what should it be? For example, would it be more appropriate to use the three, five or ten most recently ended fiscal years to provide a trend analysis?

IV. NEW RULE 17g-7 – CREDIT RATING REPORTS ON REVENUES

As discussed in detail in Section VI below, at this time the Commission has determined to defer consideration of action with respect to the proposal, set forth in the June 2008 Proposing Release, that would have required an NRSRO to publish a report each time the NRSRO published a credit rating for a structured finance product. Under that proposal, an NRSRO would have been required to disclose in the report how the credit ratings procedures and methodologies and credit risk characteristics for structured finance products differ from those of other types of rated instruments such as corporate and municipal debt securities. As an alternative to publishing the report, an NRSRO would have been allowed to use ratings symbols for structured finance products that differentiated them from the credit ratings for other types of debt securities.[95]

[95] See June 2008 Proposing Release, 73 FR, at 36235. The Commission proposed codifying these requirements in the Code of Federal Regulations ("CFR") as Rule 17g-7, which would follow

Today, the Commission is proposing a new Rule 17g-7.[96] This new rule would require an NRSRO to make publicly available on its Internet Web site a consolidated report containing information about the revenues earned by the NRSRO and, if applicable, its affiliates as a result of providing services and products to persons that paid the NRSRO to issue or maintain a credit rating. This report would need to be updated annually.

Specifically, proposed Rule 17g-7 consists of three paragraphs: (a), (b), and (c). As described in more detail below, proposed paragraph (a)(1) would require the NRSRO to include in the report: (1) the percent of the net revenue attributable to the person that paid the NRSRO that were earned by the NRSRO during the most recently ended fiscal year from providing services and products other than credit rating services to the person; (2) the relative standing of the person in terms of the person's contribution to the NRSRO's net revenue as compared with other persons that contributed to the NRSRO's net revenues; and (3) the identity of all outstanding credit ratings issued by the NRSRO and paid for by the person. Paragraph (a)(2) of proposed Rule 17g-7 would exempt an NRSRO from publishing the reports if, as of the end of the fiscal year, the NRSRO had no credit ratings outstanding that the NRSRO issued or maintained as a result of a person paying the NRSRO for the issuance or maintenance of the credit ratings. Paragraph (b) of proposed Rule 17g-7 would provide that the NRSRO must prominently include a generic disclosure statement each time the NRSRO publishes a credit rating or credit ratings indicating where on its Internet Web site the consolidated report required pursuant

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existing Rule 17g-6. As discussed in this section, the Commission is today proposing that a different rule be codified as Rule 17g-7 in the CFR. The Commission is proposing to use the title "Rule 17g-7" for this proposed new rule in order to maintain the numerical sequence of the current NRSROs rules – Rules 17g-1 through 17g-6.

96 Id.

to paragraph (a) is located. Paragraph (c) of proposed Rule 17g-7 would contain definitions applicable to the section. Specifically, paragraph (c)(1) would define the term "credit rating services" and paragraph (c)(2) would define the term "net revenue."

The purpose of this proposed rule is to provide users of credit ratings with information to assist them in evaluating the potential risk to the integrity of a credit rating that arises from the conflict inherent when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument. Specifically, the risk that the revenue generated from the person soliciting the NRSRO to determine the credit rating could compromise the NRSRO's objectivity and cause the NRSRO to determine a higher credit rating than it otherwise would have determined. Under such circumstances, the credit rating may not accurately reflect the NRSRO's true view of the level of credit risk inherent in the obligor, security, or money market instrument being rated. Providing users of credit ratings with the information in this consolidated report would enable them to better assess the degree that a particular credit rating may be subject to this risk.

The increased transparency resulting from the proposed rule also could have the ancillary benefit of helping to mitigate the possibility that a large consumer of the services and products of the NRSRO and its affiliates could successfully use its status to exercise undue influence on the NRSRO. Specifically, by making the potential conflict more transparent to the marketplace, the proposed rule could assist users of credit ratings, market participants, and others in evaluating how credit ratings solicited by large revenue providers are handled by the NRSRO.

A. Proposed Paragraph (a) of Rule 17g-7

Paragraph (a)(1) of proposed Rule 17g-7 would provide that an NRSRO must annually, not later than 90 calendar days after the end of its fiscal year (as indicated on its current Form NRSRO) make publicly available on its Internet Web site a consolidated report that shows, with respect to each person that paid the NRSRO to issue or maintain a credit rating that was outstanding as of the end of the fiscal year, information about the person as described in proposed paragraph (a)(1)(i) – (a)(1)(iii) of proposed Rule 17g-7.

Paragraph (a)(1)(i) of proposed Rule 17g-7 would require an NRSRO to show the percent of the net revenue attributable to the person earned by the NRSRO for the fiscal year from providing services and products other than credit rating services to the person. Paragraph (c)(1) of proposed Rule 17g-7 would define "credit rating services" to mean any of the following: "rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings, credit ratings data, or credit ratings analysis to a subscriber." This is the current definition of "credit rating services" contained in the instructions for Exhibit 10 to Form NRSRO.[97]

Paragraph (c)(2) of proposed Rule 17g-7 would define the term "net revenue" to mean "revenue earned for any type of service or product provided to a person, regardless of whether related to credit rating services, and net of any rebates and allowances paid or owed to the person." This definition mirrors the definition of "net revenue" in the instructions to Exhibit 10 to Form NRSRO and in Rule 17g-3. This information about the person set forth in proposed Rule 17g-3(a)(1)(i) is required to be made publicly available in the consolidated report posted on the NRSRO's Internet Web site and is

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97 See Form NRSRO Instructions for Exhibit 10.

designed to benefit users of credit ratings by alerting them to the potential risk that the revenues earned by the NRSRO could influence the objectivity of the NRSRO in determining credit ratings paid for by the person.

The method of calculating net revenue would be the same for the requirements in Form NRSRO (existing and proposed herein), Rule 17g-3, and proposed Rule 17g-7. Consequently, just as with the existing definitions in Form NRSRO and Rule 17g-3, the inclusion in the proposed Rule 17g-7 definition of revenues net of "rebates or allowances" is intended to limit offsets that reduce net revenue to items that directly reduce a payable on the revenue side and to exclude unrelated payables (e.g., payables for utility bills). In other words, the definition of "net revenues" is intended to be the same as used in Form NRSRO and Rule 17g-3 in all respects.

To generate the information on revenues earned by the NRSRO from providing services other than credit rating services to the person that paid for the issuance or maintenance of a credit rating, the NRSRO would be required to undertake a number of steps, as described below, no later than 90 calendar days after the end of its fiscal year or prior to its registration as an NRSRO. These steps would be based on the NRSRO's results for the most recently ended fiscal year, consistent with other information disclosed on Form NRSRO or furnished to the Commission under Rule 17g-3. In particular, under paragraph (a)(3)(i) of proposed Rule 17g-7, the NRSRO would be required to take the following steps, respectively, within 90 days of closing its books or before its registration as an NRSRO:

- Calculate the net revenue attributable to the person earned by the NRSRO for the fiscal year from providing services and products other than credit rating services to the person;
- Calculate the net revenue attributable to the person earned by the NRSRO for the fiscal year from providing all services and products, including credit rating services, to the person; and
- Divide the amount calculated pursuant to paragraph (a)(3)(i)(A) by the amount calculated pursuant to paragraph (a)(3)(i)(B) and convert that quotient to a percent.

These steps would generate the information the NRSRO would use in the report on the percent of revenues attributable to providing non-credit rating services to a person that paid the NRSRO for the issuance or maintenance of a credit rating. The following is an example of how the information would be generated for purposes of the proposed report with respect to a hypothetical NRSRO, ABC Credit Rating Agency, and a consumer of ABC Credit Rating Agency's services and products, XYZ Corp. For the purposes of the first step, prescribed in paragraph (a)(3)(i)(A) of proposed Rule 17g-7, assume ABC Credit Rating Agency earned gross revenues of $220,000 from providing services other than credit rating services to XYZ Corp. Assume further that ABC Credit Rating Agency agreed to rebate $20,000 of that amount back to XYZ Corp. because it exceeded $100,000. In this case the net revenue attributable to providing services other than credit rating services to XYZ Corp. would be $200,000.

Next, for the purposes of the second step, prescribed in paragraph (a)(3)(1)(B) of proposed Rule 17g-7, assume ABC Credit Rating Agency earned gross revenues of

$1,100,000 from providing all services to XYZ Corp. Assume further that ABC Credit Rating Agency agreed to rebate $100,000 of that amount back to XYZ Corp because it exceeded $100,000. In this case the net revenue attributable to providing all services and products to XYZ Corp. would be $1,000,000.

The next step, prescribed in paragraph (a)(3)(i)(C) of proposed Rule 17g-7, would be for ABC Credit Rating Agency to divide $200,000 by $1,000,000 to calculate the percent of the total revenues earned from providing all services to XYZ Corp. attributable to providing services other than credit rating services. Under the hypothetical, this calculation would yield a figure of 20%. Consequently, for purposes of the consolidated report, the NRSRO would need to indicate that 20% of the net revenues earned from providing services to XYZ Corp. was for services other than credit rating services.

Paragraph (a)(1)(ii) of proposed Rule 17g-7 would require an NRSRO to indicate in the consolidated report to be made publicly available on its Internet web site the relative standing of the person that paid the NRSRO to issue or maintain a credit rating in terms of the amount of net revenue earned by the NRSRO attributable to the person as compared to other persons that provided the NRSRO net revenues. To compute this information, the NRSRO would need to take the following steps not more than 90 calendar days after the end of each fiscal year:

- For each person from whom the NRSRO earned net revenue during the fiscal year, calculate the net revenue attributable to the person earned by the NRSRO for the fiscal year from providing all services and products, including credit rating services, to the person;

- Make a list that sorts the persons subject to the calculation above in order from largest to smallest in terms of the amount of net revenue attributable to the person, as determined pursuant to that calculation; and
- Divide the list generated above into the following categories: top 10%, top 25%, top 50%, bottom 50%, and bottom 25% and determine which category contains the person.

These steps would generate the information to indicate the relative standing of each person that paid the NRSRO to issue or maintain a credit rating that was outstanding as of the fiscal year end. The Commission preliminarily believes that the proposed categories (top 10%, top 25%, top 50%, bottom 50%, and bottom 25%) would be helpful to investors or other users of credit ratings because the rankings provide insight into customers that – given the level of revenues they provide to the firm – may be able to exercise greater undue influence.

This calculation would be performed as follows. Assume the NRSRO earned revenues from 1,000 clients during the most recently ended fiscal year. Moreover, assume that the greatest amount of net revenue derived from a client was $2,500,000 and that the 100th largest amount of net revenue derived from a client was $900,000. In this case, using hypothetical above, XYZ Corp. – from which the NRSRO derived $1,000,000 in net revenue – would rank somewhere between the largest and 100th largest clients of the NRSRO. Consequently, because there are 1,000 clients total, XYZ Corp. would need to be classified in the consolidated report as being in the top 10% of the persons that provided the NRSRO with net revenue in terms of the amount of net revenue.

Paragraph (a)(1)(iii) of proposed Rule 17g-7 would require an NRSRO to identify for each person listed in the consolidated report all outstanding credit ratings paid for by that person, which the NRSRO would need to determine in accordance with proposed paragraph (a)(3)(iii) of Rule 17g-7. Specifically, the NRSRO would need to identify by name of obligor, security, or money market instrument and, as applicable, CIK number, CUSIP, or ISIN each outstanding credit rating generated as a result of the person paying the NRSRO for the issuance or maintenance of the credit rating and attribute the outstanding credit rating to the person. For example, assume XYZ Corp. had paid the NRSRO to issue and maintain credit ratings for three different classes of debt instruments issued by XYZ Corp. and there were credit ratings outstanding for each of these classes of debt instruments as of the end of the NRSRO's fiscal year. In this case, each of these debt instruments would need to be identified by name and CUSIP number and associated with XYZ Corp. on the consolidated report.

Proposed paragraph (a)(2) of Rule 17g-7 would provide an exemption to the requirement to generate the consolidated report or to include with the publication of a credit rating the statement required by paragraph (b) of proposed Rule 17g-7 (discussed below) if, as of the end of the fiscal year, there were no credit ratings of the NRSRO outstanding that were issued or maintained as a result of a person paying the NRSRO for the issuance or maintenance of the credit rating. For example, a subscriber-paid NRSRO may be exempt from the requirements of the proposed rule if it is not paid by obligors, issuers, underwriters or investors to issue or maintain specific credit ratings. This would mean that a subscriber-paid NRSRO would not need to generate the report or make the generic statement, provided it only was paid by subscribers to access its credit ratings.

However, it would need to generate the report if it was paid, for example, by an investor to issue or maintain a credit rating on a specific debt instrument.

B. Proposed Paragraph (b) of Rule 17g-7

Proposed paragraph (b) of Rule 17g-7 would provide that an NRSRO must prominently include a statement that identifies where on its Internet Web site the consolidated report required pursuant to paragraph (a)(1) is located each time the NRSRO publishes a credit rating or credit ratings in a research report, press release, announcement, database, Internet Web site page, compendium, or any other written communication that makes the credit rating publicly available for free or a reasonable fee. Specifically, the NRSRO would need to include the following statement: "Revenue information about persons that paid the nationally statistical rating organization for the issuance or maintenance of a credit rating is available at: [insert address to Internet Web site]." The proposed statement is intended to be generic and, thereby, to minimize the burden of including it when a credit rating (or credit ratings) is published. The proposal is designed to simply alert users of credit ratings and others where they can locate the consolidated report containing information about persons who paid the NRSRO to issue or maintain a credit rating. This would allow the users of credit ratings and others accessing the consolidated report to research the persons who had paid the NRSRO for credit ratings outstanding as of the fiscal year end. The researchers could review the amount of net revenue earned by the NRSRO attributable to providing services other than credit ratings to persons who paid for specific credit ratings, the relative standing of the persons who paid for the credit ratings in terms of providing net revenue to the NRSRO, and the credit ratings that the persons paid the NRSRO to issue or maintain.

C. Conclusion

The Commission is proposing these amendments under authority to require an NRSRO to "make and disseminate such reports as the Commission, by rule, prescribes as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of [the Exchange Act]." The Commission preliminarily believes these proposed amendments are necessary and appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act for the reasons stated above and because they are designed to provide investors and other users of credit ratings with information to assess the degree of risk that a credit rating may be compromised by the undue influence of the person that paid for the issuance or maintenance of the credit rating.

D. Request for Comment

The Commission generally requests comment on all aspects of this proposed new rule. In addition, the Commission requests comment on the following questions related to the proposal.

- Are the classifications in terms of revenue provided to the NRSRO (top 10%, top 25%, top 50%, bottom 50% or bottom 25%) proposed in new Rule 17g-7 appropriate? How uniform are the potential conflicts of interest with respect to the clients within these categories? Should there be more or less classifications? What should they be? Should the classifications be defined differently, such as on the size of the client, the total revenue, the types of other services provided to the clients?
- How would investors and other users of credit rating ratings use this

information?

- Given the potential heterogeneity among clients in a particular tier, how similar is the risk of a potential conflict of interest with regard to clients within a given tier?
- Is being in a top-tier classification likely to create an undue concern that suggests to investors that a rating is conflicted, even if it is not? To the extent a negative connotation exists when an issuer is in a top percentile, what risk, if any, exists that clients will seek out those NRSROs for which their revenue contribution is less significant? Does such behavior risk disproportionately impact smaller NRSROs? If so, how? If not, why not? What other potential behavioral changes might the disclosure induce?
- To what extent is the information in these reports already observable? Can someone look at the information on rated bonds to determine who an NRSRO's biggest clients are? Is there overlap between the biggest clients for rating services and the biggest overall clients of an NRSRO?
- Are there any potential unintended consequences of the proposed disclosures?
- Is 90 days after the end of the fiscal year sufficient time for an NRSRO to generate the information to be used for the next twelve-month period?
- Would more frequent updates of the required information provide more meaningful information to investors? Would the cost of producing more frequently updated reports greatly increase the costs to NRSRO?
- Should a newly-registered NRSRO be exempt from having to generate the consolidated report and make the generic statement until the end of its first

fiscal year as a registered NRSRO?

- Would including revenue earned by persons directly or indirectly controlling, controlled by, or under common control with, the NRSRO (i.e., affiliates) provide a more enhanced disclosure of the potential conflicts of undue influence, since the organization as a whole may care about its revenues regardless of which part of the business earned the revenues? If so, would it be useful for investors and other users of credit ratings to have this information? Would it be complicated and costly to do the calculations under proposed Rule 17g-7 if affiliates are included?
- If the term affiliate was added to the proposed disclosures, should the Commission define the term affiliate? For example, if an NRSRO controlled less than 51% of an entity, should the entity be considered an affiliate? If a natural person controlled or owned an NRSRO, should other entities the individual owns or controls be considered affiliates of the NRSRO for purposes of the proposed rule?
- How is the data to be reported currently entered and stored at NRSROs, and would such data be able to be published on an automated or nearly automated basis after a one-time systems adjustment?
- Would it be useful for investors or other users of credit ratings to require an NRSRO to calculate and disclose revenue information with respect to other persons in addition to persons that paid the NRSRO for services? For example, should the Commission attribute underwriter-paid ratings to the issuer? In addition, should the consolidated report provide for double counting

of revenues earned by the NRSRO if the Commission attributes payment to both the underwriter and issuer so that users of a credit rating could more easily evaluate whether a large percentage of the NRSRO's revenues are attributable to particular issuers or underwriters or a concentrated group of clients?

- Would it be useful to require another disclosure item in the proposed consolidated report to show the issuer or underwriter who did not pay for the service but was a party to a deal? If so, should there be a particular order of disclosing this item to highlight the frequency of this person's involvement in deals that are rated by a particular NRSRO? For example, should there be a separate disclosure item to reveal the percentage of net revenue earned by the NRSRO in which the party who did not pay for the service was involved in the deal?

Additionally, the Commission is soliciting comment from investors, market participants, and others as to whether it would be appropriate to require that specific information be reported when a credit rating action is made publicly available (i.e., more than a generic statement of where relevant information can be located). Specifically, the Commission solicits comment on the following:

- Should an NRSRO be required to include the information proposed to be included in the consolidated report about a person that paid for the issuance or maintenance of a credit rating along with the publication of the credit rating? If such a requirement were in place, would it be more beneficial to users of NRSROs of credit ratings than the requirements of proposed Rule 17g-7 discussed above? Would such a requirement have higher costs than proposed Rule 17g-7?

- Should an NRSRO be required to disclose the principal procedures and methodologies used in determining the credit rating? Should this disclosure include information about key assumptions used and the qualitative and quantitative models, if any, employed in determining the credit rating? Should the level of disclosure be sufficient so that "outside parties can understand how a rating was arrived at" by the NRSRO? What would be the benefits and costs associated with such a requirement?
- If an NRSRO should disclose information about the key assumptions used, should an NRSRO also be required to disclose the degree to which the NRSRO has analyzed how sensitive a rating is to changes in these assumptions? What would be the benefits and costs associated with such a requirement?
- Should an NRSRO be required to disclose if a rating action is being taken as a result of a change to a procedure or methodology, including a change to an applicable qualitative or quantitative model? What would be the benefits and costs associated with such a requirement?
- Should an NRSRO be required to disclose that a rating action is being taken as a result of an error identified in a procedure or methodology used to generate the credit rating? What would be the benefits and costs associated with such a requirement?

- Should an NRSRO be required to disclose information on the limitations of the credit rating, including information on the reliability, accuracy, and quality of the data relied on in determining the rating? What would be the benefits and costs associated with such a requirement?
- Would a statement on the extent to which key data inputs for the credit rating were reliable or limited, including any limits on the adequacy of historical data and limits on the availability and completeness of other relevant information be beneficial? What would be the benefits and costs associated with such a requirement?
- Should an NRSRO be required to disclose a description of relevant data about the obligor, issuer, security, or money market instrument being rated that was used and relied on for the purpose of determining the credit rating? What would be the benefits and costs associated with such a requirement?
- Should an NRSRO be required to disclose whether material nonpublic information was used in determining the credit rating? Should an NRSRO be required to disclose, in general terms, the type of confidential information used and the impact this information had on its rating action? What would be the benefits and costs associated with such a requirement?
- Is the timeframe for disclosure (the NRSRO's most recent fiscal year end) the best timeframe to evaluate whether a conflict exists and the potential extent of the conflict? For example, should the information disclosed be based on the results over a 3, 5, or 10 year period in order better capture longer term trends?

V. TECHNICAL AMENDMENTS TO FORM NRSRO INSTRUCTIONS

The Commission also is proposing to make certain technical amendments to the Instructions to Form NRSRO. The Commission is proposing to amend the title to Exhibit 6 to read "Information concerning conflicts of interest or potential conflicts of interest relating to the issuance of credit ratings by the credit rating agency," rather than the current "Identification of conflicts of interest relating to the issuance of credit ratings." The Commission is proposing this change to the title of Exhibit 6 to Form NRSRO to better reflect the additional disclosures proposed to be required, as described in Section III above. In addition, in the General Instructions[98] to the Form NRSRO Instructions, the Commission is proposing to add "Division of Trading and Markets" and "Mail Stop 7010" to the mailing address for Form NRSRO. This is designed to facilitate receipt of Form NRSRO by the Division of Trading and Markets.

Further, in the "Instructions for Annual Certifications," the Commission is prosing to clarify that the annual financial reports that an NRSRO must furnish to the Commission pursuant to Section 15E(k) of the Exchange Act and Exchange Act Rules 17g-3(a)(1) through (a)(6), as applicable, should not be furnished as part of the annual certification on Form NRSRO. The Commission also is proposing additional amendments to the instructions to state that pursuant to paragraph (b) of Rule 17g-3, the NRSRO must attach to each financial report the certification required by Rule 17g-3.[99]

There has been some confusion among some NRSROs on the requirement to provide a certification for each financial report. The annual certification is a statutory

98 See Paragraph A.8. "Address" in the General Instructions to the Form NRSRO Instructions.
99 See 17 CFR 240.17g-3(b).

requirement set forth in Section 15E(b)(2) of the Exchange Act.[100] The Commission adopted Rule 17g-1(f) to require that an NRSRO furnish the Commission with its annual certification on Form NRSRO.[101] The annual financial reports that an NRSRO must furnish to the Commission pursuant to Section 15E(k) of the Exchange Act and Exchange Act Rules 17g-3(a)(1) through (a)(6), are separate and distinct requirements from the Form NRSRO requirements. Consequently, the Rule 17g-3 reports should be furnished separately from the Form NRSRO that is used to make the annual certification. Therefore, the Commission is proposing this amendment to clarify the distinct requirements with respect to Form NRSRO and Rule 17g-3(a)(1) through (a)(6).

The Commission also is proposing to correct certain typographical errors in the Form NRSRO. The Commission is proposing to change the phrase "withdrawal of registration" to "withdrawal from registration" in the first sentence in the "Instructions for Specific Line Items, Item 5." to the Form NRSRO Instructions.[102] In addition, in the instructions to Exhibit 8 to Form NRSRO, the Commission is proposing to delete the phrase "(See definition below)". In the instructions to Exhibit 10 to Form NRSRO, the Commission is proposing to change the word "person" to "user of credit rating services" in the first sentence. Finally, the Commission is proposing to change the paragraph heading for the section titled "Explanation of Terms" from "F." to "I." The corrected heading will read: "I. EXPLANATION OF TERMS".

The Commission generally requests comment on all aspects of these proposed amendments to Form NRSRO.

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100 15 U.S.C. 78o-7(b)(2).

101 17 CFR 240.17g-1(f).

102 See Paragraph H in the "Instructions for Specific Line Items, Item 5." to the Form NRSRO Instructions.

VI. DIFFERENTIATING STRUCTURED FINANCE CREDIT RATINGS

The Commission has adopted requirements that are designed to allow investors and other users of credit ratings to better understand the differences between structured finance products and their credit ratings and other types of debt instruments and their credit ratings. For example, the rules adopted in the February 2009 Adopting Release and in today's Companion Release include requirements for specific disclosures about the methodologies and procedures for determining credit ratings for structured finance products and the public disclosure of credit rating performance statistics and histories by class of credit rating. For instance, the February 2009 Adopting Release amended Exhibit 1 to Form NRSRO to require disclosure of performance statistics for each class of credit rating for which the NRSRO is registered with the Commission.[103] Moreover, the Commission amended the Exhibit to require that the performance statistics for the class of credit ratings specified in Section 3(a)(62)(B)(iv) of the Rating Agency Act[104] include credit ratings of any security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction.[105] This was designed to capture ratings actions for credit ratings of structured finance products that do not meet the narrower statutory definition of "issuers of asset-backed securities (as that term is defined is section 1101(c) of part 229 of title 17, Code of Federal Regulations)."[106] The amendment requires that an NRSRO registered in this class of credit ratings must generate and disclose performance statistics for this class, which includes all structured finance products. As a result, these statistics can be compared with performance statistics

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103 See February 2009 Adopting Release, 74 FR at 6457-6459.

104 15 U.S.C. 78c(a)(62)(B)(iv).

105 See February 2009 Adopting Release, 74 FR at 6457-6459.

106 Id.

for other classes of credit ratings for which the NRSRO is registered, such as corporate issuers.

Similarly, the Commission adopted amendments to paragraph (d) of Rule 17g-2, which require that an NRSRO make publicly available, on a six-month delayed basis ratings action information for a random sample of 10% of ratings documented pursuant to paragraph (a)(8) for each class of credit rating for which the NRSRO is registered and has issued 500 or more ratings paid for by the obligor being rated or by the issuer, underwriter, or sponsor of the security being rated ("issuer-paid credit ratings").[107] This requirement will allow investors and market participants to compare the rating action histories for an NRSRO's issuer-paid structured finance ratings with the histories of other classes of credit ratings where the NRSRO has 500 or more outstanding issuer-paid credit ratings. In the Companion Release being issued today, the Commission is adopting an amendment to Rule 17g-2 to require the disclosure of all outstanding credit ratings initially determined on or after June 26, 2007.[108] This will further enhance the ability of investors and other users of credit ratings to track the relative performance of structured finance credit ratings as compared with performance of other classes of credit ratings.

In the February 2009 Adopting Release, the Commission also adopted amendments to Exhibit 2 to Form NRSRO requiring specific disclosures with respect to the procedures and methodologies for determining credit ratings for structured finance products.[109] The amendments require, among other things, that an NRSRO disclose: (1) whether and, if so, how information about verification performed on assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of

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107 See February 2009 Adopting Release, 74 FR at 6460-6463.

108 See Companion Release.

109 See February 2009 Adopting Release, 74 FR at 6459-6460.

any asset-backed or mortgage-backed securities transaction is relied on in determining credit ratings; and (2) whether and, if so, how assessments of the quality of originators of assets underlying or referenced by a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction play a part in the determination of credit ratings.

All these measures will assist investors and other users of credit ratings in understanding the different characteristics and risks of structured finance products and the credit ratings for those products. The Commission, however, also continues to explore further ways to increase investor understanding of the differences between structured finance products and other types of debt instruments and the respective credit ratings for those products.

In the sections below, the Commission solicits comments on the following: (1) how the goal of the proposed Rule 17g-7 set forth in the June 2008 Proposing Release could be promoted through other measures designed to enhance investor understanding of the differences between the risk characteristics of structured finance products and other classes of debt instruments and the differences between the risk characteristics of credit ratings for structured finance products and credit ratings for other classes of credit ratings; and (2) what measures could be taken to facilitate the ability of NRSROs to determine unsolicited credit ratings for existing debt instruments issued by structured finance products. The goal of either initiative would be to provide the marketplace and investors with information that would allow them to differentiate structured finance credit ratings from credit ratings for other types of debt instruments.

A. The Use of Different Symbols for Structured Finance Products

In the June 2008 Proposing Release, the Commission proposed a new rule – Rule 17g-7 – that would have required an NRSRO to issue a report with respect to a structured finance credit rating or, alternatively, to use a distinct symbology to identify structured finance credit ratings.[110] Specifically, paragraph (a) of the Rule 17g-7 proposed in 2008 would have required an NRSRO to publish a report accompanying every credit rating it published for a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction. The NRSRO would have been required to describe in the report the rating methodology used to determine the credit rating and how it differed from a rating for any other type of obligor or debt security, as well as how the risks associated with a security or money market instrument issued by an asset pool or as part of any asset-backed or mortgage-backed securities transaction are different from the risks of other types of rated obligors and debt securities. Paragraph (b), however, would have permitted an NRSRO to comply with the rule by distinguishing its rating symbols for structured finance products. The Commission did not propose requiring that specific rating symbols be used to distinguish credit ratings for structured finance products, instead proposing that an NRSRO would be permitted to choose the appropriate symbol or identifier.[111]

The Commission proposed Rule 17g-7 in the June 2008 Proposing Release to address concerns that certain investors assumed the risk characteristics for structured finance products, particularly highly rated instruments, were the same as for other types

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110 As discussed above, the Commission is proposing in this release that a different proposed rule be codified as Rule 17g-7 in the CFR. The Rule 17g-7 being proposed in this Release would require an NRSRO to make publicly available a consolidated report containing information about relative percent of revenues of the NRSRO attributable to persons paying the NRSRO for the issuance or maintenance of a credit rating.

111 See June 2008 Proposing Release.

of similarly rated instruments, as well as concerns that some investors may not have performed adequate internal risk analysis on structured finance products before purchasing them.[112] The goal of the proposal was to spur investors to perform more rigorous internal risk analysis on such products so that they would not overly rely on NRSRO credit ratings in making investment decisions. At the time, the Commission noted that a potential ancillary benefit of the rule would be that it could cause certain investors to seek to better understand the risks of structured finance products that are not necessarily addressed in credit ratings, such as market and liquidity risk.[113]

In the June 2008 Proposing Release, the Commission expressed its preliminarily belief that requiring an NRSRO to publish a report along with each publication of a credit rating for a structured finance product likely would provide certain investors with useful information about structured finance products and spur investors to perform more rigorous internal risk analysis on structured finance products.[114] Alternatively, the Commission noted, the use of distinct symbology would alert investors that a structured finance product was being rated and, therefore, raise the question of how it differs from other types of debt instruments.[115]

The Commission generally requested comment on all aspects of the proposed new rule as well as on several specific questions.[116] A total of 40 commenters responded to this request.[117] Sixteen commenters expressed opposition to the proposed rule as a

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112 See June 2008 Proposing Release, 73 FR at 36235.

113 Id.

114 Id.

115 Id.

116 See June 2008 Proposing Release, 73 FR at 36236.

117 Letter dated June 10, 2008 from Deborah A. Cunningham and Boyce I. Greer, Co-Chairs Company, Co-Chairs, SIFMA Credit Rating Agency Task Force ("First SIFMA Symbology Letter"); letter dated June 19, 2008 from Rupert Schoder, Financial Engineer, Socit Gnrale, France ("SGF Symbology Letter"); letter dated July 14, 2008 from Robert Dobilas, President, CEO,

Realpoint LLC ("Realpoint Symbology Letter"); letter dated July 21, 2008 from Dottie Cunningham, Chief Executive Officer, Commercial Mortgage Securities Association ("CMSA Symbology Letter"); letter dated July 21, 2008 from Bruce Goldstein, SunTrust Robinson Humphrey ("STRH Symbology Letter"); letter dated July 21, 2008 from Raymond E. Petersen, President, Inland Mortgage Capital Corporation ("Inland Symbology Letter"); letter dated July 21, 2008 from Leonard W. Cotton, Vice Chairman, Centerline Capital Group ("Centerline Symbology Letter"); letter dated July 22, 2008 from Kevin Kohler, VP - Levered Finance, Capmark Investments LP ("Capmark Symbology Letter"); letter dated July 22, 2008 from Mary A. Downing, Director -Surveillance and Due Diligence, Hillenbrand Partners ("Hillenbrand Symbology Letter"); letter dated July 23, 2008 from Kent Wideman, Group Managing Director, Policy & Rating Committee and Mary Keogh, Managing Director, Policy & Regulatory Affairs, DBRS ("DBRS Symbology Letter"); letter dated July 24, 2008 from Takefumi Emori, Managing Director, Japan Credit Rating Agency, Ltd. ("JCR Symbology Letter"); letter dated July 24, 2008 from Amy Borrus, Deputy Director, Council of Institutional Investors ("Council Symbology Letter"); letter dated July 24, 2008 from Vickie A. Tillman, Executive Vice President, Standard & Poor's Ratings Services ("S&P Symbology Letter"); letter dated July 24, 2008 from Deborah A. Cunningham and Boyce I. Greer, Co-Chairs Company, Co-Chairs, SIFMA Credit Rating Agency Task Force ("Second SIFMA Symbology Letter"); letter dated July 25, 2008 from Sally Scutt, Managing Director, and Pierre de Lauzun, Chairman, Financial Markets Working Group, International Banking Federation ("IBFED Symbology Letter"); letter dated July 25, 2008 from Denise L. Nappier, Treasurer, State of Connecticut ("Nappier Symbology Letter"); letter dated July 25, 2008 from Suzanne C. Hutchinson, Mortgage Insurance Companies of America ("MICA Symbology Letter"); letter dated July 25, 2008 from Kieran P. Quinn, Chairman, Mortgage Bankers Association ("MBA Symbology Letter"); letter dated July 25, 2008 from Frank Chin, Chairman, Municipal Securities Rulemaking Board ("MSRB Symbology Letter"); letter dated July 25, 2008 from Charles D. Brown, General Counsel, Fitch Ratings ("Fitch Symbology Letter"); letter dated July 25, 2008 from Bill Lockyer, State Treasurer, California ("Lockyer Symbology Letter"); letter dated July 25, 2008 from Jeremy Reifsnyder and Richard Johns, Co-Chairs, American Securitization Forum Credit Rating Agency Task Force ("ASF Symbology Letter"); letter dated July 25, 2008 from Francisco Paez, Metropolitan Life Insurance Company ("MetLife Symbology Letter"); letter dated July 25, 2008 from Cate Long, Multiple-Markets ("Multiple-Markets Symbology Letter"); letter dated July 25, 2008 from Kurt N. Schacht, Executive Director and Linda L. Rittenhouse, Senior Policy Analyst, CFA Institute Centre for Financial Market Integrity ("CFA Institute Symbology Letter"); letter dated July 25, 2008 from Lawrence J. White, Professor of Economics, Stern School of Business, New York University ("White Symbology Letter"); letter dated July 25, 2008 from Jack Davis, Head of Fixed Income Research, Schroder Investment Management North America Inc. ("Schroders Symbology Letter"); letter dated July 25, 2008 from Karrie McMillan, General Counsel, Investment Company Institute ("ICI Symbology Letter"); letter dated July 25, 2008 from Michael Decker, Co-Chief Executive Officer and Mike Nicholas, Co-Chief Executive Officer, Regional Bond Dealers Association ("RBDA Symbology Letter"); letter dated July 25, 2008 from Richard M. Whiting, Executive Director and General Counsel, Financial Services Roundtable ("Roundtable Symbology Letter"); letter dated July 25, 2008 from James H. Gellert, Chairman and CEO and Dr. Patrick J. Caragata, Founder and Executive Vice Chairman, Rapid Ratings International Inc.("Rapid Ratings Symbology Letter"); letter dated July 25, 2008 from James A. Kaitz, President and CEO, Association for Financial Professionals ("AFP Symbology Letter"); letter dated July 25, 2008 from Gregory W. Smith, General Counsel, Colorado Public Employees' Retirement Association ("Colorado PERA Symbology Letter"); letter dated July 25, 2008 from Keith A. Styrcula, Chairman, Structured Products Association ("SPA Symbology Letter"); letter dated July 28, 2008 from Michel Madelain, Chief Operating Officer, Moody's Investors Service ("Moody's Symbology Letter"); letter dated July 28, 2008 from Keith F. Higgins, Chair, Committee on Federal Regulation of Securities and Vicki O. Tucker, Chair, Committee on Securitization and Structured Finance, American Bar Association ("ABA Business Law Committees Symbology Letter"); letter dated July 31, 2008 from Robert S. Khuzami Managing Director and General Counsel, Deutsche Bank Americas ("DBA Symbology Letter"); letter dated August 8, 2008 from Jeffrey A. Perlowitz, whole,[118] while six commenters expressed either full or conditional support for both parts of the proposed amendment.[119] Eleven commenters argued in favor of adopting paragraph (a) alone, thereby requiring the publication of a report to accompany structured finance ratings and eliminating the paragraph (b) option of using a distinct symbology.[120] Twenty-nine commenters expressed their opposition to adopting paragraph (b).[121]

Commenters criticized the proposed amendment as burdensome[122] and as providing little, if any, benefit to investors.[123] Several commenters argued that the proposed new requirements would be confusing and, therefore, detrimental to

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Managing Director and Co-Head of Global Securitized Markets, and Myongsu Kong, Director and Counsel, Citigroup Global Markets Inc. ("Citi Symbology Letter"); letter dated August 12, 2008 from John J. Niebuhr, Managing Director, Lehman Brothers, Inc. ("Lehman Symbology Letter"); letter dated August 17, 2008 from Olivier Raingeard, Ph.D ("Raingeard Symbology Letter"); letter dated August 22, 2008 from Robert Dobilas, CEO and President, Realpoint LLC ("Realpoint Symbology Letter").

118 See Realpoint Symbology Letter; CMSA Symbology Letter; STRH Symbology Letter; Inland Symbology Letter; Centerline Symbology Letter; Capmark Symbology Letter; Hillenbrand Symbology Letter; DBRS Symbology Letter; JCR Symbology Letter; S&P Symbology Letter; Nappier Symbology Letter; MBA Symbology Letter; MetLife Symbology Letter; AFP Symbology Letter; Moody's Symbology Letter; Raingeard Symbology Letter.

119 See MICA Symbology Letter; Lockyer Symbology Letter; CFA Symbology Letter; RDBA Symbology Letter; Colorado PERA Symbology Letter; MSRB Symbology Letter.

120 See Second SIFMA Symbology Letter; IBFED Symbology Letter; ASF Symbology Letter; Schroders Symbology Letter; ICI Symbology Letter; Principal Symbology Letter; Rapid Ratings Symbology Letter; ABA Business Law Committees Symbology Letter; DBA Symbology Letter; Citi Symbology Letter; Lehman Symbology Letter.

121 See First SIFMA Letter; Realpoint Symbology Letter; CMSA Symbology Letter; STRH Symbology Letter; Inland Symbology Letter; Centerline Symbology Letter; Capmark Symbology Letter; Hillenbrand Symbology Letter; DBRS Symbology Letter; JCR Symbology Letter; S&P Symbology Letter; Second SIFMA Symbology Letter; IBFED Symbology Letter; Nappier Symbology Letter; MBA Symbology Letter; ASF Symbology Letter; Fitch Symbology Letter; MetLife Symbology Letter; Rapid Ratings Symbology Letter; Roundtable Symbology Letter; Schroders Symbology Letter; ICI Symbology Letter; Principal Symbology Letter; AFP Symbology Letter; Moody's Symbology Letter; Raingeard Symbology Letter; ABA Business Law Committees Symbology Letter; DBA Symbology Letter; Citi Symbology Letter; Lehman Symbology Letter.

122 See JCR Symbology Letter; S&P Symbology Letter; Moody's Symbology Letter; Roundtable Symbology Letter.

123 See Realpoint Symbology Letter; Schroders Symbology Letter; Raingeard Symbology Letter; MICA Symbology Letter; Roundtable Symbology Letter.

investors.[124] Others expressed concerns that the proposed amendments would stigmatize structured finance products and further weaken the market for these instruments.[125]

The Commission, like a number of commenters, is concerned that the proposal, if adopted, could have limited utility in encouraging investors to perform more rigorous internal risk analysis on such products because NRSROs likely would have opted to use a distinguishing symbology as the less costly alternative. The Commission is concerned about whether the use of a distinct symbol or identifier for structured finance ratings might not achieve the goal of the proposal: promoting independent analysis and understanding of the distinct risks of structured finance products.

Furthermore, the Commission is concerned that mandating a distinct symbology could create the inaccurate impression that the Commission believes other types of debt instruments are less risky. The Commission believes a more effective way to differentiate credit ratings for structured finance products may be by enhancing investor understanding of the distinct risk characteristics of these debt instruments and their credit ratings. For these reasons, at this time the Commission is deferring consideration of action on the proposal to issue a report or use a distinct symbology at this time. Instead, the Commission wants to study further whether there are other ways to better achieve the goals of the proposal: greater investor awareness of the unique risks of structured finance products and credit ratings for structured finance products.

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124 See CMSA Symbology Letter; STRH Symbology Letter; Inland Symbology Letter; Centerline Symbology Letter; Capmark Symbology Letter; Hillenbrand Symbology Letter; DBRS Symbology Letter; JCR Symbology Letter; ICI Symbology Letter; Principal Symbology Letter; MetLife Symbology Letter; Rapid Ratings Symbology Letter;

125 See First SIFMA Symbology Letter; Realpoint Symbology Letter; Principal Symbology Letter; MBA Symbology Letter; Lockyer Symbology Letter; ASF Symbology Letter; MetLife Symbology Letter; ABA Business Law Committees Symbology Letter; DBA Symbology Letter; Lehman Symbology Letter.

The Commission believes that some differences in the risk characteristics seem readily apparent and are fairly well understood by investors. For example, the Commission believes that an investor would understand that the continued payment of principal and interest to the holder of a structured finance debt instrument typically depends on the performance of a pool of underlying financial assets such as mortgages, business and student loans, or credit card receivables; whereas the performance of a corporate bond typically depends on the issuer's ability to generate income from business operations, and the performance of a municipal bond typically depends on the issuer's ability to collect taxes or earn revenues from services provided by a specific utility such as a sewer or water company.

However, even high-level generalizations about the differences between classes of debt instruments may not always hold true. Some structured finance issuers actively manage the composition of the pool of underlying financial assets (in contrast to a static pool) and, as a result, these products are more risk-sensitive to the discretion of the manager. For example, the performance of the structured finance issuer will depend on the judgment of the manager of the pool of underlying assets. This is similar to how the performance of corporate issuers is sensitive to the judgment of senior management and their boards. Moreover, some corporate issuers – particularly in the financial sector – are highly risk-sensitive to the performance of financial assets similar to structured finance issuers that hold or reference the same types of assets. In short, generalizations about differences that are not carefully crafted run the risk of creating more confusion or misunderstanding than clarity for investors.

For these reasons, the Commission is asking a series of questions below designed to elicit further views from market participants and others on how the risk characteristics of structured finance products and credit ratings differ from the risk characteristics of corporate, municipality, and sovereign nation debt instruments and their credit ratings.[126] Specifically, the Commission requests market participants and others to provide their views in the following four areas: (1) the differences between structured finance products and other debt instruments; (2) the differences between credit ratings for structured finance products and credit ratings for other types of debt instruments; (3) potential measures to communicate differences in structured finance products to investors; and (4) potential measures to communicate differences in structured finance credit ratings to investors.[127]

Persons making submissions are asked to provide detailed explanations of their views and analyses and cite relevant studies.

Differences between structured finance products and other debt instruments

- What do market participants and others believe are the significant differences in the risk characteristics of structured finance debt instruments as compared with debt instruments issued by corporate issuers, municipalities, and sovereign nations in terms of credit risk, market risk, interest rate risk, and liquidity risk? What do market

126 For the purposes of this request for comment, the Commission intends the term "corporate issuer" to include any issuer that is not a structured finance issuer or a government issuer.

127 For views on some of these issues see, for example, The Role of Credit Rating Agencies in the Structured Finance Markets, May 2008, Technical Committee of the International Organization of Securities Commissioners; The Role of Ratings in Structured Finance: Issues and Implications, (CGFS 2005), January 2005, Committee on the Global Financial System, Bank of International Settlements; The Role of Credit Rating Agencies in Structured Finance, Consultation Paper, February 2008, The Committee of European Securities Regulators.

participants and others believe are the main drivers of the differences in risk characteristics?

- How do market participants and others believe the trading markets for structured finance products compare with the trading markets for debt instruments of corporate issuers, municipalities, and sovereign nations in terms of transparency and providing liquidity to investors? Do market participants and others believe differences in the trading markets for these debt instruments create differing levels of credit risk, market risk, interest rate risk, or liquidity risk for structured finance products as compared with debt instruments issued by corporate issuers companies, municipalities, and sovereign nations?
- How do market participants and others assess the relative use of leverage by structured finance issuers as compared with corporate issuers, municipalities, and sovereign nations? Do differences in the use of leverage create differing levels of credit risk, market risk, interest rate risk, or liquidity risk for structured finance products as compared with debt instruments issued by corporate issuers, municipalities, and sovereign nations? Does leverage act as a driver of differing levels of risk for structured finance products and account for the fact that certain corporate issuers also employ leverage?
- How do market participants and others assess the relative complexity of structured finance issuers as compared with corporate issuers, municipalities, and sovereign nations in terms of capital structure and

operations? For example, in assessing complexity, how do market participants and others account for the fact that a structured finance product can be comprised of a static pool of cash flow assets whereas a corporate issuer may have an array of business lines operated through hundreds of affiliates located around the globe? Do differences in complexity create differing levels of credit risk, market risk, interest rate risk, and liquidity risk for structured finance products as compared with debt instruments issued by corporate issuers, municipalities, and sovereign nations?

- How do market participants and others assess the relative sensitivity of structured finance issuers to macroeconomic factors as compared with corporate issuers, municipalities, and sovereign nations? For example, structured finance products have greater or lesser risk sensitivity to a macroeconomic stress event such as a recession than debt instruments issued by corporate issuers, municipalities, and sovereign nations?
- How do market participants and others assess the relative risks of a sector of structured finance issuers such as issuers that rely on the performance of a particular type of financial asset (e.g., residential mortgages or credit card receivables) as compared with an industry of corporate debt issuers (e.g., financial services, automakers, technology companies, or healthcare providers) or geographically concentrated municipal issuers (e.g., within a state) or sovereign debt issuers (e.g., within a region of the globe)? For example, does a structured finance sector have greater or lesser risk

sensitivity to a macroeconomic stress event such as a recession than corporate debt issuers within a specific industry or geographically concentrated municipal or sovereign issuers?

- How do market participants and others perceive the degree of idiosyncratic risk inherent in structured finance products relative to debt instruments issued by corporate issuers, municipalities, and sovereign nations? Do market participants and others believe the different ways these debt issuers generate income to meet principal and interest payments to debt holders (e.g., through underlying income generating assets for structured finance products, revenues generated through business operations for corporate issuers, and taxing authority or utility revenues for municipal and sovereign issuers) create differing levels of idiosyncratic risk?
- In assessing the relative level of idiosyncratic risk inherent in structured finance issuers as compared with debt instruments issued by corporate issuers, municipalities, and sovereign nations, what do market participants and others believe is the impact of the fact that different structured finance issuers can hold the same types of underlying cash flow generating assets (e.g., residential mortgages) and have very similar legal structures? What is the impact of the fact that corporate issuers can operate using different business models and have differing levels of management competence?
- Do market participants and others believe there are material differences between structured finance products and debt instruments issued by

corporate issuers, municipalities, and sovereign nations in terms of recovery after default? Do market participants and others believe debt holders are likely to recover more or less principal after a structured finance debt instrument defaults than after the default of a debt instrument issued by a corporate issuer, municipality, or sovereign nation?

- Do market participants and others believe there are important differences in the level of moral hazard present in structured finance products relative to debt instruments issued by corporate issuers, municipalities and sovereign nations? Could the fact that structured finance products consist of asset pools which are ultimately purchased from originators of such assets result in lower quality assets for structured finance products as compared with the assets of corporate issuers, municipalities and sovereign nations?
- To the extent that market participants and others identify differences between the risk characteristics of structured finance products and other debt instruments, do they believe the differences identified apply across all types of structured finance products or just to certain categories of products? Are generalizations about the different risk characteristics of structured finance products as compared to other debt instruments appropriate or is it more appropriate to categorize structured finance products by underlying asset type (e.g., residential mortgage, commercial mortgage, student loan, credit card receivable, lease) or structure type (e.g., asset-backed security, collateralized debt obligation (CDO), CDO-

squared or cubed, synthetic or hybrid CDO, constant proportion debt obligation, asset-backed commercial paper conduit)?

Differences between credit ratings for structured finance products and credit ratings for other types of debt Instruments

- What are the significant differences in the risk characteristics of credit ratings for structured finance products as compared with credit ratings for debt instruments issued by corporate issuers, municipalities, and sovereign nations in terms of ratings accuracy and performance?
- Are structured finance debt instruments are inherently more difficult to rate accurately than debt instruments issued by corporate issuers, municipalities, and sovereign nations? If so, what do market participants and others believe are the factors that make structured finance products more difficult to rate?
- Does the fact that the creditworthiness of a structured finance issuer typically depends on the performance of a pool of financial assets makes these debt instruments more difficult to rate accurately than debt instruments issued by corporate issuers, municipalities, and sovereign nations?
- Do market participants and others believe that the reliance on quantitative analysis (e.g., statistical models and historical data) to determine credit ratings for structured finance products as compared with a greater reliance on qualitative analysis to determine credit ratings for debt instruments issued by corporate issuers, municipalities, and sovereign nations

increases or decreases the accuracy risk for structured finance credit ratings?

- Do market participants and others believe that the information available about structured finance issuers used to determine credit ratings as compared to the information available to be used to determine credit ratings about corporate issuers, municipalities, and sovereign nations makes it more difficult to determine accurate credit ratings for structured finance debt instruments and/or to conduct surveillance on outstanding structured finance credit ratings? If so, do market participants and others believe it is easier to determine accurate credit ratings, and monitor those ratings, for corporate issuers that are required to file periodic public reports and financial statements and provide access to management? Is the information used to determine and monitor credit ratings of corporate issuers, municipalities, or sovereign nations more forward looking (e.g., based on more on forecasts)? In addition, do market participants and others believe that the historical data used to determine and monitor structured finance credit ratings of shorter duration or otherwise less robust than the historical data used to determine and monitor credit ratings for corporate issuers, municipalities, or sovereign nations?
- Do market participants and others believe it is more difficult for investors and market observers to perform independent analysis of structured finance products than of securities issued by corporate issuers, municipalities, and sovereign nations? If so, does this impact the accuracy

of structured finance credit ratings as compared to credit ratings for corporate issuers, municipalities, and sovereign nations?

- Do market participants and others believe the conflict of being paid to determine credit ratings is more attenuated in the structured finance sector than in the corporate, municipal, and sovereign sectors? If so, why? Does this impact the accuracy of structured finance credit ratings?
- Do market participants and others believe structured finance credit ratings are more likely to have a greater number of ratings transitions (i.e., upgrades or downgrades) than credit ratings for debt instruments issued by corporate issuers, municipalities, or sovereign nations? If so, what are the factors that create this effect?
- Are structured finance credit ratings more likely to experience transitions of greater magnitude (i.e., upgrades or downgrades that span a larger number of credit rating categories (notches)) than credit ratings for debt instruments issued by corporate issuers, municipalities, or sovereign nations? If so, what are the factors that make structured finance credit ratings more prone to transitions of greater magnitude in credit rating category?
- Do market participants and others believe issuers, arrangers, sponsors, and managers of structured finance products are able to "game" rating agency methodologies resulting in credit ratings that are less accurate than ratings for other debt instruments? Do they believe the ability of issuers, arrangers, sponsors and managers to adjust the characteristics of structured

finance products, including the number and relative size of tranches and the composition of the asset pool in order to achieve particular credit ratings, result in ratings that are less accurate than ratings for debt instruments issued by corporate issuers, municipalities and sovereign nations?

- To the extent that market participants and others identify differences between the risk characteristics of structured finance credit ratings and credit ratings for other debt instruments, do differences identified apply globally to all structured finance products or just to certain categories of products? Do market participants and others believe generalizations about the different risk characteristics of credit ratings for structured finance products as compared to credit ratings for other debt instruments can be made? Is it more appropriate to categorize structured finance credit ratings by underlying asset type (e.g., residential mortgage, commercial mortgage, student loan, credit card receivable, lease) or structure type (e.g., asset-backed security, collateralized debt obligation (CDO), CDO-squared or cubed, synthetic or hybrid CDO, constant proportion debt obligation, asset-backed commercial paper conduit)?

<u>Measures to communicate differences in structured finance products to investors</u>

- To the extent that market participants and others identified significant differences in the risk characteristics of structured finance debt instruments as compared with debt instruments issued by corporate issuers, municipalities, and sovereign nations in terms of credit risk, market risk, interest rate risk, and liquidity risk, what are their views on whether steps should be taken to better communicate these differences to investors in a manner reasonably designed to enhance investor understanding of the differences?

- Do market participants and others believe structured finance issuers should be required to disclose these general differences in the types of securities? If so, how should the disclosures be made? For example, should they be stated in offering documents and periodic reports or are there other mechanisms that could be used to convey the differences in the types of securities?
- Do market participants and others believe NRSROs should be required to disclose these differences? If so, how should the disclosures be made? For example, should the disclosures be included in a report issued at the same time a rating action is taken with respect to a structured finance product, in Form NRSRO, or through some other mechanism?
- Do market participants and others believe the disclosure documents should required to be delivered to prospective investors in investment pools that may hold structured finance products be required to include these disclosures? If so, how should these disclosures be made?

<u>Measures to communicate differences in structured finance credit ratings to investors</u>

- To the extent that market participants and others identified material differences in the risk characteristics of credit ratings for structured finance debt instruments as compared with credit ratings for debt instruments issued by corporate issuers, municipalities, and sovereign nations in terms of ratings accuracy and performance, what are their views on measures that can be taken to communicate these differences to investors in a manner reasonably designed to enhance investor understanding of the differences?

- Do market participants and others believe structured finance issuers should be required to disclose these differences? If so, how should the disclosures be made? Should they be stated in offering documents and periodic reports, or are there other mechanisms that could be used to convey the disclosures?
- Do market participants and others believe NRSROs should be required to disclose these differences? For example, it has been suggested that NRSRO disclose the following types of information about structured finance products:[128]

    1. The diligence that is performed by or provided to the NRSRO about the underlying assets, and quality control of numerical data provided to the NRSRO;
    2. The characteristics and sensitivities of models used or relied upon by the NRSRO in assessing the likely performance of the structured finance product or the underlying assets;
    3. The extent to which the NRSRO relies on representations and warranties made by transaction participants;

128 See e.g., June 25, 2008 Letter from Jeff Riefsnyder and Richard Johns on behalf of the American Securitization Forum to the US Securities and Exchange Commission regarding "Exchange Act Release No. 34-57967 (File No. S7-13-08)".

4. The assumptions as to future events and economic conditions that are embedded in the analytical models used by the NRSRO in arriving at a given rating;

5. Publishing "what if" scenario analyses that address the ratings implications of changes in the underlying assumptions upon which ratings are based and provide insight into ratings tolerance to changing economic or risk circumstances;

6. Providing additional information relating to default probability, loss sensitivity, severity of loss given default, short-tail and long-tail risk and similar risk metrics associated with each class of credit ratings.

- If you believe these types of disclosures and other disclosures should be made by NRSROs, how should the disclosures be made? Should the disclosures be stated in a report issued at the same time a rating action is taken with respect to a structured finance product, in Form NRSRO, or through some other mechanism?
- Do market participants and others believe the disclosure documents required to be delivered to prospective investors in investment pools that may hold structured finance products should be required to include the disclosures? If so, how should the disclosures be made?

B. Credit Ratings for Existing Structured Finance Debt Instruments

Another way to differentiate credit ratings for structured finance products from other types of debt instrument ratings is to increase the opportunity for independent analysis of the credit worthiness of the products To this end, in the companion release, the Commission is adopting amendments to Rule 17g-5 that require NRSROs that are paid by arrangers to determine credit ratings for structured finance products to provide other NRSROs access to a password protected Internet Web site that lists each deal they have been hired to rate. A hired NRSRO also would be required to obtain representations from the arranger hiring the NRSRO that the arranger will maintain a password protected Internet Web site that contains all the information the arranger provides to the hired NRSRO to determine and monitor the credit rating and that it will make this information available to NRSROs not hired to determine and monitor the rating. As discussed in detail in the Commission's Companion Release, these requirements are designed to create a mechanism by which non-hired NRSROs will be able to access the NRSRO Internet Web sites to learn of new deals being rated and then access the arranger Internet Web sites to obtain the information provided by the arranger to the hired NRSRO during the entire initial rating process and, thereafter, for the purpose of surveillance.[129] The hired NRSRO need only provide access to its password-protected Internet Web site to a non-hired NRSRO whose certification provided to the Commission indicates that it has either (1) determined and maintained credit ratings for at least 10% of the issued securities and money market instruments for which it accessed information pursuant to Rule 17g-5(a)(3) as amended in the calendar year prior to the year covered by the certification, if it accessed such information for 10 or more issued securities or money market instruments; or (2) has not accessed information pursuant to Rule 17g-5(a)(3) as amended 10 or more times in the calendar year prior to the year covered by the certification. NRSROs also will be required to disclose in their certifications the number of deals for which they

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129 See Companion Release.

obtained information through accessing the Internet Web sites and the number of ratings they issued using that information during the most recent calendar year during which it obtained information through accessing these Internet Websites certification or that they previously had not accessed such information 10 or more times in a calendar year.

These amendments to Rule 17g-5 described above are designed to allow NRSROs not hired to rate a structured finance deal to get sufficient information to determine a credit rating for the debt instruments to be issued. Generally, the information relied on by the hired NRSROs to rate new debt issuances of structured finance issuers is non-public. This makes it difficult for other NRSROs to rate these securities and money market instruments. As a result, the products frequently are issued with ratings from only one or two NRSROs and only by NRSROs that are hired by the issuer, sponsor, or underwriter (i.e., NRSROs that may be subject to the conflict of being repeatedly paid by certain arrangers to rate these securities and money market instruments).

The rule amendments also are designed to require the disclosure of the necessary information to any NRSRO – whether hired or not – to permit non-hired NRSROs to determine credit ratings for the debt instruments to be issued. The Commission believes that absent this requirement a non-hired NRSRO would have a much more difficult time obtaining the information necessary to issue an unsolicited credit rating at the time the debt instruments were issued into the market. Without the rule amendment, in most cases, the non-hired NRSRO's prospects for determining a pre-issuance credit rating would depend on the issuer's willingness to provide the information to the NRSRO notwithstanding the fact that the issuer was paying other NRSROs to rate the to-be-issued debt instruments.

The goal is to increase the number of credit ratings extant for a given structured finance security or money market instrument and, in particular, promote the issuance of credit ratings by NRSROs that are not hired by the arranger. This is designed to provide users of credit ratings with a broader range of views on the creditworthiness of the security or money market instrument. In addition, the rule amendments are designed to make it more difficult for arrangers to exert influence over the NRSROs they hire to determine credit ratings for structured finance products. By opening up the rating process to more NRSROs, the rule amendments make it easier for the hired NRSRO to resist such pressure by increasing the likelihood that any steps taken to inappropriately favor the arranger could be exposed to the market through the credit ratings issued by other NRSROs.

As the Commission noted in the February 2009 Proposing Release, the text of paragraph (a)(3)(i) refers to transactions where the NRSRO is in the process of determining an "initial" credit rating.[130] The rule does not require the NRSRO to include on the Internet Web site information about securities or money market instruments once the NRSRO has published the initial rating and is monitoring the rating. The amendment is designed to alert other NRSROs about new deals and direct them to the Internet Web site of the arranger where information to determine initial ratings and monitor the ratings can be accessed. Consequently, upon publication of the initial rating, the NRSRO can remove the information about the security or money market instrument from the list it maintains on the Internet Web site. Similarly, if the arranger decides to terminate the

130 See February 2009 Proposing Release, 74 FR at 6493.

rating process before a hired NRSRO publishes an initial rating, the NRSRO would be permitted to remove the information from the list.[131]

The Commission is aware that there are conflicting characterizations about the ability of market participants and others, including NRSROs not hired to rate the deal, to obtain information necessary to determine and monitor a credit rating for structured finance debt instrument after issuance. The Commission understands that some of the trustees and servicers involved with the structured finance issuer provide monthly reports that allow NRSROs not hired to rate the issuer's debt instruments to determine and monitor credit ratings for those securities and money market instruments. The Commission also understands that some third-party venders aggregate the information provided by the trustees and servicers in a manner that permits independent credit analysis by NRSROs and investors. The Commission understands that some market participants argue that the trustees and servicers restrict access to the information to investors and hired NRSROs and that the third-party venders do not provide sufficient information.

The Commission believes it would be helpful to solicit comments from market participants and others as to whether measures should be taken by the Commission to enhance the ability of non-hired NRSROs to determine credit ratings for structured finance debt instruments that were issued before the compliance date of the amendments to Rule 17g-5 being adopted in the Companion Release.

For these reasons, the Commission is asking a series of questions below designed to elicit comments from market participants and others about whether currently there is sufficient information (or access to such information) to permit an NRSRO to determine

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131 See Companion Release.

unsolicited credit ratings for structured finance debt instruments issued prior to the compliance date of the amendments to Rule 17g-5 being adopted today.

Persons making submissions are asked to provide detailed explanations and analyses and cite relevant studies.

- Do market participants and others believe the ability of NRSROs to access information about structured finance debt instruments issued before the compliance date for the Rule 17a-5 amendments ("compliance date") is restricted in such a manner as to preclude or seriously discourage NRSROs from determining credit ratings if they have not been hired by the arranger? Do the issuers, trustees and servicers that control access to this information preclude a non-hired NRSRO from accessing the information or impose barriers that discourage a non-hired NRSRO from accessing it?
- Do market participants and others believe the information disclosed by structured finance issuers, trustees, and servicers or by third-party venders is insufficient to determine unsolicited credit ratings for structured finance debt instruments issued before the compliance date?
- What specific measures, if any, should be taken to secure the disclosure of information by issuers, trustees or servicers of structured finance products issued before the compliance date or the NRSROs that were hired to rate those structured finance products to enable NRSROs that were not hired to determine and monitor a credit rating where the debt instrument was issued prior the compliance date?
- Do market participants and others believe if the information provided to the hired NRSRO to determine and monitor a credit rating for a structured finance product

issued before the compliance date was made available to another NRSRO, the non-hired NRSRO would be able to determine a meaningful unsolicited credit using that information alone?

VII. GENERAL REQUEST FOR COMMENT

The Commission invites interested persons to submit written comments on any aspect of the proposed amendments, in addition to the specific requests for comments. Further, the Commission invites comment on other matters that might have an effect on the proposal contained in the release, including any competitive impact.

VIII. PAPERWORK REDUCTION ACT

Certain provisions of the proposed amendments to Rule 17g-3 and the Instructions to Exhibit 6 to Form NRSRO, as well as the new proposed Rule 17g-7 contain a "collection of information" within the meaning of the Paperwork Reduction Act of 1995 ("PRA"). The Commission is submitting the proposed amendments and the proposed new collection to the Office of Management and Budget ("OMB") for review in accordance with the PRA. An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid control number. The titles for the collections of information are:

(1) Rule 17g-3, Annual reports to be furnished by nationally recognized statistical rating organizations (OMB Control Number 3235-0626);

(2) Rule 17g-1, Application for registration as a nationally recognized statistical rating organization; Form NRSRO and the Instructions for Form NRSRO (OMB Control Number 3235-0625); and

(3) Rule 17g-7, Reports to be made public by nationally recognized statistical rating organizations about persons that paid the nationally recognized statistical rating organization for the issuance or maintenance of a credit rating (a proposed new collection of information).

A. Collections of Information under the Proposed Rule Amendments

The Commission is proposing for comment rule amendments to prescribe additional requirements for NRSROs. The proposed amendments to Rule 17g-3 would require an NRSRO to submit an additional annual report to the Commission. The proposed amendments to Rule 17g-3 would require an NRSRO to furnish a new unaudited report describing the steps taken by the NRSRO's designated compliance officer during the fiscal year to administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act (prevention of misuse of material nonpublic information and management of conflicts of interest), and to ensure compliance with the securities laws and rules and regulations thereunder.[132] The proposed amendment to Rule 17g-3 also would require that the report include a description of any compliance reviews of the activities of the NRSRO; the number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such matter; a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO; and a description of the persons within the NRSRO who were advised of the results of the reviews.[133]

In addition, proposed amendments to the Instructions to Exhibit 6 to Form NRSRO would require an applicant/NRSRO to furnish the Commission with information regarding the revenues an NRSRO receives from major clients and from services other than determining credit ratings. Finally, proposed Rule 17g-7 would require an NRSRO, on an annual basis, to make publicly available on its Internet Web site a consolidated

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132 See proposed Rule 17g-3(a)(7).

133 See proposed Rule 17g-3(a)(7)(ii). The proposed report also would be certified by the designated compliance officer. See proposed Rule 17g-3(b)(2).

report that shows certain information with respect to each person that paid the NRSRO to issue or maintain a credit rating. First, the NRSRO must include the percent of the net revenue attributable to the person earned by the NRSRO for that fiscal year for providing services and products other than credit rating services. Second, the NRSRO must include the relative standing of the person in terms of the person's contribution to the net revenue of the NRSRO for the fiscal year. Third, the NRSRO must include all outstanding credit ratings paid for by the person.[134]

B. Proposed Use of Information

The collections of information in the proposed amendments to Rule 17g-3 to add an additional unaudited report to describe the steps taken by the designated compliance officer during the fiscal year to administer certain policies and procedures and to ensure compliance with securities laws and rules and regulations would improve the integrity of the ratings process by establishing a discipline under which the NRSRO's designated compliance officer would need to report to the Commission the steps taken by the compliance officer to fulfill the officer's statutory responsibilities. The act of reporting these steps is designed to promote the active engagement of the designated compliance officer in reviewing an NRSRO's compliance with internal policies and procedures. The proposed report also could strengthen the Commission's oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating processes and providing an additional tool for the Commission to monitor how the NRSRO's designated compliance officer is fulfilling the responsibilities prescribed in Section 15E(j) of the Exchange Act. In addition, with respect to the proposed amendments to Rule 17g-3, the identification of

134 See proposed Rule 17g-7.

the persons within the NRSRO advised of the results of the review could also promote the appropriate escalation of compliance issues to the management of the NRSRO.

Further, the collections of information in the proposed amendments to Exhibit 6 to the Instructions to Form NRSRO would allow users of credit ratings to more effectively evaluate the integrity of the NRSRO's credit ratings themselves and whether they believe the NRSRO is effectively managing its conflicts of interests otherwise identified in Exhibit 6. The collection of information in proposed new Rule 17g-7 would provide users of credit ratings with information about the potential conflicts of interest that arises when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument.

Finally, the collections of information in the proposed amendments also are designed to further assist the Commission in effectively monitoring, through its examination function, whether an NRSRO is conducting its activities in accordance with Section 15E of the Exchange Act[135] and the rules thereunder.

C. Respondents

In adopting the original rules under the Rating Agency Act, as well as additional rules in February 2009, the Commission estimated that approximately 30 credit rating agencies would be registered as NRSROs.[136] The Commission believes that this estimate continues to be appropriate for identifying the number of respondents for purposes of the amendments and the proposed new rule. Since the original rules under the Rating Agency Act became effective in June 2007, ten credit rating agencies have registered

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135 15 U.S.C. 78o-7.

136 See June 2007 Adopting Release, 72 FR at 33607.

with the Commission as NRSROs.[137] The rules regarding the registration have been in effect for just over two years; consequently, the Commission expects additional entities will register.

The Commission generally requests comment on all aspects of these estimates for the number of respondents. In addition, the Commission requests specific comment on the following items related to these estimates.

- For purposes of the PRA should the Commission continue to use the estimate that 30 credit rating agencies will register as NRSROs?
- Alternatively, should the Commission raise or lower that number, given that ten credit rating agencies have registered with the Commission as NRSROs in the two years that the NRSRO registration program has been in effect? If so, what should the number be? Commenters should explain how they arrived at the estimate and identify any sources of industry information used in arriving at the estimate.

Commenters should provide specific data and analysis to support any comments they submit with respect to these estimates with respect to the number of respondents.

D. Total Annual Recordkeeping and Reporting Burden

As discussed in further detail below, the Commission estimates the total recordkeeping burden resulting from the proposed rule amendments and proposed new rule would be approximately 2,760 hours[138] on an annual basis and 4,650 hours[139] on a one-time basis.

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137 A.M. Best Company, Inc.; DBRS Ltd.; Fitch.; Japan Credit Rating Agency, Ltd.; Moody's; Rating and Investment Information, Inc.; S&P; LACE Financial Corp.; Egan-Jones Rating Company; and Realpoint LLC.

138 900 + 60 + 1,800 = 2,760.

The total annual and one-time hour burden estimates described below are averages across all types of NRSROs expected to be affected by the proposed rule amendments. The size and complexity of NRSROs range from small entities to entities that are part of complex global organizations employing thousands of credit analysts. Consequently, the burden hour estimates represent the average time across all NRSROs. The Commission further notes that, given the significant variance in size between the largest NRSROs and the smallest NRSROs, the burden estimates, as averages across all NRSROs, are skewed higher because the largest firms currently predominate in the industry.

1. Proposed Amendments to Rule 17g-3

Rule 17g-3 requires an NRSRO to furnish certain reports to the Commission on an annual basis, including audited financial statements, as well as other annual reports.[140] The Commission is proposing to amend Rule 17g-3 to require an NRSRO to furnish the Commission with an additional unaudited report containing a description of the steps taken by the designated compliance officer during the fiscal year to administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act (management of conflicts of interest and prevention of the misuse of material nonpublic information); and ensure compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.[141]

Proposed new paragraph (a)(7)(ii) of Rule 17g-3 also would provide that the report must include: (1) a description of any compliance reviews of the activities of the

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139 750 + 3,900 = 4,650.

140 17 CFR 240.17g-3.

141 See proposed Rule 17g-3(a)(7)(ii).

NRSRO; (2) the number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such matter; (3) a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO; and (4) a description of the persons within the NRSRO who were advised of the results of the reviews.

The total annual burden currently approved by OMB for Rule 17g-3 is 7,000 hours.[142] The current annual hour burden estimate to prepare and file the annual reports under Rule 17g-3 is 200 hours per respondent, including the audited financial statements under Rule 17g-3(a)(1).[143] With respect to the proposed amendment, the Commission estimates, based on staff experience, that the amount of time it would take to prepare a report describing the steps taken by the designated compliance officer during the fiscal year to administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act (management of conflicts of interest and prevention of the misuse of material nonpublic information); and to ensure compliance with the securities laws and rules and regulations thereunder, would be approximately 30 hours per year for a total annual hour burden of 900 hours.[144]

The Commission based this estimate, in part, on the fact that the areas covered by the proposed amendment to Rule 17g-3 overlap with the duties already required of the NRSRO's designated compliance officer pursuant to Section 15E(j) of the Exchange Act. The Commission preliminarily believes that the estimated hour burden under the

142 See February 2009 Adopting Release, 74 FR at 6473.

143 See February 2009 Adopting Release, 74 FR at 6472. The Commission based this proposed estimate, in part, on the average number of annual hours (200 hours) divided by the number of annual reports required to be prepared under current Rule 17g-3(a)(1)-(6): 200 annual hours/6 reports = 33.33 hours (rounded to 30 hours).

144 30 hours x 30 NRSROs = 900 hours.

proposed amendment to Rule 17a-3 would include the time it would take to compile information to draft the report and the preparation and filing of the report itself. In addition, this one-time hour burden estimate also includes the time it would take to identify and describe material compliance matters, any remediation and the persons advised of the results of the reviews. Consequently, the Commission also based this estimate, in part, on the average estimated number of hours it would currently take an NRSRO to complete one annual report under current Rule 17g-3 (i.e., approximately 30 hours).[145]

Given the potentially sensitive nature of the proposed report, the Commission also preliminarily believes that an NRSRO would likely engage outside counsel to assist it in the process of drafting and reviewing the proposed report under Rule 17g-3. The Commission estimates that the time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. The Commission estimates that, on average, an outside counsel would spend approximately 20 hours assisting an NRSRO and its designated compliance officer in drafting and reviewing the proposed report on a one-time basis for an aggregate burden to the industry of 600 hours.[146] Based on industry sources, the Commission estimates that the cost of an outside counsel would be approximately $400 per hour. For these reasons, the Commission estimates that the

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[145] 15 U.S.C. 78o-7(j). Under this provision of the statute, an NRSRO must "designate an individual responsible for administering the policies and procedures that are required to be established pursuant to [Sections 15E(g) and (h) of the Exchange Act (15 U.S.C. 78o-7(g) and (h))], and for ensuring compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to [Section 15E of the Exchange Act]." Id.

[146] 30 NRSROs x 20 hours = 600 hours.

average one-time cost to an NRSRO would be approximately \$8,000[147] and the one-time cost to the industry would be approximately \$240,000.[148]

The Commission generally requests comment on all aspects of the burden estimates for the proposed amendments to Rule 17g-3. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates. In addition, the Commission requests specific comment on the following items related to these estimates.

- To what extent would NRSROs rely on outside counsel with respect to the preparation, drafting and review of the proposed report?

2. Amendments to Form NRSRO

The Commission is proposing to amend the Instructions to Exhibit 6 to Form NRSRO to require an applicant/NRSRO to furnish the Commission with information regarding the revenues an NRSRO receives from major clients and from services other than determining credit ratings.

As stated above, the Commission proposes amending the instructions for Exhibit 6 to augment the information about conflicts of interest disclosed in Form NRSRO. The Commission prescribed the information currently required in Exhibit 6 to implement Section 15E(a)(1)(B)(vi) of the Exchange Act, which requires that an application for registration contain information regarding any conflict of interest relating to the issuance of credit ratings by the applicant/NRSRO.[149] The proposed amendments to Form NRSRO would change the instructions for the Form to require that NRSROs provide specific disclosure of certain percentages of its revenue related to its large customers and services it

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147 \$400 per hour x 20 hours = \$8,000.

148 \$8,000 x 30 NRSROs = \$240,000.

149 15 U.S.C. 78o-7(a)(1)(B)(vi).

provides, other than the issuance of credit ratings, in Exhibit 6 to the Form. The Commission preliminarily believes that an NRSRO would generate the financial information and complete the proposed new additional disclosures required by Exhibit 6 to Form NRSRO using internal records and current NRSRO personnel.

The total annual burden currently approved by OMB for Rule 17g-1 and Form NRSRO is 6,400 hours.[150] Based on staff experience, the Commission estimates that the average time necessary for an applicant or NRSRO to gather the information for the first time in order to complete the additional disclosures that would be required by the proposed amendments to Exhibit 6 to Form NRSRO would be 25 hours per NRSRO, which would be a one-time hour burden to the industry of 750 hours.[151] The Commission preliminarily believes, based on staff experience, that the average time it would take an NRSRO to complete the additional disclosures that would be required by the proposed amendments would be comparable to the current estimate of 25 hours that it would take an NRSRO to complete an amendment to a Form NRSRO.[152] The Commission preliminarily believes that these burden estimates would be comparable because, based on the staff's experience with Form NRSRO filings furnished to the Commission over the past two years, the Commission believes that time and amount of information involved in filing an amendment to part of the Form NRSRO would be similar to the time involved to update the Form NRSRO with the proposed information to Exhibit 6 to Form NRSRO.

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150 2,100 annual hours + [13,000 one-time hours annualized over the three year approval period/3] = 6,433 hours = rounded to 6,400 hours.

151 30 NRSROs x 25 hours = 750 hours. The Commission also notes that the currently approved PRA collection for Rule 17g-1 and Form NRSRO includes an estimate that an outside counsel would spend approximately 40 hours assisting a credit rating agency in the process of completing and furnishing a Form NRSRO to the Commission. June 2007 Adopting Release, 72 FR at 33608. The Commission believes that any outside counsel review of the amendments to Exhibit 6 to Form NRSRO would de minimis and therefore the current estimate remains accurate.

152 See June 2007 Adopting Release, at 72 FR 33609.

In addition, the proposed amendments to the Instructions to Exhibit 6 would provide that after registration, an NRSRO with a fiscal year end of December 31 must update the proposed additional disclosures in Exhibit 6 information as part of its annual certification. Rule 17g-1(f) requires an NRSRO to furnish the annual certification no later than 90 days after the calendar year.[153] The currently approved OMB annual hour estimate to complete the annual certification is 10 hours per NRSRO, for a total aggregate annual hour burden to the industry of 300 hours. The Commission estimates that once an NRSRO completes its first annual certification with the additional proposed disclosures required in the Instructions to Exhibit 6 to Form NRSRO that the completion of subsequent annual certifications, generally, would take less time because the additional disclosures proposed to be required would be furnished on a regular basis (albeit yearly) and, therefore, become more a matter of routine over time. Consequently, the Commission believes that the annual certifications with the proposed additional discloses would take more time to complete in the first year the rule would become effective, than it would take to complete in subsequent years.

Therefore, based on staff experience, the Commission estimates that with the additional disclosures proposed to be contained in Instructions to Exhibit 6 to Form NRSRO, the annual hour burden for each NRSRO to complete the annual certification would increase 2 hours per year, from 10 to 12 hours, for a total aggregate annual hour

153 17 CFR 240.17g-4(f). The Commission also notes that if an NRSRO has an annual year end other than December 31st, the proposed additional instructions Exhibit 6 to Form NRSRO would require that the NRSRO file an Update of Registration no later than 90 days following the end of the NRSRO's fiscal year. The Commission believes that the annual hour burden for this proposed collection of information is encompassed within the time it would take an NRSRO to file an amendment to the Form NRSRO which has been estimated to be a 25 annual hour burden per year. The Commission estimates that an NRSRO will on average file two amendments to Form NRSRO per year.

burden of 360 hours, resulting in an increase to the estimated annual hour burden for Rule 17g-1 and Form NRSRO of 60 hours.[154]

The Commission preliminarily believes that an applicant/NRSRO would incur only limited internal costs to modify its systems to generate and disclose the proposed additional disclosures in Exhibit 6 to Form NRSRO because an applicant/NRSRO is already required to generate similar financial information in other parts of Form NRSRO and certain financial reports required under Rule 17g-3.

The Commission generally requests comment on all aspects of these proposed burden estimates for Rule 17g-1 and Form NRSRO, as proposed to be amended. Commenters should provide specific data and analysis to support any comments they submit with respect to these burden estimates.

3. Proposed Rule 17g-7

The Commission is proposing new Rule 17g-7, which would require an NRSRO, on an annual basis, to make publicly available on its Internet Web site a consolidated report that would contain certain information about the revenues earned by the NRSRO for providing products and services to any obligor, issuer, underwriter, sponsor, and subscriber that paid the NRSRO to issue or maintain the credit rating. In order to generate the report as required by proposed paragraph (a)(1) of Rule 17g-7, the NRSRO would have to perform two calculations and identify any outstanding credit ratings at the end of the fiscal year.

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154 12 hours x 30 NRSROs = 360 hours. The Commission also based this estimate, in part, on the time it would take an NRSRO to furnish a withdrawal of registration on Form NRSRO of 1 hour. June 2007 Proposing Release, 72 FR at 33608-33609. However, because the NRSRO would have to update information for calculations with respect to its revenues, the Commission believes it would take an NRSRO longer than 1 hour. Therefore, the Commission preliminarily believes that it would take an NRSRO approximately 2 hours each year to update the proposed information.

As proposed under new Rule 17g-7, an NRSRO would be required to perform a calculation to state the percentage of net revenue earned by the NRSRO from providing services to the entity that is derived from services other than credit ratings attributable to each person that paid the NRSRO for the issuance or maintenance of a credit rating.

The second calculation that the NRSRO would be required to perform to generate the report once a year as described in paragraph (a)(1)(i) of proposed Rule 17g-7 would require the NRSRO to derive and state the relative standing of the entity as a contributor of revenues to the NRSRO as compared to other entities that contribute revenue to the NRSRO. In particular, the NRSRO would need to identify which of the following cohorts of contributors to the annual net revenue of the NRSRO the entity is included in: top 10%, top 25%, top 50%, bottom 50%, bottom 25%. Finally, once a year an NRSRO would also be required to identify all outstanding credit ratings paid for by the person, which the NRSRO must identify by name of obligor, security, or money market instrument and, as applicable, CIK number, CUSIP, or ISIN.

The Commission also notes that paragraph (a)(2) of proposed Rule 17g-7 would exempt an NRSRO from publishing the reports if, as of the end of the fiscal year, the NRSRO had no credit ratings outstanding that the NRSRO issued or maintained as a result of a person paying the NRSRO for the issuance or maintenance of the credit ratings.[155]

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155 For purposes of this collection of information, the Commission has determined that it would preliminarily use 30 respondents in calculating the burden estimates. While some subscriber-based NRSROs would be exempt from new Rule 17g-7, the Commission has preliminarily determined to include all 30 respondents because if a subscriber-paid NRSRO was specifically requested to issue a rating, the NRSRO would no longer be exempt from Rule 17g-7. Therefore, the Commission preliminarily believes that this approach would result in an appropriate PRA estimate for new Rule 17g-7.

For purposes of the PRA, based on staff experience, the Commission estimates that it would take an NRSRO approximately 100 hours on a one-time basis to develop the calculations necessary to generate the percents required under the report under proposed Rule 17g-7; to populate the proposed report with the required data; and to develop and draft the form report. Additionally, the Commission is basing this one-time hour burden estimate on the Commission's experience with, and burden estimates for, Rules 17g-1 through 17g-6, given that the NRSRO rules have been in effect for over two years.[156] More specifically, the Commission notes that the current one-time hour burden estimates under the PRA for an NRSRO to file a Form NRSRO is 400 hours, and to file an amendment to Form NRSRO is 25 hours.[157]

The Commission preliminarily believes that the report to be required under proposed Rule 17g-7 would be more complex and comprehensive to complete than a typical amendment to Form NRSRO because the new proposed rule would require an NRSRO to calculate percents for every person that paid the NRSRO for the issuance or maintenance of a credit rating. In contrast, however, the Commission preliminarily does not believe that the one-time hour burden to comply with the new Rule 17g-7 would be as extensive and time consuming as the time necessary to complete the initial Form NRSRO. Therefore, the Commission preliminarily believes that the estimate of a one-time burden of 100 hours per respondent is conservative and reasonable given the significant variance in size between the largest NRSROs and the smallest NRSROs. Thus, based on staff experience, the Commission preliminarily estimates that the

156 See generally, June 2007 Adopting Release.

157 June 2007 Adopting Release, 72 FR at 33609; see also February 2009 Adopting Release, 74 FR at 6,470.

aggregate initial one-time hour burden to complete the report required by proposed Rule 17g-7 would be 3,000 hours for 30 NRSROs.[158]

In addition to the one-time hour burden, proposed new Rule 17g-7 also would result in an annual hour burden for an NRSRO to generate the percents required under the proposed report and to populate the proposed report with the required data once a year. The Commission notes that an NRSRO would have already developed the equations necessary to generate the percents in order to comply with the new Rule 17g-7 in the first year. Additionally, the Commission believes that once an NRSRO complies with Rule 17g-7 in the first year, that preparation of the new annual report would become more routine. Therefore, based on staff experience, the Commission estimates that it would take an NRSRO approximately 50 hours per year to generate the percents required under the proposed report, as well as to generate the report itself.[159] Thus, the Commission preliminarily estimates that this would result in a total annual hour burden of 1,500 hours for 30 NRSROs.[160]

Proposed Rule 17g-7 also would require an NRSRO to make publicly available on its Internet Web site the report required under paragraph (a)(1).[161] The Commission estimates that it would take an NRSRO approximately 30 hours to disclose the initial information in its Web site for a total one-time burden of 900 hours,[162] and thereafter 10

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158 100 hours x 30 NRSROs = 3,000 hours.

159 The Commission based this estimate, in part, on the number of estimated hours it would take an NRSRO to file an amendment to Form NRSRO of 25 hours. The Commission, however, preliminarily believes that it would take an NRSRO substantially more time to generate the information once a year to complete the proposed report under proposed Rule 17g-7. Therefore, the Commission preliminarily estimates that the average time necessary to complete the report under proposed Rule 17g-7 would be more comparable to the time it would take an NRSRO to file 2 amendments to Form NRSRO, or 50 hours (2 x 25 hours).

160 50 hours x 30 NRSROs = 1,500 hours.

161 See proposed Rule 17g-7(a)(1).

162 30 hours x 30 NRSROs = 900 hours.

hours per year to disclose updated information for a total annual burden of 300 hours.[163] This one-time hour burden is estimated in part based on the current one-time and annual burden hours for an NRSRO to publicly disclose its Form NRSRO.[164] Accordingly, the Commission estimates that implementation of proposed new Rule 17g-7 would result in a total one-time hour burden of 3,900[165] hours and a total annual hour burden of 1,800 hours.[166]

The Commission also believes that an NRSRO may need to purchase and/or modify its software and operating systems in order to generate and publish the information proposed to be required in the report in proposed new Rule 17g-7. The Commission estimates that the cost of any software incurred in connection with its systems modifications would vary based on the size and complexity of the NRSRO. The Commission estimates that some NRSROs would not need such software because they may already have such systems in place to generate the proposed report, or given their small size, other NRSROs may find the purchase of additional software unnecessary. The Commission preliminarily believes that an NRSRO would be able to generate and compile the information for the reports using the NRSRO's own personnel. Therefore, based on staff experience, the Commission estimates that the average cost of software across all NRSROs would be approximately $4,000 per firm, with an aggregate one-time cost to the industry of $120,000.[167]

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163 30 NRSROs x 10 hours = 300 hours.

164 June 2007 Adopting Release, 71 FR at 33609.

165 3,000 hours + 900 hours = 3,900 total hours for one-time burden.

166 1,500 hours + 300 hours = 1,800 total annual hours.

167 $4,000 x 30 NRSROs = $120,000. As a means of comparison, the Commission notes that the average cost of recordkeeping software across all NRSROs under Rule 17g-2 is estimated to be $1,800 per respondent. See February 2009 Adopting Release, 74 FR, at 6472. The Commission preliminarily believes that the one-time cost of purchasing software in order to comply with

The Commission generally requests comment on all aspects of these burden estimates for proposed Rule 17g-7. In addition, the Commission requests specific comment on the following items related to these burden estimates:

- Would there be additional systems costs or other costs involved in developing this collection of information?
- Given that paragraph (a)(2) of proposed Rule 17g-7 would exempt an NRSRO from publishing the reports if, as of the end of the fiscal year, the NRSRO had no credit ratings outstanding that the NRSRO issued or maintained as a result of a person paying the NRSRO for the issuance or maintenance of the credit ratings, should the Commission revise the number of respondents for this proposed new collection of information? If so, what should the number be?

Commenters should provide specific data and analysis to support any comments they submit with respect to these estimates.

E. Collection of Information Is Mandatory

The collection of information obligations imposed by the proposed rule amendments and the proposed new rule would be mandatory for credit rating agencies that are registered with the Commission as NRSROs. Such registration is voluntary.[168]

F. Confidentiality

The information collected under the proposed amendments to Rule 17g-3 would be generated from the internal records of the NRSRO and would be furnished to the

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proposed new Rule 17g-7 would be greater than $1,800 because the proposed rule would require the publication of two new reports not previously required by any rule.

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

Commission on a confidential basis, to the extent permitted by law.[169] The proposed disclosures that would be required under Exhibit 6 to Form NRSRO and proposed Rule 17g-7 would be public.

G. Record Retention Period

The records required under the proposed amendments to Rules 17g-3 and 17g-7, as well as Exhibit 6 to Form NRSRO would need to be retained by the NRSRO for at least three years.[170]

H. Request for Comment

The Commission requests pursuant to 44 U.S.C. 3306(c)(2)(B) 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 estimates of the burden of the proposed collections of information; (3) determine whether there are ways to enhance the quality, utility, and clarity of the information to be collected; (4) evaluate whether there are ways to minimize the burden of the collection of information on those who respond, including through the use of automated collection techniques or other forms of information technology; and (5) evaluate whether the proposed rule amendments would have any effects on any other collection of information not previously identified in this section.

Persons who desire to submit comments on the collection of information requirements should direct their comments to the OMB, Attention: Desk Officer for the

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169 15 U.S.C. 78o-7(k). An NRSRO can request that the Commission keep this information confidential. See Section 24 of the Exchange Act (15 U.S.C. 78x), 17 CFR 240.24b-2, 17 CFR 200.80 and 17 CFR 200.83.

170 17 CFR 240.17g-2(c).

Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and should also send a copy of their comments to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, and refer to File No. S7-28-09. 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. 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. S7-28-09, and be submitted to the Securities and Exchange Commission, Records Management Office, 100 F Street, NE, Washington, DC 20549.

IX. COSTS AND BENEFITS OF THE PROPOSED RULES

The Commission is sensitive to the costs and benefits that result from its rules. The Commission has identified certain costs and benefits of the proposed rule amendments and proposed new rule and requests comment on all aspects of this cost-benefit analysis, including identification and assessment of any costs and benefits not discussed in the analysis.[171] The Commission seeks comment and data on the value of

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171 For the purposes of this cost/benefit analysis, the Commission is using salary data from the Securities Industry and Financial Markets Association ("SIFMA") Report on Management and Professional Earnings in the Securities Industry 2008, which provides base salary and bonus information for middle-management and professional positions within the securities industry. The Commission believes that the salaries for these securities industry positions would be comparable to the salaries of similar positions in the credit rating industry. The salary costs derived from the report and referenced in this cost benefit section are modified to account for an 1800-hour work year and multiplied by 5.35 to account for bonuses, firm size, employee benefits and overhead. The Commission used comparable estimates in adopting final rules implementing the Rating Agency Act in 2007 and additional rules in 2009, requested comments on such estimates, and received no comments in response to these requests. See June 2007 Adopting Release, note 576, and February 2009 Adopting Release, note 179. Hereinafter, references to data derived from the report as modified in the manner described above will be cited as "SIFMA 2008 Report as Modified."

the benefits identified. The Commission also seeks comments on the accuracy of its cost estimates in each section of this cost-benefit analysis, and requests those commenters to provide data, including identification of statistics relied on by commenters to reach conclusions on cost estimates. Finally, the Commission seeks 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 these proposed rule amendments and the new proposed rule.

A. Benefits

The purposes of the Rating Agency Act, as stated in the accompanying Senate Report, are to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry.[172] As the Senate Report states, the Rating Agency Act establishes "fundamental reform and improvement of the designation process" with the goal that "eliminating the artificial barrier to entry will enhance competition and provide investors with more choices, higher quality ratings, and lower costs."[173]

The Commission is proposing to amend Rule 17g-3 to require an NRSRO to furnish the Commission with an additional unaudited report containing a description of the steps taken by the designated compliance officer during the fiscal year to administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act (management of conflicts of interest and prevention of the misuse of material nonpublic information); and ensure compliance with

172 See Senate Report," p. 2.
173 Id, p. 7.

the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.

The Commission's staff understands that the designated compliance officer of some NRSROs may, in some cases, not be fulfilling the compliance officer's statutorily mandated duties, as prescribed by Section 15E(j) of the Exchange Act.[174] Further, during examinations in 2008 of three of the largest NRSRO's, Commission staff also identified issues with respect to each NRSROs policies and procedures and improvements that could be made.[175] In light of these concerns and the importance of an effective NRSRO compliance program, the Commission is proposing to amend Rule 17g-3 by adding paragraph (a)(7), which would require an NRSRO to furnish to the Commission an additional unaudited annual report.

The amendments to proposed new paragraph (a)(7) of Rule 17g-3 would also provide that the report must include: (1) a description of any compliance reviews of the activities of the NRSRO; (2) the number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such finding; (3) a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO; and (4) a description of the persons within the NRSRO who were advised of the results of the reviews.[176]

The Commission believes that the proposed amendment to Rule 17g-3 would further address concerns about the integrity of the ratings process by establishing a

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174 15 U.S.C. 78o-7(j).

175 See generally, Summary Report of Issues Identified in the Commission Staff's Examinations of Select Credit Rating Agencies (July 8, 2008). The report is available on the Commission's Internet Web site, located at http://www.sec.gov/news/studies/2008/craexamination070808.pdf.

176 See proposed Rule 17g-3(a)(7)(ii).

discipline under which the NRSRO's designated compliance officer would need to report to the Commission the steps taken by the compliance officer to fulfill the officer's responsibilities as set forth in Section 15E(j) of the Exchange Act. The act of reporting these steps is designed to promote the active engagement of the designated compliance officer in reviewing an NRSRO's compliance with internal policies and procedures. The reports also could strengthen the Commission's oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating processes and providing an additional tool for the Commission to monitor how the NRSRO's designated compliance officer is fulfilling the responsibilities prescribed in Section 15E of the Exchange Act. For example, if an NRSRO reports an unusual level of significant compliance exceptions in a particular area, the Commission examination staff could focus their next review of the NRSRO in that particular area. Alternatively, if a report indicates no problems, but a subsequent staff examination reveals significant compliance exceptions, this could be brought to the attention of the NRSRO's management to be used to assess whether the designated compliance officer is adequately fulfilling the officer's statutory duties.

As stated above, the proposed amendment to Rule 17g-3 also would set forth specific items to be included in the proposed new report under Rule 17g-3(a)(7). The first item the Commission is proposing be included in the report is a description of any compliance reviews of the activities of the NRSRO.[177] The Commission intends that the designated compliance officer would describe all such reviews conducted during the most recently ended fiscal year. This would provide the Commission with an understanding of the scope of the designated compliance officer's reviews of the NRSRO's activities. The second item the Commission is proposing be included in the report is the number of

177 See proposed Rule 17g-3(a)(7)(ii)(A).

material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such finding. The Commission preliminarily intends a "material compliance matter" to be the discovery that the NRSRO or a person within the NRSRO had violated the securities laws[178] or the rules thereunder or the policies, procedures, or methodologies established, maintained and enforced by the NRSRO to, for example, determine credit ratings, prevent the misuse of material non-public information, manage conflicts of interest, and comply with the Commission's NRSRO rules.[179] The proposed requirement to report a material compliance matter would be designed to alert the Commission to matters identified by the designated compliance officer that could raise questions about the integrity of the NRSRO's activities and operations. It also could assist the Commission's oversight of NRSROs to the extent a reported material compliance matter is one that could arise in other NRSROs because, for example, it relates to a new type of debt instrument that is being rated by more than one NRSRO or involves interactions with an issuer that hired several NRSROs to rate its securities.

The third item the Commission is proposing be included in the report is a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO.[180] The reporting of these measures could assist the Commission in evaluating the risk of such re-occurrences. It also could provide the Commission with potential "best practices" for mitigating the risk of future material compliance matters, which could assist the Commission in its overall supervision of NRSROs. Finally, the fourth item the Commission is proposing be included in the report is a description of the persons within the NRSRO who were

178. The term "securities laws" is defined in Section 3(a)(47) of the Exchange Act

179. See e.g., 17 CFR 270.38a-1(e)(2); see also supra note 37.

180. See proposed Rule 17g-3(a)(7)(ii)(C).

advised of the results of the reviews. The information with respect to those persons who were advised of the results of reviews is designed to provide the Commission with an understanding of how the NRSRO responds to material compliance matters and the role and structure of the compliance program within the NRSRO. For example, it would indicate whether the compliance officer reported the matters to the NRSRO's board or senior management or only to the business unit that underwent the compliance review. This is designed to promote the appropriate escalation of compliance issues to the management of the NRSRO. The Commission also believes that this proposed information would be a useful tool for examiners to improve the focus of examination resources of a particular NRSRO on practices related to material compliance matters reported and the possible selection of NRSROs for examination.

In summary, as stated above, the amendments to Rule 17g-3 related to the new unaudited annual report related to the NRSRO's compliance function could serve to improve the NRSRO's compliance function. This improved compliance function, in turn, could improve the integrity of NRSROs' ratings processes.

The Commission also believes that the proposed new report would facilitate improvements to an NRSRO's compliance program in light of the concerns that the designated compliance officer of some NRSROs may, in some cases, not be fulfilling the compliances officer's statutorily mandated duties as prescribed in Section 15E(j) of the Exchange Act. The proposed rule amendments also would further enhance the Commission's oversight of NRSROs by providing the Commission staff an additional resource with which to evaluate the performance of the designated compliance officers in carrying out their statutory responsibilities prescribed in Section 15E(j) of the Exchange

Act. In addition to improving the quality of credit ratings, increased oversight of NRSROs could increase the accountability of an NRSRO to its subscribers, investors, and other persons who rely on the credibility and objectivity of a credit rating in making an investment decision.

Finally, the Commission believes that the proposed amendments to Rule 17g-3 would complement the Commission's examination program for NRSROs, and that the proposed amendments would enhance the Commission's ability to protect investors. The requirement to furnish the Commission with an annual report related to an NRSRO's compliance program would serve to help facilitate the examination staff's efforts to conduct each NRSRO examination in an organized and efficient manner and thus to allocate resources to maximize investor protection. The Commission notes that the proposed report would be one of numerous factors the Commission's exam staff may use to determine the focus of a particular exam.

The proposed amendments to the Instructions to Exhibit 6 to Form NRSRO would require an applicant/NRSRO to furnish the Commission with information regarding the revenues an NRSRO receives from major clients and from services other than determining credit ratings. The proposed new information is designed to assist users of NRSRO credit ratings in assessing the potential magnitude of the conflicts of interest inherent in a given NRSRO's business operations. In particular, by disclosing information about revenues received from major clients and other services, users of credit ratings would have access to more information about conflicts of interest that may exist when the NRSRO is being paid to determine credit ratings and is offering other services to persons who pay for ratings. The Commission believes these enhanced disclosures would allow users of credit ratings to more effectively assess the conflicts of interest affecting an NRSRO. Although the disclosures an NRSRO provides on the Form NRSRO, including the proposed additional disclosures to Exhibit 6 to Form NRSRO cannot substitute for an investor's due diligence in evaluating a credit rating and the integrity of an NRSRO, the Commission believes the proposed amendment to Exhibit 6 to Form NRSRO would aid investors by providing additional publicly accessible information about an NRSRO.

The first proposed new disclosure in Exhibit 6 would require that an applicant/NRSRO disclose the percentage of total net revenue attributable the 20 largest users of credit rating services of the applicant/NRSRO. The Commission preliminarily believes this disclosure would assist investors and other users of credit ratings by providing them with an understanding of the degree to which revenues earned by the NRSRO come from a concentrated base of customers. This could be useful in understanding the conflicts inherent in the NRSRO's business given that an increase in concentration would result in an increase in the potential risk that the customers could use their contribution to the NRSRO's revenues to influence the objectivity of its credit ratings. Making the degree of this concentration transparent would allow investors and market participants to take this potential risk into account when considering the accuracy and reliability of the NRSRO's credit ratings. This, in turn, could improve the integrity of NRSROs. Increased confidence in the integrity of NRSROs and the credit ratings they issue could promote participation in the securities markets. In addition, the Commission believes that the proposed disclosures would allow investors and market participants to more effectively compare the concentrations across all NRSROs.

The second proposed new disclosure would require the applicant/NRSRO to disclose the percentage of total revenue attributable to other services and products of the applicant/NRSRO. The Commission preliminarily believes this information would be useful to investors and other users of credit ratings because it would provide scale to the amount of revenues an NRSRO earns from providing services other than credit ratings. An NRSRO that obtains substantial revenues from other services may be inclined to favor a client that purchases those other services when determining credit ratings solicited by the client. Consequently, creating greater transparency about the revenues generated from other services could assist investors and other users of credit ratings in assessing the potential risks to the NRSRO's objectivity.

Proposed Rule 17g-7 would require an NRSRO to make publicly available on its Internet Web site a consolidated report, which would need to be updated annually, containing information about the revenues earned by the NRSRO as a result of providing services and products to persons that paid the NRSRO to issue or maintain a credit rating. The Commission preliminarily believes that proposed Rule 17g-7 would provide users of credit ratings with information about the potential risk that arises when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument - the risk that the revenue generated from the person paying the NRSRO to determine a credit rating could influence the NRSRO's objectivity if the NRSRO feels the need to curry favor from that person with a corresponding negative impact on the quality and accuracy of the credit rating. Simply put, it could cause the credit rating agency to determine a higher than warranted credit rating, which, as a result, does not accurately reflect the NRSRO's true view of the level of credit risk inherent in the obligor, security, or money market instrument. Providing users of credit ratings with the information on revenue generated from other services provided to the person paying the NRSRO for the issuance or maintenance of the credit rating and on the relative standing of the entity as a contributor of revenue to the NRSRO would enable them to better assess the degree that a particular rating may be subject to this risk.

In addition, proposed Rule 17g-7 could have the benefit of helping to mitigate the potential ability an obligor, issuer, underwriter, sponsor, and subscriber as a large consumer of the services and products of the NRSRO from using its status to exert undue influence on the NRSRO. Specifically, by making the potential conflict more transparent to the marketplace, users of credit ratings, market participants, and others could assess how credit ratings solicited by large revenue providers are handled by the NRSRO, particularly with respect to NRSROs that make their ratings publicly available for free.

As stated above, the Commission also believes that the reports that would be required to be published by proposed Rule 17g-7 would create greater transparency about the revenues generated from other services and could assist investors and other users of credit ratings in assessing the potential risks to the NRSRO's objectivity by providing investors and other users of credit ratings with information to assess the degree of risk that a credit rating may be compromised by the undue influence of the person that paid for the issuance or maintenance of the credit rating. The Commission generally requests comment on all aspects of the proposed new rule. In addition, the Commission requests specific comment on the following items related to these benefits.

- Are there metrics available 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?
- With respect to Rule 17g-7, to what use do users of credit ratings anticipate putting the proposed disclosures? To what extent, if any, might these disclosures create misimpressions as to the existence of potential conflicts? Are the proposed disclosures in proposed Rule 17g-7 granular enough to be of value to users of credit ratings?

Commenters should provide specific data and analysis to support any comments they submit with respect to the benefits discussed above and any other benefits identified by the commenters.

B. Costs

The Commission recognizes that there are potential costs that would result if the Commission adopts the proposed rule amendments to Rule 17g-3,[181] Exhibit 6 to Form NRSRO and proposed new Rule 17g-7. The Commission preliminarily believes that potential costs incurred by an NRSRO to comply with the proposed rule amendments to a given NRSRO would depend on its size and the complexity of its business activities. The size and complexity of NRSROs vary significantly. Therefore, the cost could vary significantly across NRSROs. The Commission is providing estimates of the average cost per NRSRO taking into consideration the variance in size and complexity of NRSROs. Any costs incurred would also vary depending on which classes of credit ratings an NRSRO issues and how many outstanding ratings it has in each class. For these reasons, the cost estimates represent the average cost across all NRSROs.

[181] See proposed Rule 17g-3(a)(7).

1. Proposed Amendments to Rule 17g-3

Rule 17g-3 requires an NRSRO to furnish audited annual financial statements to the Commission, including certain specified schedules.[182] The Commission is proposing to amend Rule 17g-3 to require an NRSRO to furnish the Commission with an additional unaudited report containing a description of the steps taken by the designated compliance officer during the fiscal year to administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act; and ensure compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act. The proposed amendments to Rule 17g-3 also would provide that the report must include: (1) a description of any compliance reviews of the activities of the NRSRO; (2) the number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such matter; (3) a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO; and (4) a description of the persons within the NRSRO who were advised of the results of the reviews.[183]

The Commission believes that the costs to NRSROs to comply with the proposed amendment to Rule 17g-3 would vary depending on the size and complexity of the NRSRO, as well as the size of its compliance programs. Larger NRSROs with comprehensive compliance programs may already periodically review portions of their compliance programs. These larger NRSROs may incur a cost associated with transforming their periodic reviews into more systematic reviews and developing the

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182 17 CFR 240.17g-3.

183 See proposed Rule 17g-3(a)(7)(ii).

report to be required under Rule 17g-3. While smaller NRSROs all have designated compliance officers, the Commission preliminarily believes, based on issues brought to the staff's attention, that some NRSROs may have less robust compliance programs than others. The Commission believes, however, that the information to be included in the proposed report under the amendments to Rule 17g-3 for smaller NRSROs would be less extensive, because smaller NRSRO's may have less complex organizational structures, fewer employees and fewer sources of revenue than larger NRSROs which may be part of a complex global organization with thousands of employees. Therefore, it may be less costly than for larger NRSROs.

Further, the Commission notes that the proposed report would explicitly require the NRSRO to describe the steps taken by the designated compliance officer during the fiscal year to administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act; and ensure compliance with the securities laws and rules and regulations thereunder. Since these are statutorily mandated responsibilities of the designated compliance officer under Section 15E(j) of the Exchange Act, the Commission notes that certain costs are already being incurred by the NRSRO and therefore are not direct costs of the proposed amendments to Rule 17g-3. The Commission has preliminarily quantified certain costs with respect to the amendments to Rule 17g-3 which are discussed in detail below.

As discussed with respect to the PRA, the Commission preliminarily believes that the estimated hour burden under the proposed amendments to Rule 17a-3 would include the time it would take to compile information to draft the report and the preparation and filing of the report itself. In addition, this one-time hour burden estimate also includes the time it would take to identify and describe material compliance matters, any remediation and the persons advised of the results of the reviews. Consequently, the Commission also based this estimate, in part, on the average estimated number of hours it would currently take an NRSRO to complete one annual report under current Rule 17g-3 (i.e., approximately 30 hours).[184] Consequently, as discussed above with respect to the PRA, the Commission estimates that the average amount of time across all NRSROs to prepare the additional report proposed to be required under the rule would be approximately 900 hours[185] at a total aggregate annual cost to the industry of $232,200.[186]

Given the potentially sensitive nature of the proposed report, the Commission also preliminarily believes that an NRSRO would likely engage outside counsel to assist it in the process of drafting and reviewing the proposed report under Rule 17g-3 on a one-time basis. The Commission estimates that the time an outside attorney would spend on this work would depend on the size and complexity of the NRSRO. Therefore, the Commission estimates that, on average, an outside counsel would spend approximately 20 hours assisting an NRSRO and its designated compliance officer in drafting and reviewing the proposed report on a one-time basis for an aggregate burden to the industry of 600 hours.[187] Based on industry sources, the Commission estimates that the cost of an outside counsel would be approximately $400 per hour. For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be

184 15 U.S.C. 78o-7(j). Under this provision of the statute, an NRSRO must "designate an individual responsible for administering the policies and procedures that are required to be established pursuant to [Sections 15E(g) and (h) of the Exchange Act (15 U.S.C. 78o-7(g) and (h))], and for ensuring compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to [Section 15E of the Exchange Act]." Id.

185 30 hours x 30 NRSROs = 900 hours.

186 $7,740 x 30 NRSROs = $232,200.

187 30 NRSROs x 20 hours = 600 hours.

approximately \$8,000[188] and the one-time cost to the industry would be approximately \$240,000.[189]

The Commission generally requests comment on all aspects of these cost estimates for the proposed amendments to Rule 17g-3. In addition, the Commission requests specific comment on the following items related to these cost estimates:

- Would an NRSRO incur any additional costs to employ an outside counsel on an annual basis to review the proposed 17g-3 report, rather than just on a one-time basis?
- Would the cost incurred by an NRSRO be less than those estimated because the designated compliance officer is already performing many of the responsibilities required to be described in the proposed report, as well as drafting compliance reports?
- What other costs are NRSROs likely to incur?
- Are the proposals likely to impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs?

Commenters should provide specific data and analysis to support any comments they submit with respect to the costs discussed above and any other costs identified by commenters.

2. Proposed Amendments to Form NRSRO

The proposed amendments to the Instructions to Exhibit 6 of Form NRSRO would require an applicant/NRSRO to furnish the Commission with information

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188 \$400 per hour x 20 hours = \$8,000.

189 \$8,000 x 30 NRSROs = \$240,000.

regarding the revenues an NRSRO receives from major clients and from products and services other than determining credit ratings. In particular, the additional disclosures to Exhibit 6 would require an applicant/NRSRO to provide the following disclosures, as applicable:

- The percentage of the applicant/NRSRO's net revenue attributable to the 20 largest users of credit rating services of the applicant/NRSRO; and
- The percentage of the applicant/NRSRO's revenue attributable to services and products other than credit rating services of the applicant/NRSRO.

The Commission believes that the costs to NRSROs to comply with the proposed amendment to Exhibit 6 to Form NRSRO would vary depending on the size and complexity of the NRSRO. Larger NRSROs may have more customers and complex revenue streams, while smaller NRSROs may be less complex in terms of sources of revenue or numbers of customers. Consequently, as discussed above with respect to the PRA, the Commission estimates that the average time necessary for an applicant or NRSRO to gather the information on a one-time basis in order to complete the additional disclosures proposed to be required by the amendments to Exhibit 6 to Form NRSRO would be one-time hour burden to the industry of 750 hours.[190] For these reasons, the Commission estimates that the average one-time cost to an NRSRO would be $6,520[191] and the total aggregate one-time cost to the industry would be $195,600.[192]

190 30 NRSROs x 25 hours = 750 hours.

191 The Commission estimates that these responsibilities would be split between a Financial Reporting Manager (10 hours) and a Compliance Manager (15 hours). The SIA Management Report 2008 indicates that the average hourly cost for a Financial Reporting Manager is $265 and for a Compliance Manager is $258. Therefore, the average one-time cost would be $6,520 [(10 hours x $265 per hour) + (15 hours x $258 per hour)].

192 $6,520 x 30 NRSROs = $195,600.

In addition, with respect to the PRA, the Commission estimated that the average annual burden to complete an annual certification under Rule 17g-1(f) would increase 60 hours for all NRSROs.[193] For these reasons, the Commission estimates that the average annual cost with respect to the proposed amendment to an NRSRO would be $516[194] and the total aggregate annual cost to the industry would be $15,480.[195]

The Commission also notes that included in the current estimated costs for the Form NRSRO are the costs related to the engagement of outside counsel to assist in the process of completing and submitting a Form NRSRO.[196] In the June 2007 Proposing Release, the Commission estimated that the amount of time an outside attorney will spend on this work will depend on the size and complexity of the NRSRO. Therefore, the Commission estimated that, on average, an outside counsel will spend approximately 40 hours assisting an NRSRO in preparing its application for registration. The Commission further estimated that the average hourly cost for an outside counsel will be approximately $400 per hour. For these reasons, the Commission estimated that the average one-time cost to an NRSRO will be $16,000 and the one-time cost to the industry will be $480,000.[197] With respect to the proposed amendments to Exhibit 6 to Form NRSRO, the Commission estimates that the cost to outside counsel to review a Form NRSRO containing the additional disclosures to Exhibit 6 to Form NRSRO would

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193 2 hours x 30 NRSROs = 60 hours.

194 The Commission estimates that these responsibilities would be performed by a Compliance Manager. The SIA Management Report 2008 indicates that the average hourly cost a Compliance Manager is $258. Therefore, the average annual cost to an NRSRO would be $516 (2 hours x $258).

195 $516 x 30 NRSROs = $15,480.

196 June 2007 Adopting Release, 72 FR at 33614.

197 Id.

already be included within the original cost estimate for Rule 17g-1 and Form NRSRO[198] or that such costs would be de minimis.[199]

As discussed above with respect to the PRA, the Commission preliminarily believes that an applicant/NRSRO would incur only limited internal costs to modify its systems to generate and disclose the proposed additional disclosures in Exhibit 6 to Form NRSRO because an applicant/NRSRO is already required to generate similar financial information in other parts of Form NRSRO and certain financial reports required under Rule 17g-3.

The Commission generally requests comment on all aspects of these cost estimates for the proposed amendment to Form NRSRO. In addition, the Commission requests specific comment on the following items related to these cost estimates:

- Whether the proposals would impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs?
- Would the one-time cost to engage an outside counsel to assist in the preparation of the Form NRSRO increase as a result of the amendments to Exhibit 6 to Form NRSRO?
- Would the proposed disclosures in Exhibit 6 to Form NRSRO have any effect on the willingness of persons to pay for ratings as well as other credit rating services? What are the risks that investors and other users of credit ratings would be

198 Id.

199 The Commission believes that the review of the additional disclosures would overlap with the review of similar financial information already required to be disclosed in Exhibits 10 and 12 in Form NRSRO.

confused as to the significance of the revenue-based conflicts of interest being disclosed as a result of the proposed amendments to Exhibit 6 to Form NRSRO? Commenters should provide specific data and analysis to support any comments they submit with respect to the costs discussed above and any other costs identified by commenters.

3. Proposed Rule 17g-7

Proposed Rule 17g-7 would require an NRSRO to make publicly available on its Internet Web site a consolidated report containing information about the revenues earned by the NRSRO as a result of providing services and products to persons that paid the NRSRO to issue or maintain a credit rating. This report would need to be updated annually. As discussed above with respect to PRA, the Commission estimates that it would take an NRSRO approximately 100 hours to develop the calculations necessary to generate the percents required by the report under proposed Rule 17g-7; to populate the proposed report with the required data; and to develop and draft the form report. The Commission estimates that the proposed new Rule 17g-7 would impose a total one-time hour burden of 3,000 hours for 30 NRSROs to prepare the report. The Commission estimates that the average one-time cost to an NRSRO would be $23,500[200] and the total aggregate one-time cost for all NRSROs would be $705,000.[201]

As discussed above with respect to the PRA, the Commission also estimates that after the first year it would take NRSRO 50 hours per year to generate the percents

[200] The Commission estimates an NRSRO would have a Senior Accountant and a Senior Programmer working together to generate the initial calculations and report and that the two senior officers would divide the estimated 100 hours equally. The SIFMA 2008 Report as Modified indicates that the average hourly cost for a Senior Accountant is $178 and that the average hourly cost for a Senior Programmer is $292. Therefore, the average one-time cost to an NRSRO would be $23,500 (50 hours x $178) + (50 hours x $292).

[201] 30 NRSROs x $23,500 = $705,000.

required under the proposed report and to populate the proposed report with the required data once a year. Therefore, the Commission estimates that the average annual cost to an NRSRO would be $3,150[202] and the total aggregate annual cost to the industry would be $94,500 to generate the proposed report once a year.[203]

Proposed Rule 17g-7 would also require an NRSRO to make publicly available on its Internet Web site the report required under paragraph (a)(1). As discussed with respect to the PRA, the Commission estimates that it would take an NRSRO approximately 30 hours to disclose the initial information in its Web site for a total one-time burden of 900 hours, and thereafter 10 hours per year to disclose updated information for an annual hour burden of 300 hours. The Commission estimates that an NRSRO would incur an average one-time cost of $8,760 and an average annual cost of $2,920.[204] The total one-time cost to the industry would be approximately $262,800[205] and the total aggregate annual cost to the industry would be approximately $87,600.[206]

Finally, the Commission also believes that an NRSRO may need to purchase and/or modify its software and operating systems in order to generate and publish the information required in the proposed reports in proposed Rule 17g-7. As discussed in the PRA, the Commission estimates that the cost of any software would vary based on the size and complexity of the NRSRO. The Commission estimates that some NRSROs

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202 The Commission estimates that after the equations and initial report has been developed that an NRSRO would have a Compliance Clerk perform the necessary tasks to generate the annual report. The SIFMA 2008 Office Salaries Report as Modified indicates that the average hourly cost for a Compliance Clerk is $63. Therefore, the average yearly cost to an NRSRO would be $3,150 (50 hours x $63).

203 $3,150 x 30 NRSROs = $94,500.

204 The Commission estimates that an NRSRO will have a Senior Programmer perform this work. The SIFMA 2008 Report as Modified indicates that a Senior Programmer is $292. Therefore the average one-time cost will be $8,760 (30 hours x $292) and the average annual cost will be $2,920 (10 hours x $292).

205 $8,760 x 30 NRSROs = $262,800.

206 $2,920 x 30 NRSROs = $87,600.

would not need such software. Therefore, the Commission estimates that the average cost of software across all NRSROs would be approximately $120,000.[207]

The Commission generally requests comment on all aspects of these cost estimates for the proposed Rule 17g-7. In addition, the Commission requests specific comment on the following items related to these cost estimates:

- Would these proposals impose costs on other market participants, including persons who use credit ratings to make investment decisions or for regulatory purposes, and persons who purchase services and products from NRSROs?
- Would the proposed disclosures in new Rule 17g-7 have any effect on the willingness of persons to pay for ratings and other credit rating services? What are the risks that investors and other users of credit ratings would be confused as to the significance of the information being disclosed as a result new Rule 17g-7?
- Would there be costs in addition to those identified above, such as costs arising from systems changes and restructuring business practices to account for the new reporting requirement?
- To what extent, if any, might issuers shift to larger NRSROs in which their revenue contribution would contribute a lower percentage to the NRSROs overall revenue to avoid being in a particular tier?

Commenters should provide specific data and analysis to support any comments they submit with respect to the costs discussed above and any other costs identified by commenters.

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207 $4,000 x 30 NRSROs = $120,000.

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

Under Section 3(f) of the Exchange Act,[208] the Commission shall, when engaging in rulemaking that requires the Commission to consider or determine whether an action is necessary or appropriate in the public interest, consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation. Section 23(a)(2) of the Exchange Act[209] requires the Commission to consider the anticompetitive effects of any rules the Commission adopts under the Exchange Act. Section 23(a)(2) prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. As discussed below, the Commission's preliminary view is that the proposed rule amendments may promote efficiency, competition, and capital formation.

The Commission generally requests comment on all aspects of this analysis of the burden on competition and promotion of efficiency, competition, and capital formation. Commenters should provide specific data and analysis to support their views.

A. Rule 17g-3

The proposed amendment to Rule 17g-3[210] would require an NRSRO to furnish the Commission with an additional unaudited report containing a description of the steps taken by the designated compliance officer during the fiscal year to administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act; and ensure compliance with the securities laws

[208] 15 U.S.C. 78c(f).
[209] 15 U.S.C. 78w(a)(2).
[210] See proposed Rule 17g-3(a)(7).

and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.[211]

The amendments to Rule 17g-3 also would provide that the proposed report must include: (1) a description of any compliance reviews of the activities of the NRSRO; (2) the number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such matter; (3) a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO; and (4) a description of the persons within the NRSRO who were advised of the results of the reviews. As stated above, the proposed new report would be unaudited, consistent with the other unaudited reports currently required under Rule 17g-3.[212]

The Commission believes that the proposed amendments to Rule 17g-3 could indirectly increase efficiency in a number of ways. The proposed amendments to Rule 17g-3 may improve the efficiency of the credit ratings process by establishing a more structured discipline under which the NRSRO's designated compliance officer would need to report to the Commission the steps taken to fulfill the officer's statutory responsibilities. The act of reporting these steps is designed to promote the active engagement of the designated compliance officer in reviewing an NRSRO's compliance with the securities laws and its own internal policies and procedures.

The Commission also believes that improved compliance as a result of the proposed rule amendments may increase efficiency in the credit ratings process by

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211 See proposed Rule 17g-3(a)(7).

212 17 CFR 240.17g-3(a)(2)-(6). Under Rule 17g-3, the only required audited report is the NRSRO's financial statements as of its most recent fiscal year. 17 CFR 240.17g-3(a)(1).

focusing the NRSRO's designated compliance officer in fulfilling his or her responsibilities prescribed under Section 15E(j) of the Exchange Act, as well as by facilitating an NRSRO's early intervention to decrease the severity of compliance violations which may occur. Because the compliance officer would be required to report these steps, the proposed amendments may foster improved compliance overall. This may, in turn, promote greater efficiencies in the credit rating process.

The Commission further believes that these proposed amendments could promote more efficient allocation of capital by investors to the extent that the quality of credit ratings is improved.

Additionally, the Commission believes that the proposed report could promote efficient allocation of Commission resources and time by facilitating the Commission's examination staff efforts to conduct each exam of an NRSRO in an organized and efficient manner. These efficiencies will help the Commission to better allocate its own resources to maximize investor protection.[213]

The Commission believes that the proposed amendments to Rule 17g-3 could promote participation in the securities markets, and, thereby, promote capital formation and competition among NRSROs by increasing confidence in the integrity of NRSROs and the credit ratings they issue. Consequently, the Commission also does not believe that the proposed amendments to Rule 17g-3 would be a burden on competition.

The proposed amendments to Rule 17g-3 could improve the integrity of the ratings process by establishing a discipline under which the NRSRO's designated

213 The Commission also notes that other areas of the Commissions rules and regulations also require an annual report by a chief compliance officer with respect to investment companies and investment advisers. See generally, Rule 38a-1, 17 CFR 270.38a-1, and Rule 206(4)-7, 17 CFR 275.206(4)-7.

compliance officer would need to report to the Commission the steps taken by the compliance officer to fulfill the officer's statutory responsibilities. The act of reporting these steps is designed to promote the active engagement of the designated compliance officer in reviewing an NRSRO's compliance with internal policies and procedures. The proposed report also could strengthen the Commission's oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating processes and providing an additional tool for the Commission to monitor how the NRSRO's designated compliance officer is fulfilling the responsibilities prescribed in Section 15E of the Exchange Act. For example, if an NRSRO reports an unusual level of significant compliance exceptions in a particular area, the Commission examination staff could focus their next review of the NRSRO in that particular area. Alternatively, if a report indicates no problems, but a subsequent staff examination reveals significant compliance exceptions, this could be brought to the attention of the NRSRO's management to be used to assess whether the designated compliance officer is adequately fulfilling the officer's statutory duties. Furthermore, the identification of the persons within the NRSRO advised of the results of the review and remediation measures implemented could also promote the appropriate escalation of compliance issues to the management of the NRSRO.

Thus, enhancing the Commission's oversight and improving compliance of the NRSROs could help in restoring confidence in credit ratings issued by NRSROs which, in turn, could promote capital formation.

B. Amendments to Form NRSRO

The proposed amendments to the Instructions to Exhibit 6 to Form NRSRO are designed to provide more information to users of credit ratings with respect to an

NRSRO's conflicts of interest. The Commission is proposing to require an applicant/NRSRO to furnish the Commission with information regarding the revenues an NRSRO receives from major clients and from services other than determining credit ratings. In particular, the additional disclosures to Exhibit 6 to Form NRSRO would require an applicant/NRSRO to provide the following disclosures, as applicable:

- The percentage of the applicant/NRSRO's net revenue attributable to the 20 largest users of credit rating services of the applicant/NRSRO; and
- The percentage of the applicant/NRSRO's revenue attributable to services and products other than credit rating services of the applicant/NRSRO.

By assisting investors and other users of credit ratings in assessing the potential magnitude of the conflicts of interest inherent in a given NRSRO's business operations, the proposed additional disclosures to Exhibit 6 to Form NRSRO may promote more efficient investment analyses and decisions by these investors and users.

The proposed additional disclosures are designed to provide the marketplace with additional information for comparing NRSROs and, therefore, provide users of credit ratings with more useful metrics with which to compare these NRSROs. In particular, by disclosing information about revenues received from major clients and for other services, users of credit ratings would be given more information about the potential dimensions of the conflict of being paid to determine credit ratings and offering other services to persons who pay for ratings. Increased disclosure of these conflicts would make the incentives of the NRSROs more transparent to the marketplace and, thereby, highlight those firms that may have fewer or less significant conflicts of interest. These proposed disclosures would allow investors and other users of credit ratings to compare concentrations of revenue across all NRSROs, thus promoting efficiency for investors and other users of credit ratings in evaluating NRSROs and a particular credit rating in making an investment decision.

The Commission further believes that these proposed amendments could promote more efficient allocation of capital by investors to the extent that the quality of credit ratings is improved.

These proposed disclosures are also designed to increase competition and promote capital formation by restoring confidence in the NRSROs credit ratings, which are an integral part of the capital formation process.

By proposing to provide more information about an NRSRO's conflicts of interest, investors and users of credit ratings will be better able to evaluate the integrity of an NRSRO and the credit ratings that it issues. This enhanced information, in turn, may promote greater competition among NRSROs for the business of those users and investors. Consequently, the Commission does not believe that the proposed disclosures would be a burden on competition among NRSROs.

Moreover, because users of credit ratings would have greater confidence in the integrity of the NRSROs as well as the credit ratings that they issue, such increased confidence could promote investor participation in the securities markets, and, thereby, promote capital formation.

C. Rule 17g-7

The Commission also is proposing to adopt a new rule – Rule 17g-7 – which would require an NRSRO to make publicly available on its Internet Web site a consolidated report containing information about the revenues earned by the NRSRO as a result of providing services and products to persons that paid the NRSRO to issue or maintain a credit rating. This report would need to be updated annually. Specifically, proposed Rule 17g-7 would require the NRSRO to include in the report: (1) the percent of the net revenue attributable to the person that paid the NRSRO that were earned by the NRSRO during the most recently ended fiscal year from providing services and products other than credit rating services to the person; (2) the relative standing of the person in terms of the person's contribution to the NRSRO's net revenue as compared with other persons that contributed to the NRSRO's net revenues; and (3) the identity of all outstanding credit ratings issued by the NRSRO and paid for by the person.

The Commission preliminarily believes that proposed Rule 17g-7 would provide users of credit ratings with information about the potential risk that arises when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument. Namely, the risk that the revenue generated from the person soliciting the NRSRO to determine a credit rating could influence the NRSRO's objectivity in an effort to favor with that person with a corresponding negative impact on the quality and accuracy of the credit rating.

By assisting investors and other users of credit ratings in analyzing the nature and degree of potential conflicts, proposed Rule 17g-7 may promote more efficient investment analyses and decisions by these investors and users.

The proposed additional disclosures are designed to provide the marketplace with additional information for comparing NRSROs and, therefore, provide users of credit ratings with more useful metrics with which to compare these NRSROs. The Commission believes that the enhanced disclosure requirements of proposed Rule 17g-7 may enable investors and other users of credit ratings to better assess when and to what degree a NRSRO's objectivity may be compromised. Increased disclosures also will make the incentives of the NRSROs more transparent to the marketplace. Based on this information, investors and users of credit ratings issued by an NRSRO may make more informed investment decisions when considering credit ratings, which could promote efficiency.

The Commission further believes that these proposed amendments could promote more efficient allocation of capital by investors to the extent that the quality of credit ratings is improved.

These proposed disclosures, like the proposed additional disclosures to Form NRSRO, are designed to increase competition and promote capital formation by restoring confidence in the credit ratings. By providing more information about the nature and extent of potential revenue-based conflicts, investors and users of credit ratings will be better able to evaluate the integrity of an NRSRO and the credit ratings that it issues and assess whether its objectivity may be compromised. This enhanced information, in turn, may promote greater competition among NRSROs for the business of those users and investors.

A risk, however, exists with respect to proposed Rule 17g-7 that competition may be negatively impacted to the extent that issuers shift to larger NRSROs in which their revenue contribution will likely make up a smaller percentage of revenue to avoid any potential "stigma" associated with being perceived as a large client of an NRSRO.

Moreover, because users of credit ratings would have greater confidence in the integrity of the NRSROs as well as the credit ratings that they issue, such increased confidence could promote investor participation in the securities markets, and, thereby, promote capital formation.

XI. CONSIDERATION OF IMPACT ON THE ECONOMY

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996, or "SBREFA,"[214] the Commission must advise OMB whether a proposed regulation constitutes a major rule. Under SBREFA, a rule is "major" if it has resulted in, or is likely to result in:

- an annual effect on the economy of $100 million or more;
- a major increase in costs or prices for consumers or individual industries; or
- a significant adverse effect on competition, investment, or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review. The Commission requests comment on the potential impact of the proposed rule 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.

XII. 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,[215] regarding the proposed rule amendments to Rule 17g-3 and Form NRSRO under the Exchange Act and proposed new Rule 17g-7.

A. Reasons for the Proposed Action

The proposed amendments and proposed new rule would prescribe additional

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214 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).

215 5 U.S.C. 603.

requirements for NRSROs to address concerns raised about the role of credit rating agencies in the recent credit market turmoil. The proposed amendments and proposed new rule would enhance and strengthen the rules the Commission to implement specific provisions of the Rating Agency Act.[216] The Rating Agency Act defines the term "nationally recognized statistical rating organization" as a credit rating agency registered with the Commission, provides authority for the Commission to implement registration, recordkeeping, financial reporting, and oversight rules with respect to registered credit rating agencies.

As discussed in detail above, the proposed amendments seek to further the substantive goals of the Commission's current oversight program for NRSROs, including, increasing transparency and disclosure, diminishing conflicts, and strengthening oversight more generally.[217]

The Commission believes that the proposed amendments to Rule 17g-3 would improve the integrity of the ratings process by establishing a discipline under which the NRSRO's designated compliance officer would need to report to the Commission the steps taken by the compliance officer to fulfill the officer's statutory responsibilities.[218] The act of reporting these steps is designed to promote the active engagement of the designated compliance officer in reviewing an NRSRO's compliance with internal policies and procedures. The proposed report also could strengthen the Commission's oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating

216 Pub. L. No. 109-291 (2006); see also Exchange Act Release No. 55857 (June 5, 2007), 72 FR 33564, 33609 (June 18, 2007).

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

218 See proposed Rule 17g-3(a)(7) and (b)(2).

processes and providing an additional tool for the Commission to monitor how the NRSRO's designated compliance officer is fulfilling the responsibilities prescribed in Section 15E of the Exchange Act. Furthermore, the identification of the persons within the NRSRO advised of the results of the review and remediation measures implemented could also promote the appropriate escalation of compliance issues to the management of the NRSRO.

The Commission believes that the proposed amendments to Exhibit 6 to the Instructions to Form NRSRO would allow users of credit ratings to more effectively evaluate the integrity of the NRSRO's credit ratings themselves and whether they believe the NRSRO is effectively managing its conflicts of interests otherwise identified in Exhibit 6. Finally, the purpose of proposed new Rule 17g-7 is to provide users of credit ratings with information about the potential risk that arises when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument.

B. Objectives

The objectives of the Rating Agency Act are "to improve ratings quality for the protection of investors and in the public interest by fostering accountability, transparency, and competition in the credit rating industry."[219] The proposed amendments and proposed new rule are designed to further enhance these objectives and assist the Commission in monitoring whether an NRSRO complies with the provisions of the Rating Agency Act and rules thereunder, fulfilling the Commission's statutory mandate to adopt rules to implement the NRSRO regulatory program, and provide information regarding NRSROs to the public and to users of credit ratings.

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[219] See Senate Report, supra note 217.

The objective of the proposed amendment to Rule 17g-3 is to improve the integrity of the ratings process and enhance accountability by requiring the designated compliance officer to annually report on actions taken to fulfill the officer's statutory responsibilities. The requirement to provide the Commission with such a report would, the Commission believes, help establish or reinforce a discipline and rigor in the compliance officer's performance of his or her duties. It also is designed to strengthen the Commission's oversight of NRSROs by highlighting possible problem areas in an NRSRO's rating processes and providing an additional tool for the Commission to determine whether the NRSRO's designated compliance officer is fulfilling the responsibilities prescribed in Section 15E of the Exchange Act.[220] In addition, this information is designed to assist the Commission staff in its examination of NRSROs. Furthermore, the identification of the persons within the NRSRO advised of the results of the review and remediation measures implemented could also promote the appropriate escalation of compliance issues to the management of the NRSRO.

The proposed amendments to the Exhibit 6 Instructions to Form NRSRO that would require additional disclosures are designed to increase transparency by allowing users of credit ratings to more effectively evaluate the integrity of an NRSRO's credit ratings and analyze whether the NRSRO is effectively managing its conflicts of interests.

Finally, proposed new Rule 17g-7 is designed to increase transparency as well as enhance disclosures with respect to an NRSRO's management of its conflicts of interest by providing users of credit ratings with information about the potential risk of undue influence that arises when an NRSRO is paid to determine a credit rating for a specific obligor, security, or money market instrument.

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

C. Legal Basis

Pursuant to the Exchange Act[221] and, particularly, Sections 15E and 17(a) of the Exchange Act, the Commission is proposing amendments to Rule 17g-3 and Exhibit 6 to Form NRSRO, as well as proposing new Rule 17g-7.[222]

D. Small Entities Subject to the Rule

Paragraph (a) of Rule 0-10 provides that for purposes of the Regulatory Flexibility Act, a small entity "[w]hen used with reference to an 'issuer' or a 'person' other than an investment company" means "an 'issuer' or 'person' that, on the last day of its most recent fiscal year, had total assets of $5 million or less."[223] The Commission believes that an NRSRO with total assets of $5 million or less would qualify as a "small" entity for purposes of the Regulatory Flexibility Act. Currently, there are two NRSROs that are classified as "small" entities for purposes of the Regulatory Flexibility Act.[224]

E. Reporting, Recordkeeping, and Other Compliance Requirements

The proposal would amend Rule 17g-3 to require an NRSRO to furnish the Commission with an additional unaudited annual report containing a description of the steps taken by the designated compliance officer during the fiscal year to administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act; and ensure compliance with the securities laws

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221 15 U.S.C. 78a et seq.

222 15 U.S.C. 78o-7.

223 17 CFR 240.0-10(a).

224 See 17 CFR 240.0-10(a). Two of the 10 credit rating agencies currently registered as NRSROs would be considered "small" entities for purposes of the Regulatory Flexibility Act. The Commission previously sought comment on the number of small entities that may be effected by other proposed rule amendments to the Commission's NRSRO rules. The Commission received no comments in response to those requests. See generally, February 2009 Adopting Release, at 74 FR 6481.

and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.[225]

The amendments to proposed new paragraph (a)(7) of Rule 17g-3 would also provide that the report must include: (1) a description of any compliance reviews of the activities of the NRSRO; (2) the number of material compliance matters identified during each review of the activities of the NRSRO and a brief description of each such matter; (3) a description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the NRSRO; and (4) a description of the persons within the NRSRO who were advised of the results of the reviews.[226]

The Commission believes that the costs to NRSROs to comply with the proposed amendment to Rule 17g-3 would vary depending on the size and complexity of the NRSRO, as well as the size of its compliance programs. Larger NRSROs with comprehensive compliance programs may already periodically review portions of their compliance programs. These larger NRSROs may incur a cost associated with transforming their periodic reviews into a more systematic review and developing a form of report. While smaller NRSROs all have designated compliance officers, the Commission preliminarily believes, based on issues brought to the staff's attention, that some NRSROs may have less robust compliance programs than others NRSRO's. The Commission believes that the information to be included in the proposed report for smaller NRSROs would be less extensive, because smaller NRSRO's may have less complex organizational structures, fewer employees and fewer sources of revenue than

225 See proposed Rule 17g-3(a)(7).

226 See proposed Rule 17g-3(a)(7)(ii).

larger NRSROs which may be part of a complex global organization with thousands of employees. Therefore, it may be less costly than for larger NRSROs. Finally, the proposed new report under Rule 17g-3 would need to be retained by NRSROs for three years under Rule 17g-2.

The Commission is proposing to amend the Instructions to Exhibit 6 to Form NRSRO to require an applicant/NRSRO to furnish the Commission with information regarding the revenues an NRSRO receives from major clients and from services other than determining credit ratings. In particular, the amendments to Exhibit 6 would require an applicant/NRSRO to provide the following disclosures, as applicable:

- The percentage of the applicant/NRSRO's net revenue attributable to the 20 largest users of credit rating services of the applicant/NRSRO; and
- The percentage of the applicant/NRSRO's revenue attributable to services and products other than credit rating services of the applicant/NRSRO.

In order to comply with the proposed amendments to Exhibit 6 to Form NRSRO, an applicant/NRSRO would need to compile the information in order to complete the additional disclosures. The Commission believes that the burdens imposed by the proposed rule amendments would vary based on the size and complexity of each applicant/NRSRO. The Commission believes that the potential impact of the amendments to Exhibit 6 to Form NRSRO on small NRSROs should not be significant because these entities would have fewer clients and less revenue and therefore lower costs to produce the additional disclosures under the amendments to Exhibit 6 to Form NRSRO.

The Commission is also proposing new Rule 17g-7, which would require an NRSRO to make publicly available on its Internet Web site a consolidated report containing information about the revenues earned by the NRSRO as a result of providing services and products to persons that paid the NRSRO to issue or maintain a credit rating. This report would need to be updated annually. In order to comply with new Rule 17g-7, each NRSRO would need to develop the calculations necessary to generate the percents required under the report; to populate the proposed report with the required data; and to develop and draft the form report. The Commission believes that the burdens imposed by new Rule 17g-7 would vary based on the size and complexity of each applicant/NRSRO. The Commission believes that the potential impact of the proposed Rule 17g-7 on small NRSROs should not be significant because these entities would have fewer clients and less revenue and therefore lower costs to produce the consolidated report required by proposed new Rule 17g-7. The consolidated report would need to be retained for three years in accordance with Rule 17g-2.

F. Duplicative, Overlapping, or Conflicting Federal Rules

The Commission believes that there are no federal rules that duplicate, overlap, or conflict with the proposed rule amendments and the proposed new rule.

G. Significant Alternatives

Pursuant to Section 3(a) of the Regulatory Flexibility Act,[227] 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

[227] 5 U.S.C. 603(c).

performance rather than design standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

The Commission considered whether it is necessary or appropriate to establish different compliance or reporting requirements or timetables; or clarify, consolidate, or simplify compliance and reporting requirements under the rule for small entities. Because the proposed rule amendments are designed to improve the overall quality of ratings and enhance the Commission's oversight, the Commission preliminarily believes that small entities should be covered by the rule. The Commission also preliminarily believes that the proposed rule amendments and proposed new rule are flexible and simple enough to allow small NRSROs to comply without the need for the establishment of differing compliance or reporting requirements for small entities.

H. Request for Comments

The Commission encourages written comments on matters discussed in this IRFA. In particular, the Commission seeks comment on the number of small entities that would be affected by the proposed rule amendments and the proposed new rule, and whether the effect on small entities would be economically significant. Commenters are asked to describe the nature of any effect and to provide empirical data to support their views.

XIII. STATUTORY AUTHORITY

The Commission is proposing amendments to Rule 17g–3 and the Instructions to Form NRSRO and new Rule 17g-7, pursuant to the authority conferred by the Exchange Act, including Sections 15E and 17(a).[228]

Text of Proposed Rules

[228] 15 U.S.C. 78o–7 and 78q.

List of Subjects in 17 CFR Parts 240 and 249b

Brokers, Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, the Commission hereby proposes that Title 17, Chapter II of the Code of Federal Regulation be amended as follows.

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, and 7201 et. seq.; and 18 U.S.C. 1350, unless otherwise noted.

2. Section 240.17g–3 is amended by:

a. Adding a new paragraph (a)(7); and

b. Revising paragraph (b).

The additions and revisions read as follows:

(a) * * *

(7)(i) An unaudited report containing a description of the steps taken by the designated compliance officer during the fiscal year to:

(A) Administer the policies and procedures that are required to be established pursuant to paragraphs (g) and (h) of Section 15E of the Exchange Act (15 U.S.C. 78o-7(g) and (h)); and

(B) Ensure compliance with the securities laws and rules and regulations thereunder, including those promulgated by the Commission pursuant to Section 15E of the Exchange Act.

(ii) The report required pursuant to paragraph (a)(7)(i) of this section must include:

(A) A description of any compliance reviews of the activities of the nationally recognized statistical rating organization;

(B) The number of material compliance matters identified during each review of the activities of the nationally recognized statistical rating organization and a brief description of each such matter;

(C) A description of any remediation measures implemented to address material compliance matters identified during the reviews of the activities of the nationally recognized statistical rating organization; and

(D) A description of the persons within the nationally recognized statistical rating organization who were advised of the results of the reviews.

* * * * *

(b) The nationally recognized statistical rating organization must:

(1) Attach to the financial reports furnished pursuant to paragraphs (a)(1) through (a)(6) of this section a signed statement by a duly authorized person associated with the nationally recognized statistical rating organization stating that the person has responsibility for the financial reports and, to the best knowledge of the person, the financial reports fairly present, in all material respects, the financial condition, results of

operations, cash flows, revenues, analyst compensation, and credit rating actions of the nationally recognized statistical rating organization for the period presented; and

(2) Attach to the report furnished pursuant to paragraph (a)(7) of this section a signed statement by the designated compliance officer of the nationally recognized statistical rating organization stating that the person has responsibility for the report and, to the best knowledge of the designated compliance officer, the report fairly presents, in all material respects, steps taken by the designated compliance officer for the period presented.

* * * * *

3. Section 240.17g-7 is added to read as follows:

§ 240.17g-7 Reports to be made public by nationally recognized statistical rating organizations about persons that paid the nationally recognized statistical rating organization for the issuance or maintenance of a credit rating.

(a)(1) A nationally recognized statistical rating organization must annually, not later than 90 calendar days after the end of its fiscal year (as indicated on its current Form NRSRO), make publicly available on its Internet Web site a consolidated report that shows, with respect to each person that paid the nationally recognized statistical rating organization to issue or maintain a credit rating that was outstanding as of the end of the fiscal year, the following information:

(i) the percent of the net revenue attributable to the person earned by the nationally recognized statistical rating organization for that fiscal year from providing services and products other than credit rating services to the person, which the nationally recognized statistical rating organization must calculate in accordance with paragraph (a)(3)(i) of this section;

(ii) the relative standing of the person in terms of the person's contribution to the net revenue of the nationally recognized statistical rating organization for the fiscal year, which the nationally recognized statistical rating organization must determine in accordance with paragraph (a)(3)(ii) of this section; and

(iii) all outstanding credit ratings paid for by the person, which the nationally recognized statistical rating organization must determine in accordance with paragraph (a)(3)(iii) of this section.

(2) A nationally recognized statistical rating organization is not required to make publicly available on its Internet Web site the report required by paragraph (a)(1) of this section or include with the publication of a credit rating the statement required by paragraph (b) of this section if, as of the end of the fiscal year, there are no credit ratings outstanding that the nationally recognized statistical rating organization issued or maintained as a result of a person paying the nationally recognized statistical rating organization for the issuance or maintenance of such credit ratings.

(3)(i) The nationally recognized statistical rating organization must calculate the percent of the net revenue attributable to the person earned by the nationally recognized statistical rating organization for the fiscal year from providing services and products other than credit rating services to the person as follows:

(A) Calculate the net revenue attributable to the person earned by the nationally recognized statistical rating organization for the fiscal year from providing services and products other than credit rating services to the person;

(B) Calculate the net revenue attributable to the person earned by the nationally recognized statistical rating organization for the fiscal year from providing all services and products, including credit rating services, to the person; and

(C) Divide the amount calculated pursuant to paragraph (a)(3)(i)(A) of this section by the amount calculated pursuant to paragraph (a)(3)(i)(B) of this section and convert that quotient to a percent.

(ii) The nationally recognized statistical rating organization must determine the relative standing of the person in terms of the person's contribution to the net revenue of the nationally recognized statistical rating organization for the fiscal year as follows:

(A) For each person from whom the nationally recognized statistical rating organization earned net revenue during the fiscal year, calculate the net revenue attributable to the person earned by the nationally recognized statistical rating organization for the fiscal year from providing all services and products, including credit rating services, to the person;

(B) Make a list that sorts the persons subject to the calculation in paragraph (a)(3)(ii)(A) of this section in order from largest to smallest in terms of the amount of net revenue attributable to the person, as determined pursuant to that paragraph; and

(C) Divide the list generated pursuant to paragraph (a)(3)(ii)(B) of this section into the following categories: top 10%, top 25%, top 50%, bottom 50%, and bottom 25% and determine which category contains the person.

(iii) Identify by name of obligor, security, or money market instrument and, as applicable, CIK number, CUSIP, or ISIN each outstanding credit rating generated as a result of the person paying the nationally recognized statistical rating organization for the issuance or maintenance of the credit rating and attribute the outstanding credit rating to the person.

(b) A nationally recognized statistical rating organization must prominently include the following statement indicating where on its Internet Web site the consolidated report required pursuant to paragraph (a)(1) of this section is located each time the nationally recognized statistical rating organization publishes a credit rating or credit ratings in a research report, press release, announcement, database, Internet Web site page, compendium, or any other written communication that makes the credit rating publicly available for free or a reasonable fee: "revenue information about persons that paid the nationally statistical rating organization for the issuance or maintenance of a credit rating is available at: [insert address to Internet Web site]."

(c) For purposes of this section:

(1) The term credit rating services means any of the following: rating an obligor (regardless of whether the obligor or any other person paid for the credit rating); rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and providing credit ratings, credit ratings data, or credit ratings analysis to a subscriber.

(2) The term net revenue means revenue earned for any type of service or product provided to a person, regardless of whether related to credit rating services, and net of any rebates and allowances paid or owed to the person.

PART 249b—FURTHER FORMS, SECURITIES EXCHANGE ACT OF 1934

4. The authority citation for part 249b continues to read in part as follows:

Authority: 15 U.S.C. 78a et seq., unless otherwise noted;

* * * * *

5. Form NRSRO (referenced in § 249b.300) is amended by revising Exhibit 6 in Item 9 to read as follows:

Note: The text of Form NRSRO does not and this amendment will not appear in the Code of Federal Regulations.

Form NRSRO

* * * * *

9. Exhibits * * *

* * * * *

Exhibit 6. Information concerning conflicts of interest or potential conflicts of interest relating to the issuance of credit ratings by the credit rating agency.

☐ Exhibit 6 is attached to and made a part of this Form NRSRO.

* * * * *

6. Amend Form NRSRO Instructions (referenced in § 249b.300) by:

a. Revising Instruction A.8.;

b. Adding a Note to the end of Instruction F;

c. Removing the words "withdrawal of registration" and adding in their place the words "withdrawal from registration" in the first sentence of Instruction H, Item 5;

d. Revising Exhibit 6 in Instruction H, Item 9;

e. Removing the words "(See definition below)" from the first sentence of Exhibit 8 in Instruction H, Item 9;

f. Removing the word "person" and adding in its place the words "user of credit rating services" in the first sentence in Exhibit 10, Instruction H, Item 9, and removing the fifth sentence in Exhibit 10, Instruction H, Item 9, which includes the definitions of "net revenue" and "credit rating services";

g. Redesignating Instruction F as Instruction I; and

h. Revising newly redesignated Instruction I.

The revisions and addition read as follows:

Note: The text of Form NRSRO does not and this amendment will not appear in the Code of Federal Regulations.

FORM NRSRO INSTRUCTIONS

* * * * *

A. GENERAL INSTRUCTIONS.

* * * * *

8. ADDRESS - The mailing address for Form NRSRO is:

Division of Trading and Markets

U.S. Securities and Exchange Commission

100 F Street, NE

Washington, DC 20549-7010

* * * * *

F. INSTRUCTIONS FOR ANNUAL CERTIFICATIONS

* * * * *

<u>**Note to Instruction F**</u>: The annual financial reports that an NRSRO must furnish to the Commission pursuant to Section 15E(k) of the Exchange Act and Exchange Act Rules 17g-3(a)(1) through (a)(6), as applicable, should not be furnished as part of the Annual Certification on Form NRSRO. If the fiscal year end of the NRSRO is December 31, however, the financial reports may be furnished in the

same mailing as the Annual Certification. In accordance with Exchange Act Rule 17g-3(b), the NRSRO must attach to <u>each</u> report the certification required by the Rule.

* * * * *

H. INSTRUCTIONS FOR SPECIFIC LINE ITEMS

* * * * *

Item 9. Exhibits. * * *

* * * * *

Exhibit 6. Provide in this Exhibit information concerning conflicts of interest or potential conflicts of interest relating to the issuance of credit ratings by the Applicant/NRSRO.

Part A. Identify the types of conflicts of interest relating to the issuance of credit ratings by the Applicant/NRSRO that are material to the Applicant/NRSRO. First, identify the conflicts described in the list below that apply to the Applicant/NRSRO. The Applicant/NRSRO may use the descriptions below to identify an applicable conflict of interest and is not required to provide any further details. Second, briefly describe any other type of conflict of interest relating to the issuance of credit ratings by the Applicant/NRSRO that is not covered in the descriptions below that is material to the Applicant/NRSRO (for example, one the Applicant/NRSRO has established specific policies and procedures to address):

- The Applicant/NRSRO is paid by issuers or underwriters to determine credit ratings with respect to securities or money market instruments they issue or underwrite.

- The Applicant/NRSRO is paid by obligors to determine credit ratings of the obligors.
- The Applicant/NRSRO is paid for services in addition to determining credit ratings by issuers, underwriters, or obligors that have paid the Applicant/NRSRO to determine a credit rating.
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons may use the credit ratings of the Applicant/NRSRO to comply with, and obtain benefits or relief under, statutes and regulations using the term "nationally recognized statistical rating organization."
- The Applicant/NRSRO is paid by persons for subscriptions to receive or access the credit ratings of the Applicant/NRSRO and/or for other services offered by the Applicant/NRSRO where such persons also may own investments or have entered into transactions that could be favorably or adversely impacted by a credit rating issued by the Applicant/NRSRO.
- The Applicant/NRSRO allows persons within the Applicant/NRSRO to:
    - Directly own securities or money market instruments of, or have other direct ownership interests in, obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.
    - Have business relationships that are more than arms length ordinary course business relationships with obligors or issuers subject to a credit rating determined by the Applicant/NRSRO.

- A person associated with the Applicant/NRSRO is a broker or dealer engaged in the business of underwriting securities or money market instruments (identify the person).
- The Applicant/NRSRO has any other material conflict of interest that arises from the issuances of credit ratings (briefly describe).

Part B. Provide the following information concerning revenues of the Applicant/NRSRO. An Applicant must provide this information for the fiscal year ending immediately before the date of the Applicant's initial application to the Commission. An NRSRO with a fiscal year end of December 31 must provide this information as part of its Annual Certification. Otherwise, an NRSRO must provide this information with an Update of Registration not later than 90 days after the end of each fiscal year.

(1) Provide the percentage of total net revenue attributable to the 20 largest users of credit rating services of the Applicant/NRSRO by dividing:

- The total amount of net revenue earned by the Applicant/NRSRO attributable to the 20 largest users of credit rating services of the Applicant/NRSRO; by
- The total amount of the four classifications of revenue of the Applicant as reported in Exhibit 12 to Form NRSRO or the NRSRO as reported in the financial report furnished to the Commission under Exchange Act Rule 17g-3(a)(4).

Note to Part B(1) of Exhibit 6: The 20 largest users of credit rating services includes issuers, subscribers, obligors, and underwriters, and may not be the same as the list of 20 largest issuers and subscribers identified by the Applicant in Exhibit 10 to Form NRSRO or by the NRSRO in the financial report furnished to the Commission under Exchange Act Rule 17g-3(a)(5).

(2) Provide the percentage of total net revenue attributable to other services and products of the Applicant/NRSRO by dividing:

- The total amount of revenue earned by the Applicant/NRSRO for "all other services and products" of the Applicant as reported in Exhibit 12 to Form NRSRO or of the NRSRO as reported in the financial report furnished to the Commission under Exchange Act Rule 17g-3(a)(4); by
- The total amount of the four classifications of revenue of the Applicant as reported in Exhibit 12 to Form NRSRO or of the NRSRO as reported in the financial report furnished to the Commission under Exchange Act Rule 17g-3(a)(4).

* * * * *

Exhibit 10. Provide in this Exhibit a list of the largest users of credit rating services of the Applicant by the amount of net revenue earned by the Applicant attributable to the user of credit rating services during the fiscal year ending immediately before the date of the initial application. First, determine and list the 20 largest <u>issuers</u> and <u>subscribers</u> in terms of net revenue. Next, add to the list any <u>obligor</u> or <u>underwriter</u> that, in terms of net revenue during the fiscal year, equaled or exceeded the 20th largest issuer or subscriber. In making the list, rank the

persons in terms of net revenue from largest to smallest and include the net revenue amount for each person.

An NRSRO is not required to make this Exhibit publicly available on its Web site, or through another comparable, readily accessible means pursuant to Exchange Act Rule 17g-1(i). An NRSRO may request that the Commission keep this Exhibit confidential by marking each page "Confidential Treatment" and complying with Commission rules governing confidential treatment (See 17 CFR 200.80 and 17 CFR 200.83). The Commission will keep the information and documents in the Exhibit confidential upon request to the extent permitted by law.

* * * * *

I. EXPLANATION OF TERMS.

1. COMMISSION - The U. S. Securities and Exchange Commission.
2. CREDIT RATING [Section 3(a)(60) of the Exchange Act] - An assessment of the creditworthiness of an obligor as an entity or with respect to specific securities or money market instruments.
3. CREDIT RATING AGENCY [Section 3(a)(61) of the Exchange Act] - Any person:
    - engaged in the business of issuing credit ratings on the Internet or through another readily accessible means, for free or for a reasonable fee, but does not include a commercial credit reporting company;
    - employing either a quantitative or qualitative model, or both to determine credit ratings; and

- receiving fees from either issuers, investors, other market participants, or a combination thereof.

4. CREDIT RATING SERVICES - Any of the following services:

   - rating an obligor (regardless of whether the obligor or any other person paid for the credit rating);
   - rating an issuer's securities or money market instruments (regardless of whether the issuer, underwriter, or any other person paid for the credit rating); and
   - providing credit ratings, credit ratings data, or credit ratings analysis to a subscriber.

5. NATIONALLY RECOGNIZED STATISTICAL RATING ORGANIZATION [Section 3(a)(62) of the Exchange Act] - A credit rating agency that:

   - has been in business as a credit rating agency for at least the 3 consecutive years immediately preceding the date of its application for registration as an NRSRO;
   - issues credit ratings certified by qualified institutional buyers in accordance with Section 15(a)(1)(B)(ix) of the Exchange Act with respect to:
     - financial institutions, brokers, or dealers;
     - insurance companies;
     - corporate issuers;
     - issuers of asset-backed securities;

- issuers of government securities, municipal securities, or securities issued by a foreign government; or
- a combination of one or more of the above; and

- is registered as an NRSRO.

6. NET REVENUE - revenue earned by the Applicant/NRSRO for any type of service or product provided to a person, regardless of whether related to credit rating services, and net of any rebates and allowances the Applicant/NRSRO paid or owes to the person.

7. PERSON - An individual, partnership, corporation, trust, company, limited liability company, or other organization (including a separately identifiable department or division).

8. PERSON WITHIN AN APPLICANT/NRSRO – The person furnishing Form NRSRO identified in Item 1, any credit rating affiliates identified in Item 3, and any partner, officer, director, branch manager, or employee of the person or the credit rating affiliates (or any person occupying a similar status or performing similar functions).

9. SEPARATELY IDENTIFIABLE DEPARTMENT OR DIVISION - A unit of a corporation or company:

- that is under the direct supervision of an officer or officers designated by the board of directors of the corporation as responsible for the day-to-day conduct of the corporation's credit rating activities for one or more affiliates, including the supervision of all employees engaged in the performance of such activities; and

- for which all of the records relating to its credit rating activities are separately created or maintained in or extractable from such unit's own facilities or the facilities of the corporation, and such records are so maintained or otherwise accessible as to permit independent examination and enforcement by the Commission of the Exchange Act and rules and regulations promulgated thereunder.

10. QUALIFIED INSTITUTIONAL BUYER [Section 3(a)(64) of the Exchange Act] - An entity listed in 17 CFR 230.144A(a) that is not affiliated with the credit rating agency.

* * * * *

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Dated: November 23, 2009

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61055 / November 24, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13695

In the Matter of **Downey Financial 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 Downey Financial Corp. ("Downey" or "Respondent").

II.

In anticipation of the institution of these proceedings, Downey 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, Downey consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. Downey (CIK No. 935063) is a Delaware corporation located in Newport Beach, California with a class of securities registered with the Commission under Exchange Act Section 12(g). As of June 17, 2009, the common stock of Downey (symbol "DWNFQ") was quoted on the Pink Sheets. The Respondent filed a Chapter 7 bankruptcy proceeding on November 25, 2008, which was still pending as of June 17, 2009.

2. Downey 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, 2008.

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 Downey's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61054 / November 24, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13694

In the Matter of **Dynamic Sciences International, 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 Dynamic Sciences International, Inc. ("Dynamic Sciences" or "Respondent").

II.

In anticipation of the institution of these proceedings, Dynamic Sciences 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, Dynamic Sciences consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. Dynamic Sciences (CIK No. 729520) is a Nevada corporation located in Woodland Hills, California with a class of securities registered with the

Commission under Exchange Act Section 12(g). As of June 10, 2009, the company's common stock (symbol "DYNS") was quoted on the Pink Sheets, had five market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3). The Respondent filed a Chapter 11 bankruptcy petition in the U.S. Bankruptcy Court for the Central District of California on October 14, 2005, which was still pending as of June 10, 2009.

2. Dynamic Sciences 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, 2000.

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 Dynamic Sciences's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61056 / November 24, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13696

In the Matter of ClearComm LP, 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 ClearComm LP ("ClearComm" or "Respondent").

II.

In anticipation of the institution of these proceedings, ClearComm 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, ClearComm consents to the entry of this Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Order"), as set forth below.

III.

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

1. ClearComm (CIK No. 1013267) is a Delaware limited partnership located in New York, New York with a class of securities registered with the Commission under Exchange Act Section 12(g).

2. ClearComm 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 May 31, 2007.

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 ClearComm's securities registered pursuant to Section 12 of the Exchange Act be, and hereby is, revoked.

By the Commission.

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
November 25, 2009

In the Matter of	
Customer Sports, Inc., Leonidas Films, Inc. (n/k/a Consolidated Pictures Group, Inc.), Sportsprize Entertainment, Inc., U.S. Interactive, Inc., and USA Biomass Corp.,	**ORDER OF SUSPENSION OF TRADING**
File No. 500-1	

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Customer Sports, Inc. because it has not filed any periodic reports since the period ended April 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Leonidas Films, Inc. (n/k/a Consolidated Pictures Group, Inc.) because it has not filed any periodic reports since the period ended March 31, 2001.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of Sportsprize Entertainment, Inc. because it has not filed any periodic reports since the period ended August 31, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of U.S. Interactive, Inc. because it has not filed any periodic reports since the period ended September 30, 2000.

It appears to the Securities and Exchange Commission that there is a lack of current and accurate information concerning the securities of USA Biomass Corp. because it has not filed any periodic reports since the period ended December 31, 2002.

The Commission is of the opinion that the public interest and the protection of investors require a suspension of trading in the securities of the above-listed companies. Therefore, it is ordered, pursuant to Section 12(k) of the Securities Exchange Act of 1934, that trading in the securities of the above-listed companies is suspended for the period from 9:30 a.m. EST on November 25, 2009, through 11:59 p.m. EST on December 9, 2009.

By the Commission.

Elizabeth M. Murphy
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. 61063 / November 25, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13698

In the Matter of **Customer Sports, Inc.,** **General Magic, Inc.,** **Leonidas Films, Inc.** **(n/k/a Consolidated Pictures Group, Inc.),** **Sportsprize Entertainment, Inc.,** **U.S. Interactive, Inc., and** **USA Biomass Corp.** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Customer Sports, Inc., General Magic, Inc., Leonidas Films, Inc. (n/k/a Consolidated Pictures Group, Inc.), Sportsprize Entertainment, Inc., U.S. Interactive, Inc., and USA Biomass Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Customer Sports, Inc. ("CTMR")[1] (CIK No. 51853) is an expired Utah corporation located in Del Mar, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CTMR is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended April 30, 2000, which reported a net loss of $593,993 for the prior nine months. The audit report accompanying the company's Form 10-K for the period ended July 31, 1999 included a "going concern" opinion based on the company's accumulated deficit and negative

[1]The short form of each issuer's name is also its stock symbol.

net worth. As of November 23, 2009, the common stock of CTMR was quoted on the Pink Sheets, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

2. General Magic, Inc. ("GMGCQ") (CIK No. 933524) is a void Delaware corporation located in Sunnyvale, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). GMGCQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended June 30, 2002, which reported a net loss of $5,484,000 for the prior six months. On December 11, 2002, GMGCQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Northern District of California, which was terminated on June 30, 2005. As of November 23, 2009, the common stock of GMGCQ was traded on the over-the-counter markets.

3. Leonidas Films, Inc. (n/k/a Consolidated Pictures Group, Inc.) ("CPGU") (CIK No. 848296) is a Nevada corporation located in Woodland Hills, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). CPGU is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2001, which reported a net loss of $1,614,000 for the prior nine months. In early 2009, CPGU changed its name in the records of the Nevada Secretary of State to Consolidated Pictures Group, Inc., but failed to record that change in the Commission's EDGAR database or report it on Form 8-K as required by Commission rules. As of November 23, 2009, the common stock of CPGU was quoted on the Pink Sheets, had nine market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

4. Sportsprize Entertainment, Inc. ("JOCKQ") (CIK No. 1078593) is a Nevada corporation located in Culver City, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). JOCKQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended August 31, 2000, which reported a net loss of $3,014,855 for the prior six months. On December 1, 2000, JOCKQ filed a Chapter 7 petition in the U.S. Bankruptcy Court for the Central District of California, which was terminated on January 31, 2003. As of November 23, 2009, the common stock of JOCKQ was quoted on the Pink Sheets, had three market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

5. U.S. Interactive, Inc. ("USITQ") (CIK No. 1086637) is a forfeited Delaware corporation located in Cupertino, California with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). USITQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2000, which reported a net loss of $78,833,000 for the prior nine months. On January 22, 2001, USITQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the District of Delaware which was still pending as of November 23, 2009. As of November 23, 2009, the common stock of USITQ was quoted on the Pink Sheets, had four market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

6. USA Biomass Corp. ("UBMSQ") (CIK No. 831002) is a void Delaware corporation located in Orange, California with a class of securities registered with the

Commission pursuant to Exchange Act Section 12(g). UBMSQ is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-KSB for the period ended December 31, 2002, which reported a net loss of $3,201,118 for the prior year. UBMSQ also failed to file Forms 10-QSB for any of the interim periods for fiscal years 2001 and 2002 and failed to file a Form 10-KSB for the fiscal year ended December 31, 2000. On December 8, 2000, UBMSQ filed a Chapter 11 petition in the U.S. Bankruptcy Court for the Central District of California, which was terminated on February 27, 2006. As of November 23, 2009, the common stock of UBMSQ was quoted on the Pink Sheets, had eight market makers, and was eligible for the "piggyback" exception of Exchange Act Rule 15c2-11(f)(3).

B. DELINQUENT PERIODIC FILINGS

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

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

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

III.

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

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

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

IV.

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

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

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

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Attachment

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

Appendix 1

Chart of Delinquent Filings

In the Matter of Customer Sports, Inc., et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Customer Sports, Inc.					
	10-KSB	07/31/00	10/30/00	Not filed	109
	10-QSB	10/31/00	12/15/00	Not filed	107
	10-QSB	01/31/01	03/19/01	Not filed	104
	10-QSB	04/30/01	06/14/01	Not filed	101
	10-KSB	07/31/01	10/29/01	Not filed	97
	10-QSB	10/31/01	12/17/01	Not filed	95
	10-QSB	01/31/02	03/18/02	Not filed	92
	10-QSB	04/30/02	06/14/02	Not filed	89
	10-KSB	07/31/02	10/29/02	Not filed	85
	10-QSB	10/31/02	12/16/02	Not filed	83
	10-QSB	01/31/03	03/17/03	Not filed	80
	10-QSB	04/30/03	06/16/03	Not filed	77
	10-KSB	07/31/03	10/29/03	Not filed	73
	10-QSB	10/31/03	12/15/03	Not filed	71
	10-QSB	01/31/04	03/16/04	Not filed	68
	10-QSB	04/30/04	06/14/04	Not filed	65
	10-KSB	07/31/04	10/29/04	Not filed	61
	10-QSB	10/31/04	12/15/04	Not filed	59
	10-QSB	01/31/05	03/17/05	Not filed	56
	10-QSB	04/30/05	06/14/05	Not filed	53
	10-KSB	07/31/05	10/31/05	Not filed	49
	10-QSB	10/31/05	12/15/05	Not filed	47
	10-QSB	01/31/06	03/17/06	Not filed	44
	10-QSB	04/30/06	06/14/06	Not filed	41
	10-KSB	07/31/06	10/30/06	Not filed	37
	10-QSB	10/31/06	12/15/06	Not filed	35
	10-QSB	01/31/07	03/19/07	Not filed	32
	10-QSB	04/30/07	06/14/07	Not filed	29
	10-KSB	07/31/07	10/29/07	Not filed	25
	10-QSB	10/31/07	12/17/07	Not filed	23
	10-QSB	01/31/08	03/17/08	Not filed	20
	10-QSB	04/30/08	06/16/08	Not filed	17
	10-KSB	07/31/08	10/29/08	Not filed	13

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Customer Sports, Inc. (continued)	*10-Q**	10/31/08	12/15/08	Not filed	11
	*10-Q**	01/31/09	03/17/09	Not filed	8
	*10-Q**	04/30/09	06/16/09	Not filed	5
	*10-K**	07/31/09	10/29/09	Not filed	1
Total Filings Delinquent	37				
General Magic, Inc.					
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
	*10-Q**	09/30/09	11/16/09	Not filed	0
Total Filings Delinquent	29				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Leonidas Films, Inc. (n/k/a Consolidated Pictures Group, Inc.)					
	10-KSB	06/30/01	09/28/01	Not filed	98
	10-QSB	09/30/01	11/14/01	Not filed	96
	10-QSB	12/31/01	02/14/02	Not filed	93
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-KSB	06/30/02	09/30/02	Not filed	86
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-QSB	12/31/02	02/14/03	Not filed	81
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-KSB	06/30/03	09/29/03	Not filed	74
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-QSB	12/31/03	02/17/04	Not filed	69
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-KSB	06/30/04	09/28/04	Not filed	62
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-QSB	12/31/04	02/14/05	Not filed	57
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-KSB	06/30/05	09/28/05	Not filed	50
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-QSB	12/31/05	02/14/06	Not filed	45
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-KSB	06/30/06	09/28/06	Not filed	38
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-QSB	12/31/06	02/14/07	Not filed	33
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-KSB	06/30/07	09/28/07	Not filed	26
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-QSB	12/31/07	02/14/08	Not filed	21
	10-QSB	03/31/08	05/15/08	Not filed	18
	10-KSB	06/30/08	09/29/08	Not filed	14
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-Q**	12/31/08	02/17/09	Not filed	9
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-K**	06/30/09	09/28/09	Not filed	2
	*10-Q**	09/30/09	11/16/09	Not filed	0
Total Filings Delinquent	34				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Sportsprize Entertainment, Inc.					
	10-Q	11/30/00	01/16/01	Not filed	106
	10-K	02/28/01	05/29/01	Not filed	102
	10-Q	05/31/01	07/16/01	Not filed	100
	10-Q	08/31/01	10/15/01	Not filed	97
	10-Q	11/30/01	01/14/02	Not filed	94
	10-K	02/28/02	05/29/02	Not filed	90
	10-Q	05/31/02	07/15/02	Not filed	88
	10-Q	08/31/02	10/15/02	Not filed	85
	10-Q	11/30/02	01/14/03	Not filed	82
	10-K	02/28/03	05/29/03	Not filed	78
	10-Q	05/31/03	07/15/03	Not filed	76
	10-Q	08/31/03	10/15/03	Not filed	73
	10-Q	11/30/03	01/14/04	Not filed	70
	10-K	02/29/04	06/01/04	Not filed	65
	10-Q	05/31/04	07/15/04	Not filed	64
	10-Q	08/31/04	10/15/04	Not filed	61
	10-Q	11/30/04	01/14/05	Not filed	58
	10-K	02/28/05	05/31/05	Not filed	54
	10-Q	05/31/05	07/15/05	Not filed	52
	10-Q	08/31/05	10/17/05	Not filed	49
	10-Q	11/30/05	01/17/06	Not filed	46
	10-K	02/28/06	05/30/06	Not filed	42
	10-Q	05/31/06	07/17/06	Not filed	40
	10-Q	08/31/06	10/16/06	Not filed	37
	10-Q	11/30/06	01/16/07	Not filed	34
	10-K	02/28/07	05/29/07	Not filed	30
	10-Q	05/31/07	07/16/07	Not filed	28
	10-Q	08/31/07	10/15/07	Not filed	25
	10-Q	11/30/07	01/14/08	Not filed	22
	10-K	02/29/08	05/29/08	Not filed	18
	10-Q	05/31/08	07/15/08	Not filed	16
	10-Q	08/31/08	10/15/08	Not filed	13
	10-Q	11/30/08	01/14/09	Not filed	10
	10-K	02/28/09	05/29/09	Not filed	6
	10-Q	05/31/09	07/15/09	Not filed	4
	10-Q	08/31/09	10/15/09	Not filed	1
Total Filings Delinquent	36				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
U.S. Interactive, Inc.					
	10-K	12/31/00	04/02/01	Not filed	103
	10-Q	03/31/01	05/15/01	Not filed	102
	10-Q	06/30/01	08/14/01	Not filed	99
	10-Q	09/30/01	11/14/01	Not filed	96
	10-K	12/31/01	04/01/02	Not filed	91
	10-Q	03/31/02	05/15/02	Not filed	90
	10-Q	06/30/02	08/14/02	Not filed	87
	10-Q	09/30/02	11/14/02	Not filed	84
	10-K	12/31/02	03/31/03	Not filed	80
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75
	10-Q	09/30/03	11/14/03	Not filed	72
	10-K	12/31/03	03/30/04	Not filed	68
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-K	12/31/04	03/31/05	Not filed	56
	10-Q	03/31/05	05/16/05	Not filed	54
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-K	12/31/05	03/31/06	Not filed	44
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36
	10-K	12/31/06	04/02/07	Not filed	31
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-K	12/31/07	03/31/08	Not filed	20
	10-Q	03/31/08	05/15/08	Not filed	18
	10-Q	06/30/08	08/14/08	Not filed	15
	10-Q	09/30/08	11/14/08	Not filed	12
	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
	10-Q	09/30/09	11/16/09	Not filed	0
Total Filings Delinquent	36				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
USA Biomass Corp.					
	10-KSB	12/31/00	04/02/01	Not filed	103
	10-QSB	03/31/01	05/15/01	Not filed	102
	10-QSB	06/30/01	08/14/01	Not filed	99
	10-QSB	09/30/01	11/14/01	Not filed	96
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15
	*10-Q**	09/30/08	11/14/08	Not filed	12

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
USA Biomass Corp.	*10-K**	12/31/08	03/31/09	Not filed	8
(continued)	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
	*10-Q**	09/30/09	11/16/09	Not filed	0
Total Filings Delinquent	34				

*Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, have been removed from the federal securities laws. *See* Release No. 34-56994 (Dec. 19, 2007). The removal took effect over a transition period that concluded on March 15, 2009. All reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB are now required to use Forms 10-Q and 10-K instead. Forms 10-QSB and 10-KSB will no longer be available, though issuers that meet the definition of a "smaller reporting company" (generally, a company that has less than $75 million in public equity float as of the end of its most recently completed second fiscal quarter) have the option of using new, scaled disclosure requirements that Regulation S-K now includes.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61076 / November 30, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13699

In the Matter of HOME SOLUTIONS OF AMERICA, INC., Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

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

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

Home Solutions of America, Inc. is a Delaware corporation that has maintained its headquarters in Dallas, Texas and New Orleans, Louisiana. HSOA has been in the remediation and construction business. HSOA's shares are registered with the Commission pursuant to Section 12(g) of the Securities Exchange Act of 1934 ("Exchange Act"), and the Respondent files its annual and quarterly reports on Forms 10-K and 10-Q respectively.

B. DELINQUENT PERIODIC FILINGS

HSOA is delinquent in its periodic filings with the Commission. Specifically, HSOA has failed to file any quarterly or annual reports since August 2007, when HSOA filed its Form 10-Q for the quarter ended June 30, 2007. HSOA has thus failed to file its Forms 10-K for the years ended December 31, 2007 and 2008, as well as its Forms 10-Q for the quarters ended September 30, 2007, March 31, 2008, June 30, 2008, September 30, 2008, March 31, 2009, and June 30, 2009.

NEWS DIGEST

IN THE MATTER OF HOME SOLUTIONS OF AMERICA, INC.

On November 30, 2009, the Commission announced the institution of an administrative proceeding against Home Solutions of America, Inc. pursuant to Section 12(j) of the Securities Exchange Act of 1934 (the Exchange Act). Home Solutions is a Delaware corporation headquartered in New Orleans, Louisiana. The purpose of the proceeding is to determine whether the registration of Home Solutions' common stock should be suspended for a period not to exceed twelve months or revoked. The Division of Enforcement (the Division) alleges that Home Solutions failed to comply with Section 13(a) of the Exchange Act and Exchange Act Rules 13a-1 and 13a-13, by failing to file any periodic reports since August 2007, when it filed a Form 10-Q for the period ending June 30, 2007.

A hearing will be scheduled before an administrative law judge to take evidence on the Division's allegations, to afford Home Solutions the opportunity to establish defenses to the allegations, and to determine whether the registration of Home Solutions' common stock should be suspended for a period not to exceed twelve months or revoked.

The Commission ordered that the Administrative Law Judge in these proceedings issue an initial decision not later than 120 days from the date of service of the order instituting proceedings. (Rel. 34-61076; File No. 3-13699).

Contact Persons:

Rose L. Romero
Regional Director
Fort Worth Regional Office
817-900-2623

Stephen Korotash
Associate Regional Director
Fort Worth Regional Office
817-978-6490

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

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

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public proceedings be instituted pursuant to Section 12(j) of the Exchange Act to determine:

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

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

IV.

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

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

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

This Order shall be served forthwith upon the Respondent personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

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

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

Elizabeth M. Murphy

Elizabeth M. Murphy
Secretary

Commissioner Casey
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 61079 / November 30, 2009

INVESTMENT ADVISERS ACT OF 1940
Release No. 2957 / November 30, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13532

In the Matter of **Prime Capital Services, Inc.,** **Gilman Ciocia, Inc.,** **Michael P. Ryan,** **Rose M. Rudden,** **Christie A. Andersen,** **Eric J. Brown,** **Matthew J. Collins,** **Kevin J. Walsh,** **Mark W. Wells,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940 AS TO CHRISTIE A. ANDERSEN**

I.

On June 30, 2009, the Securities and Exchange Commission ("Commission") instituted administrative proceedings pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Christie A. Andersen ("Andersen" or "Respondent").

II.

Respondent has submitted an Offer of Settlement (the "Offer"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over her and the subject matter of these proceedings, which are admitted, Respondent 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 and Section 203(f) of the Investment Advisers Act of 1940 as to Christie Andersen ("Order"), as set forth below.

III.

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

Respondent

1. Andersen, 39, is a resident of Greenacres, Florida. She joined the Boca Raton branch office of Prime Capital Services, Inc. ("PCS") in 2002 as a compliance officer and became the supervisor of the office in 2004. As a supervisor, she reviewed and approved variable annuity transactions for registered representatives in the Boca Raton office until she left PCS in October 2006. While at PCS, Respondent was an employee of Gilman Ciocia, Inc. ("G&C"), and was licensed to sell securities and as a securities principal. Since leaving PCS, Respondent has served as the chief compliance officer of a broker-dealer.

Relevant Entities

2. Gilman Ciocia, Inc. is an income tax preparation business headquartered in Poughkeepsie, New York. It also offers financial services in New York, New Jersey, Pennsylvania and Florida through its wholly-owned subsidiaries, Prime Capital Services, Inc., a broker-dealer registered with the Commission, and Asset & Financial Planning, Ltd., an investment adviser registered with the Commission. Respondent was an employee of G&C during the time of the conduct at issue in these proceedings. G&C was registered with the Commission as an investment adviser from 2000 through 2006.

3. Prime Capital Services, Inc. is a wholly-owned subsidiary of G&C that provides securities brokerage services. It is registered with the Commission as a broker-dealer and is a member of the Financial Industry Regulatory Authority ("FINRA"). Respondent was associated with PCS during the time of the conduct at issue in these proceedings.

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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.

Background

4. From at least 2004 through 2006 (the "relevant period"), representatives associated with PCS offered and sold variable annuities to senior citizen customers in south Florida. At various times during the relevant period, a registered representative in PCS's Boca Raton office (the "Registered Representative") was among those offering and selling variable annuities to senior citizens. Most of the Registered Representative's customers had attended G&C's free-lunch seminar, during which he touted PCS's financial services in general and, during most of the relevant period, variable annuities in particular.

5. Variable annuities are long-term investments with an insurance component. The insurance component provides a death benefit for the owner's beneficiaries, guaranteeing that they will receive at least the amount of principal the owner invested (excluding any withdrawals or outstanding loans), regardless of the variable annuity's investment value at the time of the insured person's death. Earnings accumulate on a tax deferred basis and are taxed as ordinary income upon withdrawal. Each variable annuity contract offers subaccounts to which a contract owner may allocate premiums. The subaccounts invest in underlying funds which have investment strategies similar to retail mutual funds, such as growth, speculation or money market. Variable annuity issuers charge fees that include annual mortality, expense and administrative fees, and other fees are assessed for the management of the underlying funds by investment advisers. The variable annuities the Registered Representative sold were also structured so that a sales charge was not incurred upon purchase but was instead charged if, during the first six to eight years, the owner surrendered the contract for cash, withdrew funds above a certain amount from the account, or exchanged the variable annuity for another annuity. Those charges, called surrender charges, were highest during the initial years of the variable annuity, typically starting at approximately six to eight percent of the amount the customer invested. The charges decreased over the surrender period. The owner of a variable annuity contract can reallocate his or her investment among the available subaccounts offered through the variable annuity without incurring surrender charges.

6. During some or all of the relevant period, the Registered Representative induced customers to purchase variable annuities by means of material misrepresentations and omissions. For example: he sometimes told customers that the principal invested in the variable annuity was guaranteed not to lose money, without disclosing that the guarantee was triggered by the death of an annuitant, and without disclosing that until the annuitant's death the value could fluctuate and decline; he sometimes promised customers that the customers would receive a guaranteed return on their investment without disclosing that such return would be paid only over the course of the annuitization period if, in the future, the customers elected to annuitize; he sometimes told customers they would have access to their invested money whenever they needed it, omitting to tell them about charges for early withdrawals above a certain amount; he often failed to disclose to customers the ownership costs of variable annuities, which in some cases were more than three percent annually of the invested amount. Certain written disclosures provided to customers, and other records in customers' files, were incomplete and/or inaccurate, and in some cases were altered after the customer signed to make it appear that disclosures had been provided and that the sales were suitable when, in fact, they were not.

7. Many of the variable annuities sold by the Registered Representative were unsuitable investments based on the customers' ages, incomes, liquid assets and investment objectives. For example, because of their advanced age, some customers who wanted full access to their money were unlikely to outlive the period during which they would pay surrender fees on their variable annuities, and other customers were induced to invest more than seventy-five percent of their liquid assets in variable annuities with limitations and/or fees on withdrawals. In addition, variable annuities limited access to the invested principal that was expressly contrary to some customers' objectives for their money.

8. Compared to other investment products, which generally paid less than three percent in sales commissions, the variable annuities sold by the Registered Representative generally paid approximately a six percent gross sales commission to PCS. As compensation, PCS paid out to the Registered Representative as much as seventy percent of the sales commission. During the relevant period, the Registered Representative earned millions of dollars in sales commissions from variable annuity transactions.

9. Most of customers who bought variable annuities from the Registered Representative met him at free-lunch seminars that G&C marketed and arranged. At the free-lunch seminars, the Registered Representative discussed tax and financial planning, including during most of the relevant period, variable annuities. After the seminars, the customers were invited to schedule private appointments with the Registered Representative at PCS's Boca Raton office, where during one-on-one sales meetings, he sold them variable annuities.

Variable Annuity Sales at PCS's Boca Raton, Florida Office

10. The Registered Representative's misrepresentations to variable annuity customers included misleading statements and material omissions about access to invested money, guaranteed minimum returns and/or guarantees against losses. Some of the Registered Representative's customer files included inaccurate information about customers' net worth, liquid assets and/or income. The registered representative violated Section 17(a) of the Securities Act, Section 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and aided and abetted PCS's violation of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder.

11. Annual branch exams from the Boca Raton office from 2004 through 2006, which Respondent reviewed at least for 2004 and 2005, included details of unsuitable variable annuity sales to senior citizen investors, including high percentages of elderly customers' liquid assets invested in illiquid variable annuities, and ongoing deficiencies in disclosure forms provided to customers to explain the terms of their variable annuity investments. In addition, net worth figures frequently matched figures for liquid assets, even where customers already owned variable annuities.

12. Paperwork for the Registered Representative's variable annuity customers contains patterns that indicate the sales were unsuitable for individual customers' needs and circumstances. As one example, the Registered Representative's customer disclosure forms acknowledging understanding of the terms of the investment were initialed by the Registered

Representative's assistant, not the customers. This would have been evident to the Respondent from the handwriting of the initials, which belonged to the sales assistant and bears no resemblance to the customers' authentic signatures. As another example, explanations of the reason for investing in variable annuities are not initialed by customers, as required by the firm's form. Respondent did not follow up on these patterns, make inquiries or take any remedial action.

13. The Registered Representative made material misrepresentations and omissions, and/or sold unsuitable variable annuities to senior citizen customers, including in the following instances:

a. In 2004 and 2005, the Registered Representative induced a 71-year-old woman to liquidate her retirement account and invest all of her retirement savings – which was more than half her net worth – in variable annuities. The Registered Representative earned more than $5,000 in sales commissions. Respondent approved some of the transactions, but failed to review others.

b. In 2004 and 2005, the Registered Representative induced a 65-year-old retiree into buying six variable annuities in his trading and retirement accounts, thereby subjecting the customer to limitations for eight years on about two-thirds of his liquid assets. The Registered Representative earned more than $16,000 in sales commissions. Respondent approved some of the transactions, but failed to review others.

c. In 2006, the Registered Representative induced an 80-year-old widow to exchange a variable annuity that was out of its surrender period for a new one that limited her access to half her net worth for six years. The Registered Representative earned more than $6,000 in sales commissions. Despite a comparison that showed the customer's new annuity would cost more in fees and be worth less in the future than her old one, and despite the customer's age and concentration of her net worth in the variable annuity, Respondent approved the transaction as suitable.

d. In 2003 and 2004, the Registered Representative induced a 67-year-old widow to invest nearly eighty percent of her liquid assets in variable annuities with surrender periods as long as eight years, earning nearly $15,000 in sales commissions. The Registered Representative's assistant discouraged the customer from seeking a comparison form that Florida requires be offered to variable annuity customers by instructing her to initial a box declining the comparison; neither the Registered Representative nor Respondent questioned the sales assistant's written indication that the customer should decline the comparative information form. Paperwork in the customer's file indicates signed documents were copied and altered. Respondent approved some of the transactions, but failed to review others.

Respondent's Failure to Reasonably Supervise

14. Respondent failed to respond reasonably to red flags of wrongdoing in the variable annuity sales practices of the Registered Representative, and thereby failed to detect and prevent the Registered Representative's violations of Section 17(a) of the Securities Act, Section

10(b) of the Securities Exchange Act and Rule 10b-5 thereunder, and his aiding and abetting PCS's violation of Section 17(a) of the Exchange Act and Rule 17a-3 thereunder. For example, Respondent knew that:

a. successive annual branch exams in 2003 through 2005 indicated deficiencies in the disclosures the Registered Representative provided to his variable annuity customers, and resulted in their purchasing unsuitable investments with terms and limitations of which they were unaware or which they misunderstood.

b. successive annual branch exams in 2003 through 2005 indicated that almost all randomly selected files were variable annuities sold to senior citizens involving high concentrations of customers' liquid assets, and that customers had uniform investment objectives and/or time horizons.

c. The Registered Representative's assistant continued to initial customer disclosure forms that should have been initialed by the customers themselves as an acknowledgment of having received disclosures in 2004 and 2005, even after Respondent instructed her to stop that practice.

d. documentation in certain of the Registered Representative's customer files in 2003 through 2005 indicated that variable annuities were unsuitable for those customers.

15. As a result of the conduct described above, Respondent failed reasonably to supervise pursuant to Section 15(b)(6) of the Exchange Act, which incorporates by reference Section 15(b)(4)(E), and pursuant to Section 203(f) of the Advisers Act, which incorporates by reference Section 203(e)(6), with a view to preventing and detecting the registered representative's violations of the federal securities statutes, rules and regulations.

Undertaking

Respondent undertakes to provide cooperation to the Commission and its staff in its investigation and litigation related to the matters described herein. Specifically, Respondent undertakes to: upon reasonable request by the Commission or its staff, and on reasonable notice, and without service of a subpoena, Respondent will provide documents or other information, and accept service and take all reasonable actions to make herself available to testify truthfully at any interview, investigative testimony, deposition, at any judicial proceeding related to this Order and at any administrative proceeding arising as a result of the Commission's investigation relating to the matters described herein. This provision shall not be construed to waive Respondent's applicable attorney-client, work product or other privileges recognized under federal law, if asserted timely and in good faith.

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 Section 15(b) of the Exchange Act and Section 203(f) of the Advisers Act it is hereby ORDERED that:

A. Respondent be, and hereby is, suspended from association in a supervisory capacity with any broker, dealer or investment adviser for a period of twelve months, effective on the second Monday following the entry of this Order.

B. Respondent shall, within thirty days of the entry of this Order, pay a civil money penalty in the amount of $10,000.00 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. 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 Christie A. Andersen 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 Andrew M. Calamari, Associate Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 3 World Financial Center, 4th Floor, New York, NY 10281-1022.

C. Respondent shall provide to the Commission, within thirty days after the end of the twelve-month suspension period described above, an affidavit that she has complied fully with the sanctions set forth in Section IV.A. and IV.B above.

By the Commission.

Elizabeth M. Murphy
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. 61077 / November 30, 2009

ADMINISTRATIVE PROCEEDING
File No. 3-13700

In the Matter of **Pacific Acquisition Corp. (a/k/a Pacific Aquisition Corp.),** **Pan Smak Pizza, Inc.,** **Parkcrest Explorations, Ltd. (n/k/a Fossil Bay Resources, Ltd.),** **Payline Systems, Inc.,** **PentaStar Communications, Inc.,** **Peruvian Gold, Ltd.,** **Petromin Resources, Ltd., and** **Pinnacle Property Group, Inc. (n/k/a Ontus Corporation),** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Pacific Acquisition Corp. (a/k/a Pacific Aquisition Corp.), Pan Smak Pizza, Inc., Parkcrest Explorations, Ltd. (n/k/a Fossil Bay Resources, Ltd.), Payline Systems, Inc., PentaStar Communications, Inc., Peruvian Gold, Ltd., Petromin Resources, Ltd., and Pinnacle Property Group, Inc. (n/k/a Ontus Corporation.)

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II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Pacific Acquisition Corp. (a/k/a Pacific Aquisition Corp.) (CIK No. 1112163) is a permanently revoked Nevada corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pacific Acquisition is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-SB/A registration statement on April 24, 2000, which reported a net loss of $5,332 from March 6 to March 31, 2000.

2. Pan Smak Pizza, Inc. (CIK No. 1009406) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pan Smak is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR registration statement on February 27, 1996, which reported a net loss of over $1.73 million (Canadian) for the year ended October 31, 1995. On June 24, 1999, the British Columbia Securities Commission ("BCSC") issued a cease trade order against the company's stock for failure to make its filings to the BCSC.

3. Parkcrest Explorations, Ltd. (n/k/a Fossil Bay Resources, Ltd.) (CIK No. 1052596) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Parkcrest is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-FR registration statement on June 23, 1998, which reported a net loss of $490,000 (Canadian) for the fiscal year ended September 30, 1997.

4. Payline Systems, Inc. (CIK No. 779628) is a dissolved Oregon corporation located in Portland, Oregon with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Payline is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended April 30, 1994, which reported a net loss of $505,629 for the prior nine months.

5. PentaStar Communications, Inc. (CIK No. 1093221) is a void Delaware corporation located in Denver, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). PentaStar is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended September 30, 2001, which reported a net loss of over $2.4 million for the prior nine months. On April 9, 2002, the company announced that it had ceased operations and that all officers and directors had resigned. As of November 23, 2009, the company's stock (symbol "PNTA") was traded on the over-the-counter markets.

6. Peruvian Gold, Ltd. (CIK No. 1043360) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Peruvian Gold is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F for the period ended December 31, 2001, which reported a loss of $440,000 (Canadian) for the prior twelve months.

7. Petromin Resources, Ltd. (CIK No. 1013747) is a British Columbia corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Petromin is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 20-F/A for the period ended September 30, 2000, which reported a loss of $316,342 (Canadian) for the prior twelve months. As of November 23, 2009, the company's common stock (symbol "PEMNF") was traded on the over-the-counter markets.

8. Pinnacle Property Group, Inc. (n/k/a Ontus Corporation) (CIK No. 1107544) is a void Delaware corporation located in Portland, Oregon with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Pinnacle Property is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended November 30, 2001, which reported a net loss of $43,628 since the company's August 17, 1999 inception.

B. DELINQUENT PERIODIC FILINGS

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

10. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports and Rule 13a-13 requires domestic issuers to file quarterly reports. Rule 13a-16 requires foreign private issuers to furnish quarterly and other reports to the Commission under cover of Form 6-K if they make or are required to make the information public under the laws of the jurisdiction of their domicile or in which they are incorporated or organized; if they file or are required to file information with a stock exchange on which their securities are traded and the information was made public by the exchange; or if they distribute or are required to distribute information to their security holders.

11. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 or 13a-16 thereunder.

III.

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

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

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

IV.

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

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

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

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

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

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

By the Commission.

Elizabeth M. Murphy
Secretary

Attachment

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

Appendix 1

Chart of Delinquent Filings
Pacific Acquisition Corp. (a/k/a Pacific Aquisition Corp.), et al.

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Pacific Acquisition Corp. (a/k/a Pacific Aquisition Corp.)					
	10-QSB	06/30/00	08/14/00	Not filed	111
	10-QSB	09/30/00	11/14/00	Not filed	108
	10-KSB	12/31/00	04/02/01	Not filed	103
	10-QSB	03/31/01	05/15/01	Not filed	102
	10-QSB	06/30/01	08/14/01	Not filed	99
	10-QSB	09/30/01	11/14/01	Not filed	96
	10-KSB	12/31/01	04/01/02	Not filed	91
	10-QSB	03/31/02	05/15/02	Not filed	90
	10-QSB	06/30/02	08/14/02	Not filed	87
	10-QSB	09/30/02	11/14/02	Not filed	84
	10-KSB	12/31/02	03/31/03	Not filed	80
	10-QSB	03/31/03	05/15/03	Not filed	78
	10-QSB	06/30/03	08/14/03	Not filed	75
	10-QSB	09/30/03	11/14/03	Not filed	72
	10-KSB	12/31/03	03/30/04	Not filed	68
	10-QSB	03/31/04	05/17/04	Not filed	66
	10-QSB	06/30/04	08/16/04	Not filed	63
	10-QSB	09/30/04	11/15/04	Not filed	60
	10-KSB	12/31/04	03/31/05	Not filed	56
	10-QSB	03/31/05	05/16/05	Not filed	54
	10-QSB	06/30/05	08/15/05	Not filed	51
	10-QSB	09/30/05	11/14/05	Not filed	48
	10-KSB	12/31/05	03/31/06	Not filed	44
	10-QSB	03/31/06	05/15/06	Not filed	42
	10-QSB	06/30/06	08/14/06	Not filed	39
	10-QSB	09/30/06	11/14/06	Not filed	36
	10-KSB	12/31/06	04/02/07	Not filed	31
	10-QSB	03/31/07	05/15/07	Not filed	30
	10-QSB	06/30/07	08/14/07	Not filed	27
	10-QSB	09/30/07	11/14/07	Not filed	24
	10-KSB	12/31/07	03/31/08	Not filed	20
	*10-Q**	03/31/08	05/15/08	Not filed	18
	*10-Q**	06/30/08	08/14/08	Not filed	15

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	*10-Q**	09/30/08	11/14/08	Not filed	12
	*10-K**	12/31/08	03/31/09	Not filed	8
	*10-Q**	03/31/09	05/15/09	Not filed	6
	*10-Q**	06/30/09	08/14/09	Not filed	3
	*10-Q**	09/30/09	11/16/09	Not filed	
Total Filings Delinquent	*38*				
Pan Smak Pizza, Inc.					
	20-F	10/31/96	04/30/97	Not filed	151
	20-F	10/31/97	04/30/98	Not filed	139
	20-F	10/31/98	04/30/99	Not filed	127
	20-F	10/31/99	05/01/00	Not filed	114
	20-F	10/31/00	04/30/01	Not filed	103
	20-F	10/31/01	04/30/02	Not filed	91
	20-F	10/31/02	04/30/03	Not filed	79
	20-F	10/31/03	04/30/04	Not filed	67
	20-F	10/31/04	05/02/05	Not filed	54
	20-F	10/31/05	05/01/06	Not filed	42
	20-F	10/31/06	04/30/07	Not filed	31
	20-F	10/31/07	04/30/08	Not filed	19
	20-F	10/31/08	04/30/09	Not filed	7
Total Filings Delinquent	**13**				
Parkcrest Explorations, Ltd. (n/k/a Fossil Bay Resources, Ltd.)					
	20-F	09/30/98	03/31/99	Not filed	128
	20-F	09/30/99	03/31/00	Not filed	116
	20-F	09/30/00	04/02/01	Not filed	103
	20-F	09/30/01	04/01/02	Not filed	91
	20-F	09/30/02	03/31/03	Not filed	80
	20-F	09/30/03	03/31/04	Not filed	68
	20-F	09/30/04	03/31/05	Not filed	56
	20-F	09/30/05	03/31/06	Not filed	44
	20-F	09/30/06	04/02/07	Not filed	31
	20-F	09/30/07	03/31/08	Not filed	20

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	20-F	09/30/08	03/31/09	Not filed	8
Total Filings Delinquent	**11**				
Payline Systems, Inc.					
	10-K	07/31/94	10/31/94	Not filed	181
	10-Q	10/31/94	12/15/94	Not filed	179
	10-Q	01/31/95	3/17/95	Not filed	176
	10-Q	04/30/95	6/15/95	Not filed	173
	10-K	07/31/95	10/30/95	Not filed	169
	10-Q	10/31/95	12/15/95	Not filed	167
	10-Q	01/31/96	3/18/96	Not filed	164
	10-Q	04/30/96	6/14/96	Not filed	161
	10-K	07/31/96	10/29/96	Not filed	157
	10-Q	10/31/96	12/16/96	Not filed	155
	10-Q	01/31/97	3/17/97	Not filed	152
	10-Q	04/30/97	6/16/97	Not filed	149
	10-K	07/31/97	10/29/97	Not filed	145
	10-Q	10/31/97	12/15/97	Not filed	143
	10-Q	01/31/98	3/17/98	Not filed	140
	10-Q	04/30/98	6/15/98	Not filed	137
	10-K	07/31/98	10/29/98	Not filed	133
	10-Q	10/31/98	12/15/98	Not filed	131
	10-Q	01/31/99	3/17/99	Not filed	128
	10-Q	04/30/99	6/14/99	Not filed	125
	10-K	07/31/99	10/29/99	Not filed	121
	10-Q	10/31/99	12/15/99	Not filed	119
	10-Q	01/31/00	3/16/00	Not filed	116
	10-Q	04/30/00	6/14/00	Not filed	113
	10-K	07/31/00	10/30/00	Not filed	109
	10-Q	10/31/00	12/15/00	Not filed	107
	10-Q	01/31/01	3/19/01	Not filed	104
	10-Q	04/30/01	6/14/01	Not filed	101
	10-K	07/31/01	10/29/01	Not filed	97
	10-Q	10/31/01	12/17/01	Not filed	95
	10-Q	01/31/02	3/18/02	Not filed	92
	10-Q	04/30/02	6/14/02	Not filed	89
	10-K	07/31/02	10/29/02	Not filed	85
	10-Q	10/31/02	12/16/02	Not filed	83

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	01/31/03	3/17/03	Not filed	80
	10-Q	04/30/03	6/16/03	Not filed	77
	10-K	07/31/03	10/29/03	Not filed	73
	10-Q	10/31/03	12/15/03	Not filed	71
	10-Q	01/31/04	3/16/04	Not filed	68
	10-Q	04/30/04	6/14/04	Not filed	65
	10-K	07/31/04	10/29/04	Not filed	61
	10-Q	10/31/04	12/15/04	Not filed	59
	10-Q	01/31/05	3/17/05	Not filed	56
	10-Q	04/30/05	6/14/05	Not filed	53
	10-K	07/31/05	10/31/05	Not filed	49
	10-Q	10/31/05	12/15/05	Not filed	47
	10-Q	01/31/06	3/17/06	Not filed	44
	10-Q	04/30/06	6/14/06	Not filed	41
	10-K	07/31/06	10/30/06	Not filed	37
	10-Q	10/31/06	12/15/06	Not filed	35
	10-Q	01/31/07	3/19/07	Not filed	32
	10-Q	04/30/07	6/14/07	Not filed	29
	10-K	07/31/07	10/29/07	Not filed	25
	10-Q	10/31/07	12/17/07	Not filed	23
	10-Q	01/31/08	3/17/08	Not filed	20
	10-Q	04/30/08	6/16/08	Not filed	17
	10-K	07/31/08	10/29/08	Not filed	13
	10-Q	10/31/08	12/15/08	Not filed	11
	10-Q	01/31/09	3/17/09	Not filed	8
	10-Q	04/30/09	06/15/09	Not filed	5
	10-K	07/31/09	10/29/09	Not filed	1
Total Filings Delinquent	**61**				
PentaStar Communications, Inc.					
	10-K	12/31/01	04/01/02	Not filed	91
	10-Q	03/31/02	05/15/02	Not filed	90
	10-Q	06/30/02	08/14/02	Not filed	87
	10-Q	09/30/02	11/14/02	Not filed	84
	10-K	12/31/02	03/31/03	Not filed	80
	10-Q	03/31/03	05/15/03	Not filed	78
	10-Q	06/30/03	08/14/03	Not filed	75

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-Q	09/30/03	11/14/03	Not filed	72
	10-K	12/31/03	03/30/04	Not filed	68
	10-Q	03/31/04	05/17/04	Not filed	66
	10-Q	06/30/04	08/16/04	Not filed	63
	10-Q	09/30/04	11/15/04	Not filed	60
	10-K	12/31/04	03/31/05	Not filed	56
	10-Q	03/31/05	05/16/05	Not filed	54
	10-Q	06/30/05	08/15/05	Not filed	51
	10-Q	09/30/05	11/14/05	Not filed	48
	10-K	12/31/05	03/31/06	Not filed	44
	10-Q	03/31/06	05/15/06	Not filed	42
	10-Q	06/30/06	08/14/06	Not filed	39
	10-Q	09/30/06	11/14/06	Not filed	36
	10-K	12/31/06	04/02/07	Not filed	31
	10-Q	03/31/07	05/15/07	Not filed	30
	10-Q	06/30/07	08/14/07	Not filed	27
	10-Q	09/30/07	11/14/07	Not filed	24
	10-K	12/31/07	03/31/08	Not filed	20
	10-Q	03/31/08	05/15/08	Not filed	18
	10-Q	06/30/08	08/14/08	Not filed	15
	10-Q	09/30/08	11/14/08	Not filed	12
	10-K	12/31/08	03/31/09	Not filed	8
	10-Q	03/31/09	05/15/09	Not filed	6
	10-Q	06/30/09	08/14/09	Not filed	3
	10-Q	09/30/09	11/16/09	Not filed	
Total Filings Delinquent	**32**				
Peruvian Gold, Ltd.					
	20-F	12/31/02	06/30/03	Not filed	77
	20-F	12/31/03	06/30/04	Not filed	65
	20-F	12/31/04	06/30/05	Not filed	53
	20-F	12/31/05	06/30/06	Not filed	41
	20-F	12/31/06	07/02/07	Not filed	28
	20-F	12/31/07	06/30/08	Not filed	17
	20-F	12/31/08	06/30/09	Not filed	5
Total Filings Delinquent	7				

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
Petromin Resources, Ltd.					
	20-F	09/30/01	04/01/02	Not filed	91
	20-F	09/30/02	03/31/03	Not filed	80
	20-F	09/30/03	03/31/04	Not filed	68
	20-F	09/30/04	03/31/05	Not filed	56
	20-F	09/30/05	03/31/06	Not filed	44
	20-F	09/30/06	04/02/07	Not filed	31
	20-F	09/30/07	03/31/08	Not filed	20
	20-F	09/30/08	03/31/09	Not filed	8
	20-F	12/31/08	06/30/09	Not filed	5
Total Filings Delinquent	**9**				
Pinnacle Property Group, Inc. (n/k/a Ontus Corporation)					
	10-KSB	02/28/02	05/29/02	Not filed	90
	10-QSB	05/31/02	07/15/02	Not filed	88
	10-QSB	08/31/02	10/15/02	Not filed	85
	10-QSB	11/30/02	01/14/03	Not filed	82
	10-KSB	02/28/03	05/29/03	Not filed	78
	10-QSB	05/31/03	07/15/03	Not filed	76
	10-QSB	08/31/03	10/15/03	Not filed	73
	10-QSB	11/30/03	01/14/04	Not filed	70
	10-KSB	02/29/04	06/01/04	Not filed	65
	10-QSB	05/31/04	07/15/04	Not filed	64
	10-QSB	08/31/04	10/15/04	Not filed	61
	10-QSB	11/30/04	01/14/05	Not filed	58
	10-KSB	02/28/05	05/31/05	Not filed	54
	10-QSB	05/31/05	07/15/05	Not filed	52
	10-QSB	08/31/05	10/17/05	Not filed	49
	10-QSB	11/30/05	01/17/06	Not filed	46
	10-KSB	02/28/06	05/30/06	Not filed	42
	10-QSB	05/31/06	07/17/06	Not filed	40
	10-QSB	08/31/06	10/16/06	Not filed	37
	10-QSB	11/30/06	01/16/07	Not filed	34
	10-KSB	02/28/07	05/29/07	Not filed	30

Company Name	Form Type	Period Ended	Due Date	Date Received	Months Delinquent (rounded up)
	10-QSB	05/31/07	07/16/07	Not filed	28
	10-QSB	08/31/07	10/15/07	Not filed	25
	10-QSB	11/30/07	01/14/08	Not filed	22
	10-KSB	02/29/08	05/29/08	Not filed	18
	*10-Q**	05/31/08	07/15/08	Not filed	16
	*10-Q**	08/31/08	10/15/08	Not filed	13
	*10-Q**	11/30/08	01/14/09	Not filed	10
	*10-K**	02/28/09	05/29/09	Not filed	6
	*10-Q**	05/31/09	07/15/09	Not filed	4
	*10-Q**	08/31/09	10/15/09	Not filed	1

Total Filings Delinquent **31**

*Regulation S-B and its accompanying forms, including Forms 10-QSB and 10-KSB, have been removed from the federal securities laws. *See* Release No. 34-56994 (Dec. 19, 2007). The removal took effect over a transition period that concluded on March 15, 2009. All reporting companies that previously filed their periodic reports on Forms 10-QSB and 10-KSB are now required to use Forms 10-Q and 10-K instead. Forms 10-QSB and 10-KSB will no longer be available, though issuers that meet the definition of a "smaller reporting company" (generally, a company that has less than $75 million in public equity float as of the end of its most recently completed second fiscal quarter) have the option of using new, scaled disclosure requirements that Regulation S-K now includes.